

Dollar Advances as Fed May Increase Interest-Rate Gap with Europe, Japan

Dec. 7 (Bloomberg) -- The dollar rose the most in a week against the euro on speculation the Federal Reserve next week will raise borrowing costs, widening the gap between U.S. rates and those set by other central banks. The USD also approached a 32-month high against the JPY after Prime Minister Junichiro Koizumi said today it's too early for the Bank of Japan to raise rates from near zero. The extra yield offered by two-year U.S. Treasury notes over comparable Japanese bonds is close to the most since May 2001 and near a three-month high versus German debt.

"The dominating theme in the market is yield," said Marios Maratheftis, a currency strategist at Standard Chartered Plc in London. "That's supporting the dollar and will continue to do so in the short term until the Fed signals it's thinking about the end of the rate cycle."

The dollar gained to USD 1.1709 per EUR at 12:29 p.m. in New York, from 1.1779 USD/EUR late yesterday, according to electronic currency-dealing system EBS. The U.S. currency rose to 121.03 JPY/USD from 120.89 JPY/USD

Fed policy makers have raised their target rate 12 times since June last year, to 4 percent, and will do so again next week, according to economists surveyed by Bloomberg. "We're more optimistic that the economy is strong enough" for the Fed to push its rate to 5 percent next year, said Meg Browne, a senior currency strategist at Brown Brothers Harriman in New York. "That would continue to support the dollar."

Vitor Constancio, who votes on rates at the European Central Bank, told Portugal's *Jornal de Negocios* newspaper that the ECB doesn't plan to add to last week's quarter-point increase to 2.25 percent.

'No Pause' From Fed

"I don't think the Fed are going to signal any kind of pause in rate increases next week," said Ian Gunner, head of foreign exchange at Mellon Financial Corp. in London. "There's no reason the dollar can't continue to benefit from the rate advantage through to the end of the year."

Japan's investors have been net buyers of overseas assets for the past 10 weeks, Ministry of Finance figures show, during which time the yen has weakened 7.3 percent. The latest figures are scheduled to be released tomorrow.

"There's still strong demand for the dollar, and there are investors and companies who want to buy when the dollar weakens," said Akihiro Tanaka, a senior currency dealer in Tokyo at Resona Bank Ltd. "The dollar will stay on an up trend and the yen on a down trend, at least through the end of this year."

Koizumi told reporters in Tokyo it's "too early" for the BOJ to lift borrowing costs from zero. He spoke after meeting with central bank Governor Toshihiko Fukui.

Dollar's Rally

The dollar has gained 18 percent against the yen this year, the most since 1979. It's gained 15.6 percent versus the euro, the biggest rally since 1999 when the euro made its debut.

The U.S. currency extended its gains against the euro as traders sold the 12-nation currency against the yen, said Boris Schlossberg, a currency strategist at Forex Capital Markets LLC, a New York-based foreign-exchange broker. The euro retreated to 141.70 JPY/EUR after yesterday rising to a record 142.81 JPY/EUR.

Japanese individuals are likely to boost their investments overseas, seeking higher yields than can be earned at home. "The trend is your friend," Browne said. "Non-Japanese yields will continue to be attractive to Japanese investors."

The yield gap between two-year U.S. and Japanese bonds was at 4.13 percentage point today, 0.08 percentage point less than its widest in 4 1/2 years, according to data compiled by Bloomberg. The difference in yields with German debt is 1.75 percentage points, 0.06 percentage points less than its three-month high of 1.81 percentage points, reached on Dec. 5

Sending Money Abroad

Workers in private companies are expected to receive winter bonuses totaling 16.5 trillion yen (\$136 billion), up 3.7 percent from a year earlier, according to data published by UFJ Institute Ltd. on Nov. 8.

"Japan's money is flowing into foreign-currency denominated assets such as dollars, where returns are higher," said Michiyoshi Kato, vice president of currency sales at Mizuho Corporate Bank Ltd. in Tokyo. "Winter bonus season is also encouraging yen-selling." The yen will trade between 120.50 and 121.50 per dollar, and 141.80 and 142.80 per euro today, Kato said.

Japan's currency failed to sustain a rally even after the country's index of leading economic indicators gained for the fifth month this year, signaling the economy will keep expanding.

The index, which includes consumer confidence, rose to 80 percent in October from a revised 41.7 percent in September, the Cabinet Office said in Tokyo today. The median forecast of economists in a Bloomberg survey was for 80 percent. A number at or above 50 indicates faster growth in three to six months.

"The data may provide some support for the yen, which has weakened a lot already," said Tetsu Aikawa, a currency sales manager in Tokyo at UFJ Bank Ltd., a unit of the world's biggest lender by assets. "People have become cautious about the yen's decline." The Japanese currency may strengthen to 119.50 against the dollar this week, he said.