

FX Briefing

4 March 2011

Highlights

- Bernanke repeats himself yet again
- Trichet signals interest rate hike in April
- Sounds familiar: We are not planning a series of interest rate rises

Trichet propels euro to a four-month high

The dollar lost ground again this week. EUR-USD traded for the most part within quite a narrow range between 1.37 and 1.39. Only after the ECB's rate rise signal, which took many by surprise, did the euro surge to its highest levels of the week, rising to a 4-month high. The yen also regained some ground against the dollar, trading below 83. Reports about the unrest in North Africa and the Middle East had little impact on the forex market – market participants appear to have got used to the uncertain situation in Libya. It is noticeable, however, that when oil prices rise, the dollar tends to fall.

The week had begun with Fed chairman Ben Bernanke's testimony before both houses of Congress. Nothing new emerged, as for some time now, the central bank chief has taken to repeating himself. Mr Bernanke did not endorse the hints given by some other Fed representatives that QE2 may end early. He admitted that the surge in commodity prices could push inflation up temporarily, but is not expecting a permanent increase in inflation rates. Inflation expectations were well anchored, he said. Economic growth had picked up, but was still relatively weak. Unemployment was thus likely to remain high for several years to come. He did, however, hint that the Fed was more likely to tighten monetary policy than to implement further easing measures.

The fact that the Fed chairman defended the accommodative monetary policy stance so determinedly was probably one of the reasons why the upbeat US economic data had little impact on the

exchange rate. The ISM manufacturing index, which was already at a high level, rose again in February, and the ADP private employment figures also came in better than expected. It now looks very much as though the US economic recovery is rapidly gathering steam.

The ECB, on the other hand, now appears to be ready to take action to ward off the inflation risks posed by the economic recovery. In its meeting yesterday, the ECB governing council signalled much more clearly than usual that it was intending to raise interest rates at the beginning of April. This step was seen as a pre-emptive measure to prevent increasing cost pressures from higher commodity prices from leading to inflationary second-round effects. Furthermore, the ECB wanted to demonstrate its determination to combat inflation in order to keep inflation expectations in check. In the past, the ECB had expressed concern that the dampening effect of fiscal consolidation could pose risks to growth, but these risks are apparently now perceived to be less acute; risks and benefits are now seen to be equally balanced.

However, the European central bank is combining monetary policy tightening with further support for the financial sector. It has decided to continue conducting its refinancing operations as fixed rate tender procedures with full allotment until the end of the sixth maintenance period on 12 July. The three-month tender, however, will no longer be offered at the current main refinancing rate, but at a rate which will be fixed at the

average rate of the MROs over the life of the respective LTRO. In a tightening cycle, this will in fact make the “long tender” less attractive.

Although a few executive council members had already made some very hawkish comments before the meeting, the central bank’s prompt action took markets completely by surprise. European money market rates rose after the announcement, and the euro also managed to breach 1.39.

As it looks as though the first quarter will turn out to be quite strong in the eurozone, the rate rise discussion is likely to continue. Even though Mr Trichet has indicated that there will not be a

whole series of interest rate hikes, past experience shows that such utterances have little value once the cat is out of the bag. In football, for example, when players claim that the trainer has their full support, or when an athlete insists he is not guilty of doping. At the beginning of the last tightening cycle, Mr Trichet had also stated that a series of rate rises was not on the cards.

In our view, the European currency will benefit from the rate rise discussion as long as the Fed sticks to its expansive monetary policy stance. Given the rapid pace of economic recovery, however, this might not be for very much longer.

Uwe Angenendt +49 69 718-3648

Key indicators and important events

Country	Indicator / Event	Release date	Forecast (in % mom/yoy)	Prev. period (in % mom/yoy)	Comments
GE	Industrial new orders / Jan	8.3.	3.0 / 16.4	-3.4 / 19.5	
GE	Industrial production / Jan	9.3.	3.0 / 12.6	-1.5 / 9.9	
FR	Industrial production / Jan	10.3.	0.8 / 5.1	0.3 / 7.0	
IT	Industrial production / Jan	10.3.	0.8 / 4.5	0.3 / 5.7	
GE	Trade balance and current account / Jan	10.3.	€13.0bn €11.0bn	€11.9bn €17.6bn	
EMU	ECB Monthly Bulletin / Mar	10.3.			
UK	BoE interest rate decision	10.3.	0.50	0.50	
US	Trade balance / Jan	10.3.	-\$41.5bn	-\$40.6bn	
US	Retail sales / Feb	11.3.	1.0	0.3	mom
US	UMI consumer sentim. / Mar	11.3.	77.5	77.5	

Money and foreign exchange market quotations

	Spot vs. EUR	Change vs. EUR	Interbank offered rates		
	04/03/11	in % week-on-week	1 month	3 months	6 months
EUR	–	–	0.85	1.12	1.43
USD	1.3972	-1.3	0.26	0.31	0.46
JPY	115.45	-2.2	0.14	0.19	0.35
GBP	0.8573	-0.1	0.61	0.81	1.11
CHF	1.2988	-1.5	0.14	0.17	0.25
SEK	8.8360	-0.2	1.99	2.26	2.43
PLN	3.9979	-0.6	3.90	4.17	4.37
CZK	24.270	0.9	1.11	1.23	1.50
CAD	1.3593	-0.5	1.08	1.22	1.42
AUD	1.3792	-1.3	4.85	4.95	5.15
NZD	1.8971	-3.1	3.04	3.09	3.18
SGD	1.7705	-0.8	0.38	0.50	0.63
ZAR	9.6569	-0.4	6.14	6.16	6.50

This report has been prepared by BHF-BANK Aktiengesellschaft on behalf of itself and its affiliated companies (together "BHF-BANK Group") solely for the information of its clients.

The information and opinions in this document are based on sources believed to be reliable and acting in good faith, but no representation or warranty, express or implied, is made by any member of the BHF-BANK Group as to their accuracy, completeness or correctness. Opinions and recommendations are given in good faith but without legal responsibility and are subject to change without notice. The information does not constitute advice or personal recommendation, for which the duty of suitability would be owed, but may facilitate your own investment decision. Moreover, you should seek your own advice as to the suitability of an investment matter mentioned herein. Investors are reminded that the price of securities and the income from them can go down as well as up and that the past performance of an investment or a market is not necessarily indicative for future results.

This document is for information purposes only. Descriptions of any company or companies or their securities mentioned herein are not intended to be complete, and this document is not, and should not be construed as, an offer to sell or solicitation of any offer to buy the securities mentioned in it.

BHF-BANK Group and its officers and employees may have a long or short position or engage in transactions in any of the securities mentioned in this document, or in any related securities.

This publication must not be distributed in the United States.

This document is published by us in German and English only. Publications in other languages have not been authorised by us.

© 2011 BHF-BANK Aktiengesellschaft

All rights reserved. Please mention source when quoting from it.