

# Dollar Falls as China Interest Rate Decision Spurs Demand for Risk Assets

By Allison Bennett - Dec 13, 2010 11:52 AM CT

The dollar fell against most of its 16 major counterparts as China refrained from raising interest rates, lifting stock markets at the expense of safer assets.

The euro extended its gains as Moody's Investors Service Inc. said the U.S. tax-cut package up for a procedural vote in the Senate boosts the chances for a negative outlook on the U.S. credit rating. The U.S. currency declined for the third straight day against the Australian dollar (AUD) and fourth day against the Canadian currency (CAD).

"It's a relief that China didn't raise rates that allowed risk to be applied yet again to the market," said Dean Popplewell, head analyst in Toronto at the online currency- trading firm Oanda Corp. "The euro and commodities and growth-sensitive currencies are all being helped."

The USD declined 1.3% against the euro to 1.3392 USD/EUR in New York from 1.3226 USD/EUR Dec. 10. It fell 0.6% against the yen to 83.43 USD/JPY. The USD has lost 2.1% this year in a measure of the currencies of 10 developed nations, according to Bloomberg Correlation-Weighted Currency Indexes.

The MSCI World Index of equities rose 1% and the Standard & Poor's 500 index gained 0.4%, reaching the most since September 2008.

## Ratings Outlook

Moody's Investors Service Inc. said President Barack Obama's agreement to extend tax cuts are a negative for the Aaa credit rating of the U.S. and will increase the likelihood of a negative outlook in the next two years unless offsetting measures are enacted.

While the tax and unemployment benefit package is likely to boost economic growth in the next two years it will "adversely affect the federal government budget deficit and debt level," Steven Hess, senior credit officer at Moody's in New York, wrote in a note dated Dec. 13. "From a credit perspective, the negative effects on government finance are likely to outweigh the positive effects of higher economic growth."

Consumer prices in China rose a more-than-forecast 5.1% in November from a year earlier, statistics showed during the weekend.

Even as inflation accelerated to the fastest pace in more than two years, the Chinese central bank did not make the rate move predicted by firms including UBS AG and Mizuho Securities Asia Ltd. Chinese policy makers have instead drained money from the financial system during the past two months by setting higher reserve requirements for banks.

### **Risk Bounce**

“Chinese stocks had a big rally,” said Richard Franulovich, a senior currency strategist at Westpac Banking Corp. in New York. “You have good conditions for a bounce in risk. Against that background, the dollar’s getting sold.”

China’s yuan (CNY) weakened 0.1% to 6.6628 CNY/USD. The CNY has strengthened 2.4% since a two-year dollar peg was scrapped on June 19. The government will push forward the reform on the yuan’s exchange rate next year, according to a statement on the State Council’s website yesterday following the Central Economic Work Conference.

The Dollar Index, which the ICE futures exchange uses to track the greenback against the currencies of six major U.S. trading partners, fell 0.9%. The index touched 79.306, the lowest since Dec. 7.

### **‘Negative Watch List’**

“We are hearing Moody’s is saying the U.S. might be on the negative watch list and suddenly the dollar went south,” said Hidetoshi Yanagihara, a senior currency trader at Mizuho Financial Group Inc. in New York.

U.S. two-year Treasury yields fell today after rising the most on a weekly basis since January. The two-year benchmark fell four basis points, or 0.04 percentage point to 0.6%. The increase in Treasury yields in the week ending Dec. 10 has led the market to be “long dollars against the majors” and has contributed to the U.S. currency’s decline today as “the market has been unwinding existing trades,” Yanagihara said.

The Australian dollar and was the top performer against the greenback as the Reuters/Jefferies CRB Index of raw materials rose 1.2 percent. China is Australia’s largest trading partner and investors speculated an increase in interest rates would damp exports to the nation.

Australia’s currency rose gained 0.7 percent to 99.24 USD/AUD and New Zealand’s dollar, nicknamed the kiwi, appreciated 0.7 percent to 75.35 USD/NZD.

The CADr extended this month's increase to 2% versus the USD, trading within half a cent of parity. The fourth straight days of gains is the longest winning streak in more than a month. The Canadian currency appreciated 0.2% to 1.0068 CAD/USD.

The euro, which declined 1.4% against the USD last week, rose against most its major counterparts even amid signs of division among European governments about how to stem the region's debt crisis. European Union leaders attend a summit on Dec. 16 and 17, with Italy, Belgium and Luxembourg favoring euro-area bonds, while Germany and France oppose the idea.

The euro's survival is "non-negotiable," requiring budget vigilance and closer economic cooperation to overcome "structural weaknesses" within the euro region, German Chancellor Angela Merkel and French President Nicolas Sarkozy said Dec. 10. They ruled out joint bonds and rejected any increase in the size of a rescue fund set up in May.