



# Currency Profile for the U.S. Dollar

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A MarketLink<sup>sm</sup> Service from Travelex Global Business Payments

## Trade-weighted USD performance:

*Current bias for the USD: Positive*

### **USD set a 12-month peak in early May**

Past week: +0.8%

Past month: +5.3%

Year-to-date: +8.9%

### Sources of USD strength:

Recent upside surprises to U.S. economic data have improved the recovery outlook and stoked speculation that the Fed could begin to normalize policy sooner than previously expected.

The rise in U.S. Treasury bond yields, particularly above their Japanese counterpart, makes carry trades funded in the dollar slightly more expensive.

Mounting sovereign credit risk in the euro zone has undermined the appeal of the euro as a reserve currency. The dollar has benefited as a result of the weaker euro and reduced risk appetite.

The largest increase in non-farm payrolls in four years in April added optimism about a sustainable U.S. recovery. The 290,000 U.S. jobs created in April signaled an improving labor market and boded better for consumer spending.

### Sources of USD weakness:

While a recent string of solid U.S. data have encouraged optimism about the recovery, Fed officials have maintained that rates will not rise in the foreseeable future.

Soaring government spending and deficits and the required debt issuance to fund them threaten the U.S. fiscal outlook which can weigh on foreign demand for dollar-denominated assets.

While the rise in U.S. Treasury yields is supportive for the dollar in the near-term, continued fiscal worries in the U.S. could put upward pressure on yields and pose risks to the nascent recovery.

While the jobless rate has come down from a recent 26-year high above 10%, labor market conditions are expected to remain fragile for some time. Consequently, U.S. rates are expected to hold near zero over the coming months.

Talk of central bank reserve diversification out of dollar assets remains a key liability for the greenback.

**Monetary Policy:** The Federal Reserve has left its key lending rate near zero since December 2008. In addition to its ultra-accommodative borrowing costs, the Fed has been pumping stimulus into the economy through the use of various unconventional policy tools or quantitative easing. Since the peak of the financial crisis and subsequent recession early last year, signs of improvement in the domestic and global economies have prompted monetary officials to begin normalizing monetary conditions by removing some of the extraordinary stimulus from the market. In October 2009, the Fed allowed its \$300 billion Treasury purchase program, which was aimed at keeping longer-term rates low and the banks flush with liquidity, to expire. In February the Fed raised its discount rate at which it lends emergency funds to banks by 25 basis points and in March, officials allowed their \$1.25 trillion mortgage purchase program to expire. The removal of some of the emergency measures put in place during the height of the economic downturn is a clear vote of confidence on the part of monetary officials that the recovery is moving in the right direction. Indeed, that view has been supported by recent data showing strong gains in manufacturing and services sectors, resilient retail sales and improving business and consumer confidence. Even the all important jobs market showed signs of improving, posting the largest monthly gain in four years in April. Still, the tentative and fragile state of the economy suggests that lending rates might not rise until late 2010 or early 2011.

### USD Outlook: Balance of market opinion: Positive

The U.S. dollar soared to a one-year high against a currency basket in early May, broadly fueled by two key factors. First, mounting sovereign credit concerns in the euro zone have undermined the single currency and weighed on investor tolerance for riskier assets. The deteriorating fiscal positions of euro zone states like Greece, Portugal and Spain fanned worries that fiscal tightening could exacerbate their economic downturn and pushed back the timetable for ECB monetary normalization. Even the announcement of enormous rescue packages that the EU and IMF created to backstop Greece failed to meaningfully reduce concerns. Second, the recent string of generally upbeat U.S. economic data, including April's upbeat employment report, suggests that the time frame for Fed policy normalization may be brought closer, especially if upcoming reports, principally on the jobs front, show continued improvement. The factors that have led to the greenback's generally buoyant tone recently are likely to remain in place for the foreseeable future. Consequently, the dollar should continue to outperform most of its major rivals, especially if sovereign credit risk remains elevated and data continues to highlight the likely outperformance of America's recovery.

### Upcoming critical events:

May 12: US March Trade Balance

May 19: US April CPI

May 24: US April Existing Home Sales

May 27: US Q1 GDP Revision

May 28: US May U of Mich Consumer Sentiment

Economic indicators	USD
3-month Deposit Rate	0.22%
GDP (annual rate)	3.2%
Inflation (annual rate)	2.3%
Unemployment	9.9%
US\$ Trade Balance	-532.9 bln

