



# Weekly FX Strategy Briefing

November 8, 2005

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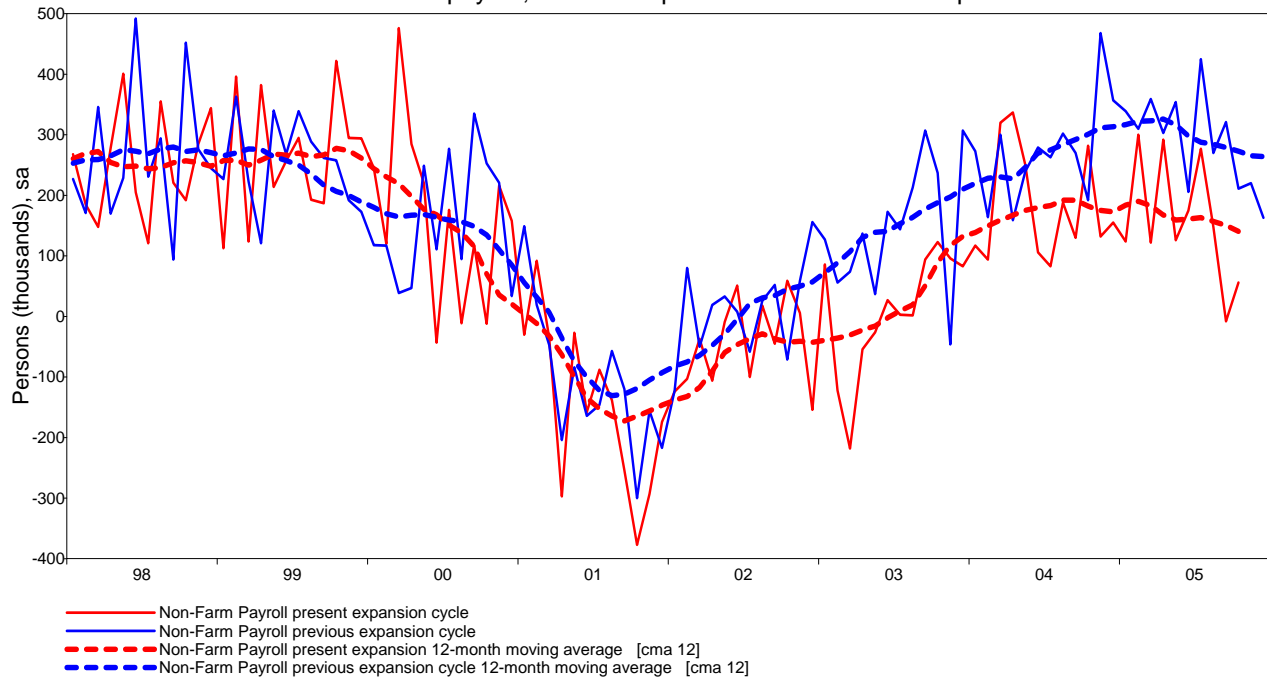
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## Greenback Rules

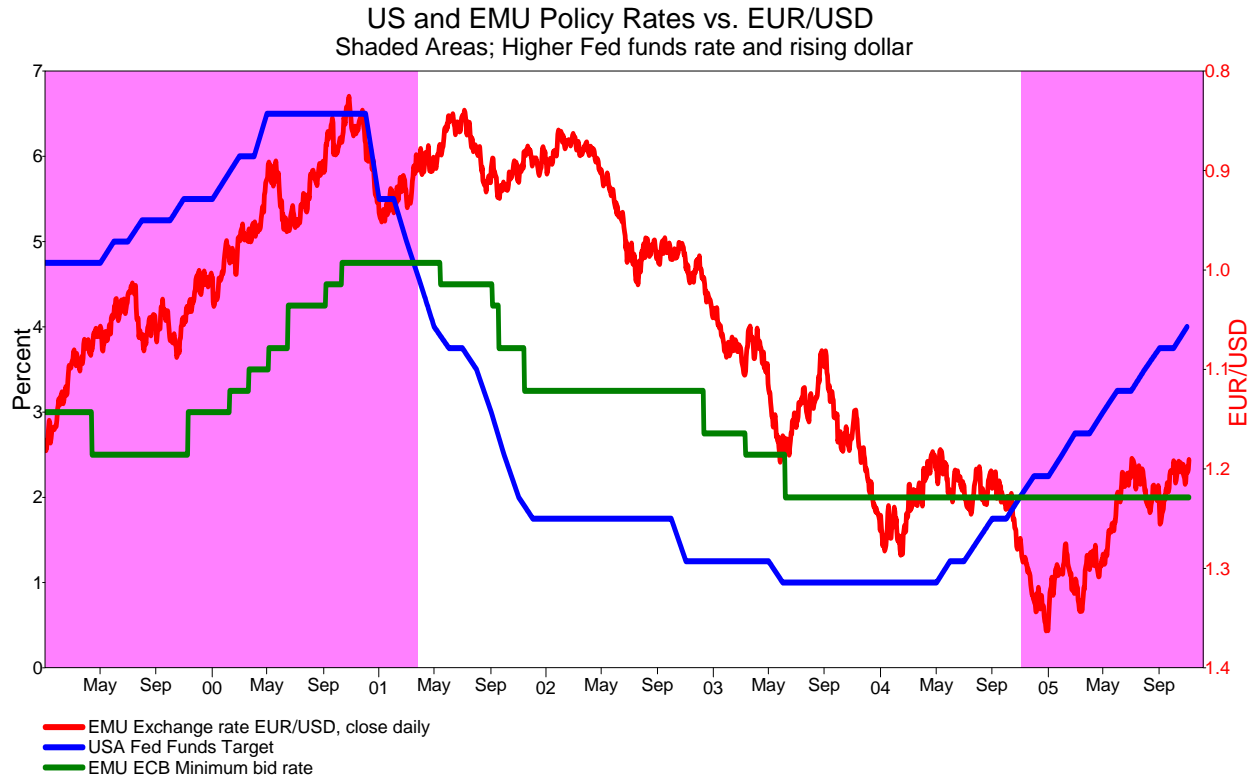
The dollar built on last week's advances, with investors betting that the US interest rate outlook would continue to underpin the greenback.

Despite a weaker-than-expected payroll report, the dollar hit an 18-month high against the euro and a 27-month high versus the yen. Non-farm payrolls rose by 56K last week, about half the number that was expected, but wages increased 0.5%. The chart below compares job growth this time with the last 1991-2001 expansion. Job growth has been weaker this expansion by about 150K but still follows the general pattern of last expansion. The payrolls' growth is in a decelerating phase, which is the normal pattern at this stage of the expansion. However, we expect it to move back to trend growth, about 140K for this expansion, as the effect of the hurricanes wears off. The slowdown is not enough for the Fed to remove its monetary tightening.

US Non-Farm payroll; Present Expansion vs. 1991-2001 Expansion

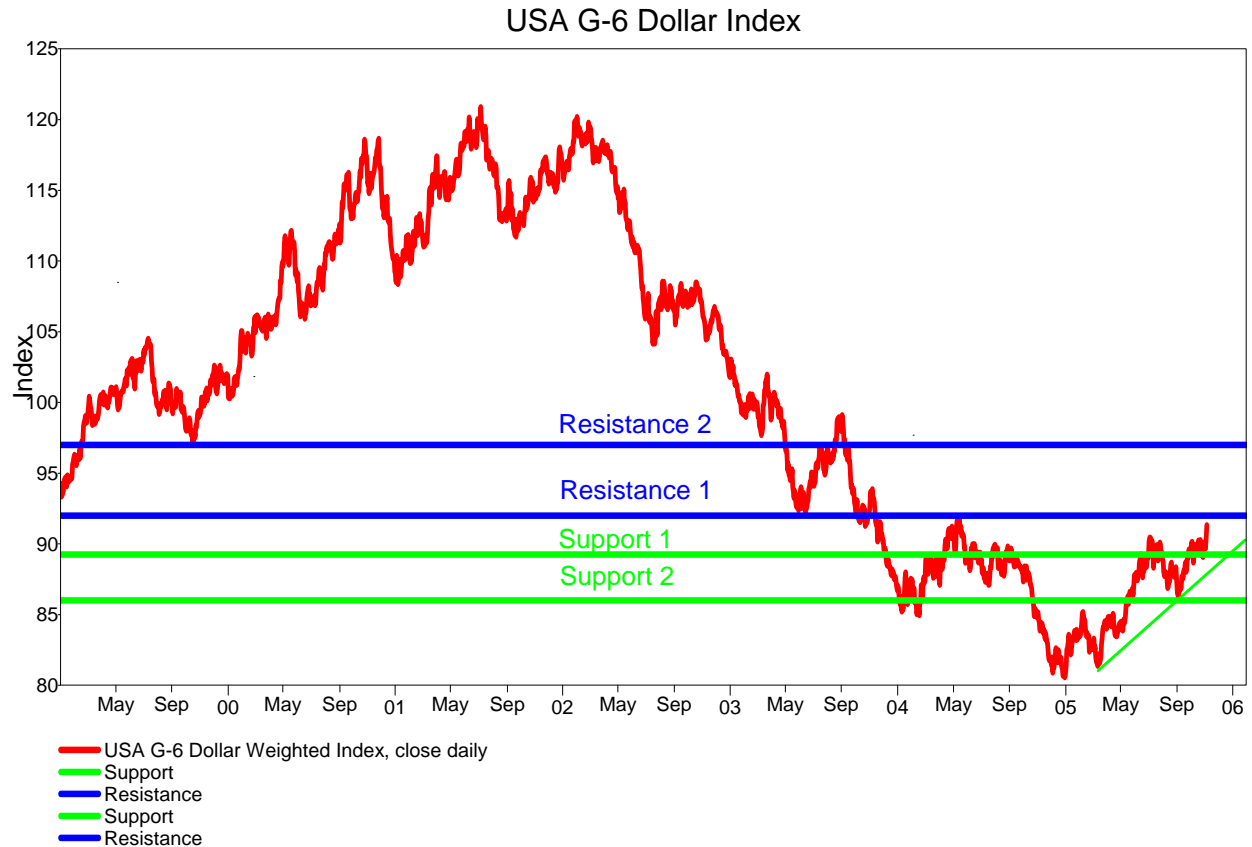


The reason for the dollar strength is the US yield and growth advantage. The Fed's tightening policy is the key factor supporting the dollar. The Fed hiked rates for the twelfth consecutive time last week and gave no hint that an end to its tightening policy was in sight. Meanwhile the ECB left its policy rate unchanged but implied that rates could rise "at any time." We believe the EMU will raise rates by the year-end but US rates will still be higher as we see the Fed funds rate reaching 4.5% early next year. An ECB rate hike will temporarily support the euro but it will take a long time before the strengthening dollar trend will be reversed. The US Fed funds rate is now 200 basis points higher than the European policy rate. It is evident that periods of a rising US dollar are associated with the Fed funds rate above the ECB's policy rate (pink area), and periods of falling greenback are associated with the ECB rate above the Fed funds rate (white area). Although there are lags and temporary setbacks, the trend is clear; as long as the interest rate differential is not reversed or at least significantly diminished, the dollar will continue to appreciate.



When the US interest rates were lower, investors borrowed at the low short-term dollar to buy higher-yielding assets. Now investors are reversing these trades and financing new carry trades by the low yielding European and Japanese currencies. This is the reason why despite signs of improving economic prospects in Euroland and Japan, their currencies has weakened as their interest rates are 2% and 0% respectively compared to 4% in the US.

After testing resistance at the 90-handle for about a month, the dollar index finally broke through this important hurdle last week. The index rose 1.95% and is now at the highest level since May 2004. This has very bullish long-term implications for the greenback and should take the index up to the next resistance level (Resistance 1) in a short time. This resistance level is unlikely to hold more than a relatively short time as the final phase of completing the reversed head-and-shoulders formation will be played out at the end of the year, which will take the index to Resistance 2.



## EUR/USD

**Outlook:** Negative

The EUR/USD broke long-term support at the 1.19 handle last week. Despite the important break of the 1.19 level, the pair is not oversold. This level will now act as resistance and the next long-term support level is 1.15. We expect the pair to trade within these limits for the next few weeks, with a possible break of the 1.15 level at the end of the year.

The fundamental for the EUR/USD is negative based on yield and growth differential. ECB continues to make hawkish statements but did not raise rates at last week's meeting, while the Fed raised Fed funds rate another 25 basis points.

French President Chirac calls crisis session as riots worsen and spread to 300 towns.

Action: Sell  
Objective: 1.1620  
Stop: 1.1935  
Support: 1.1780  
Resistance: 1.1920, 1.2020



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## USD/JPY

**Outlook:** Positive/Neutral

The USD/JPY rallied strongly last week supported by a huge interest rate differential and Japanese institutional investors hunger for yield. The pair is overbought, both on a daily and weekly basis, but a monthly chart indicates that the yen will fall much further. The pair is getting ahead of itself as it is breaking out to the upside from the positive channel established this year. This is a sign that the pair need to consolidate gains. But it is likely to be a temporary pause in the ongoing dollar bull market.

The latest data showed that Japanese are net buyers of foreign bonds at double the rate of foreigner's are net buying of Japanese stocks.

Bank of Japan Governor Toshihiko Fukui predicted at a central bank meeting in Switzerland that there would be "no abrupt change" to the policy of keeping interest rates near zero and its policy of flooding the banking system with cash.

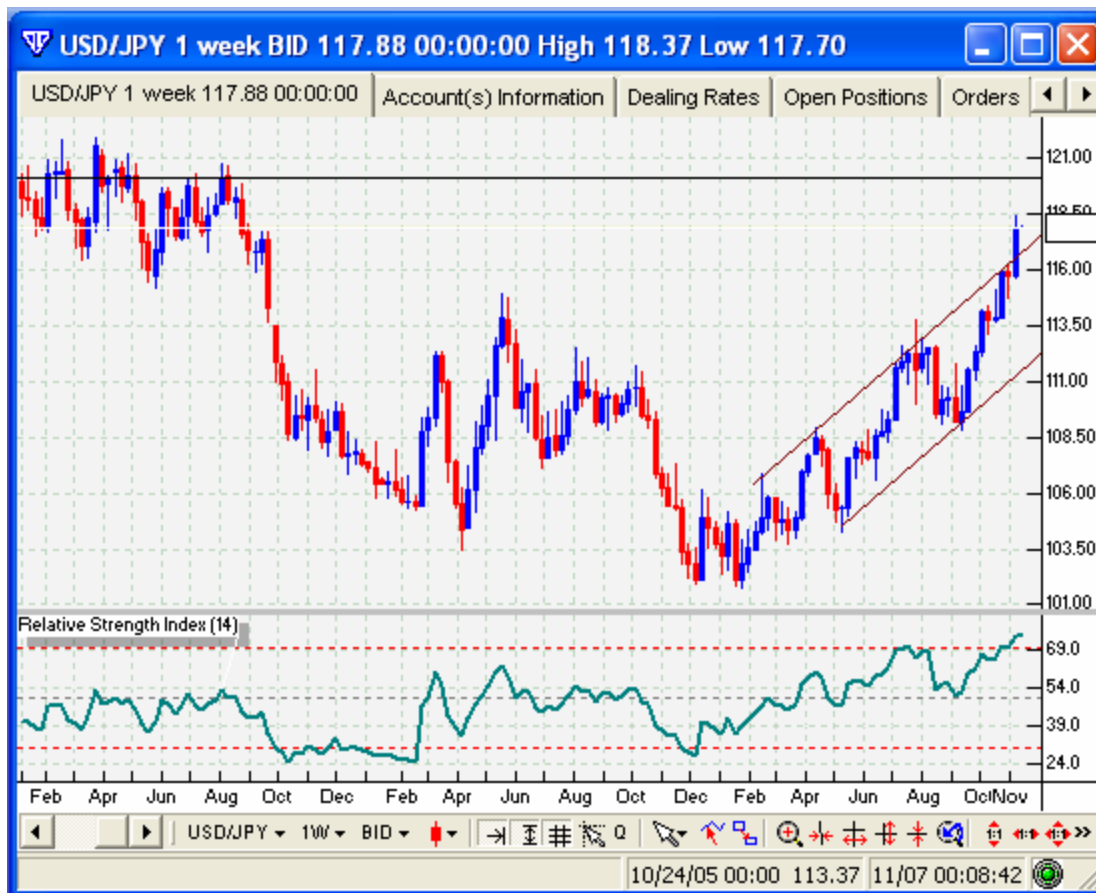
Action: None

Objective: NA

Stop: NA

Support: 116.00

Resistance: 118.50, 120.00



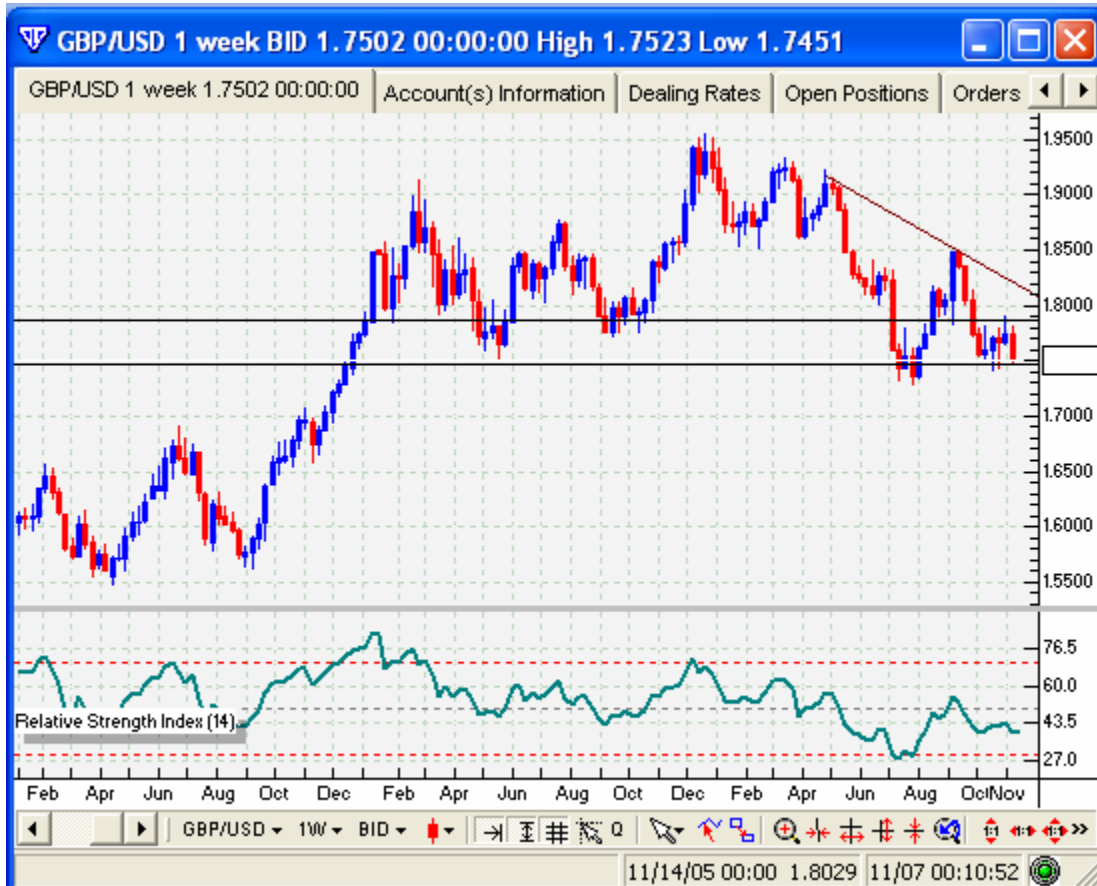
## GBP/USD

**Outlook:** Negative

GBP/USD fell last week after an unsuccessful challenge of the 1.78 resistance. The pair is now on top of support at the 1.75-1.74 area. If this support is broken it would indicate a much lower pound. The long-term technical outlook for sterling is negative; although, we expect some consolidation before a break of this important support level.

UK manufacturing output fell for the second month running in September, down 0.3%, the biggest drop since March. Meanwhile, UK industrial production was weaker than expected in September; industrial output rose 0.5% instead of the expected 0.8% rise. The MPC is likely to leave UK rates unchanged when they meet on Thursday. The BOE has a delicate task as it attempts to balance the slowdown in the economy against inflation running close to a nine-year high.

Action: None  
Objective: NA  
Stop: NA  
Support: 1.7520, 1.7400  
Resistance: 1.7880, 1.8020



## USD/CHF

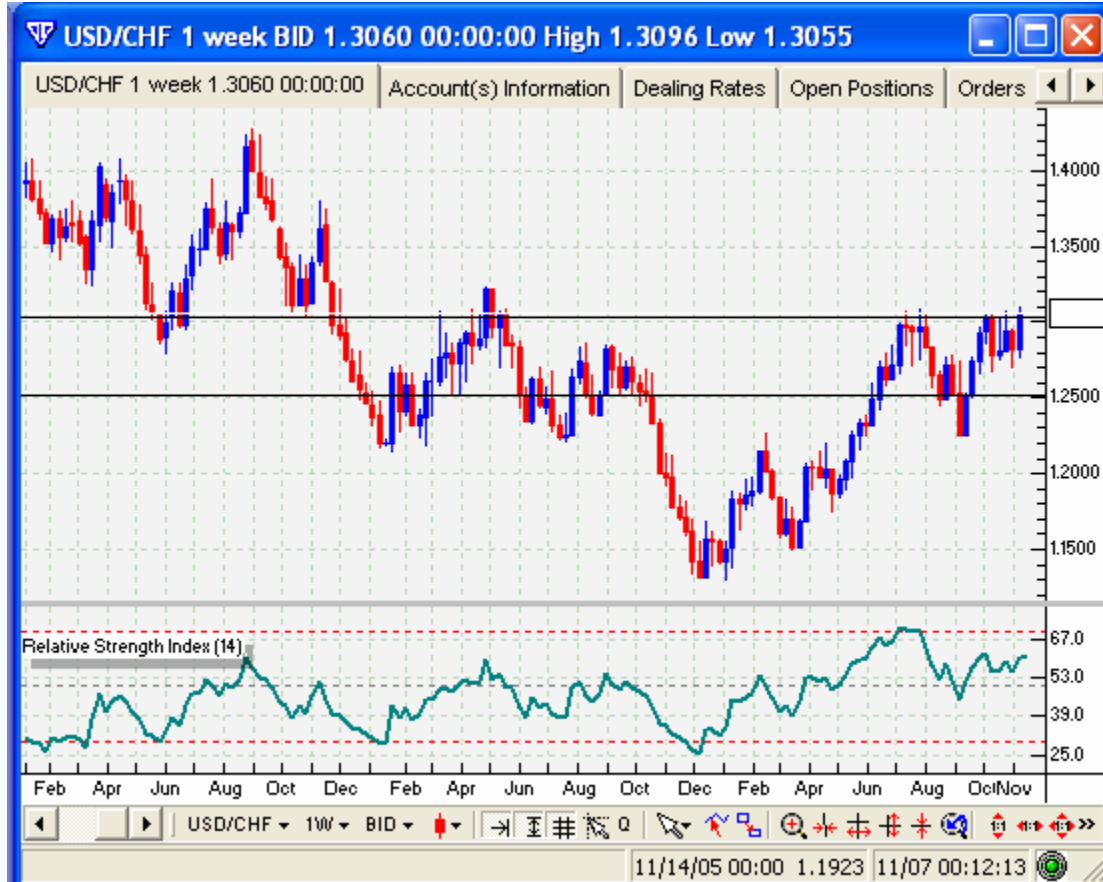
**Outlook:** Positive

The USD/CHF rallied right back to the resistance at the 1.30-1.31 area last week. The technical outlook is very favorable for the pair with an inverted head-and-shoulder bottom indicating much higher prices in the future.

Action: None  
Objective: NA  
Stop: NA

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Support: 1.2700, 1.2520  
Resistance: 1.3020



## USD/CAD

**Outlook:** Neutral/Positive

The USD/CAD appears to be in the process of forming a bottom after a long string of losses. We expect sideways movement with a slight positive bias for the pair.

The Canadian economy is still growing relatively strong; however, it is showing signs of slowing down. GDP grew by 0.4% in August or 2.8% at an annual rate. However, Canadian payrolls grow by 69K in October, more than triple analysts' expectations, sending the unemployment rate to a 30-year low of 6.6%. We expect further rate hikes by the BOC.

Action: None  
Objective: NA  
Stop: NA  
Support: 1.1700, 1.620  
Resistance: 1.1780, 1.2020



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## AUD/USD

**Outlook:** Negative

The AUD/USD broke the important support from the long-term uptrend and 0.75-0.74 support last week. This was a very important development and we believe this is the beginning of a long term decline due to unwinding of carry trades as these trades no longer make economic sense against the US dollar.

The Reserve bank of Australia said it expects only a modest gain in the underlying inflation rate in the coming year, adding to our expectations it will keep interest rates on hold for the foreseeable future.

Action: Sell

Objective: 0.7130

Stop: 0.7535

Support: 0.7420

Resistance: 0.7520, 0.7750



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## EUR/JPY

**Outlook:** Neutral

The EUR/JPY did not manage to break through resistance at the 140-141 area last week. This has been tested unsuccessfully several times during the last 12 months. However, the test is still not concluded as the uptrend is still intact. A penetration of this level would be significant as it indicates much lower yen. However, the most likely outcome is that the resistance will hold; this will be confirmed by a break of a "close" below 139. Conversely a penetration of the 141 level would be a powerful buy signal.

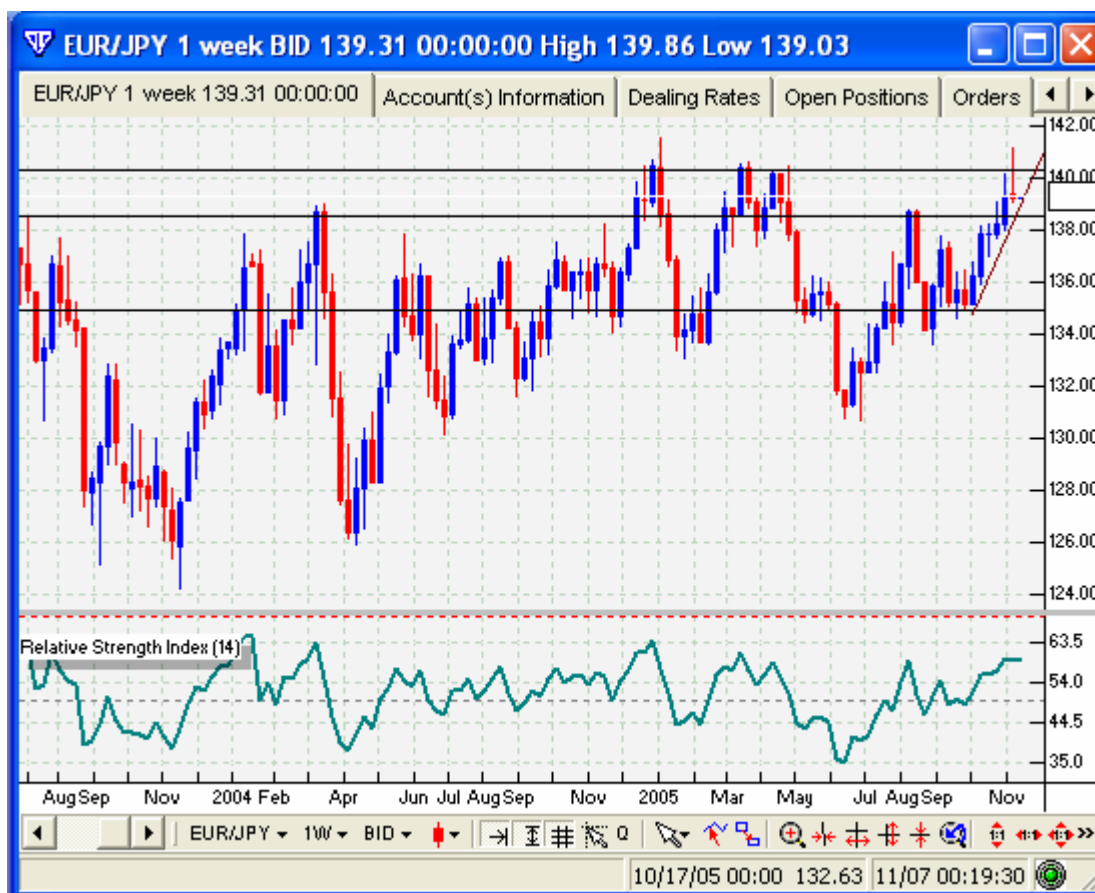
Action: None

Objective: NA

Stop: NA

Support: 139.20, 137.50

Resistance: 141.20



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This is a light economic data week and we expect the market to trade on technical factors for most of the time. However, on Thursday US trade deficit for September is released; the deficit is expected to widening to \$61 billion from \$59 billion in August and it will be a test if the market is ignoring US structural problems.

## Economic Data on Tap Tomorrow

### Tuesday's Economic Calendar

<u>Time (ET)</u>	<u>Region</u>	<u>Data</u>	<u>Period</u>	<u>Change</u>	<u>Our Forecast</u>	<u>Market Forecast</u>	<u>Last</u>
2:45	France	Budget Deficit	Sep				E62.7B
8:55	US	Redbook Retail Sales Index	Nov 5 W				1.3%

Notes: NA Not available or not applicable, SA seasonally adjusted, 3mo 3 months, m/m month-on-month, q/q quarter-on-quarter, y/y year-on-year, B billion, T trillion, Unch unchanged

November 7, 2005

Hans Nilsson