

CHAPTER 3 – International Financial Markets

Data Lift Dollar But Euro Concerns Mount

By Daniel Bases
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NEW YORK (Reuters) - Favorable U.S. economic data helped push the dollar higher on Thursday but European policy makers continue to harp on its overall weakness while at the same time U.S. policy makers remain sanguine about its fall.

Upbeat regional U.S. manufacturing data for January and a better than expected weekly jobless claims report overshadowed a smaller than expected rise in December retail sales. Consumer inflation data rose slightly, as expected, indicating no need for any increase in official U.S. interest rates.

"I think people were a little short the dollar, and they needed to cover and the data gives them a good excuse to buy the dollar back," said Mike King, trader at Commerzbank in New York, adding "The euro is sitting right on a crucial support level of USD 1.2560. A close below opens the way for a deeper correction."

In late New York trade, the euro dropped to USD 1.2576, off 0.52 percent from Wednesday's New York close, according to Reuters data, 3 cents below Monday's record high.

Against the yen, the euro was down about 0.54 percent at JPY 133.63, while the dollar held near unchanged against the yen at JPY 106.36 amid continued wariness of possible yen-selling intervention by Japanese authorities.

The dollar rose over 1 percent against the Swiss franc to CHF 1.2473 before dropping to CHF 1.2452. Sterling fell to USD 1.8219, off 0.55 percent on the day.

UPBEAT U.S. DATA

The Philadelphia Federal Reserve (news - web sites)'s index measuring manufacturing activity in the mid-Atlantic states rose to 38.8 in January, a 20-year high, from a revised 30.3 in December.

"The data is certainly dollar-supportive, but it is not strong enough to get off the dollar's current consolidation phase," said David Durrant, chief currency strategist at Bank Julius Baer in New York.

What leaps out from the data is the increase in prices paid to 35.3 in January from 30.9 in December, indicating there is some rise in pricing pressure, belying comments from Fed officials that inflation remains muted, Durrant said.

"We have Fed official Ben Bernanke saying he sees there is no inflation through 2004. But against this growth backdrop, that seems a bit of a difficult pill to swallow," he added.

Atlanta Federal Reserve Bank President Jack Guynn said on Thursday the dollar's slide has not "terribly impacted our economy or is likely to be some very disruptive force."

Analysts said the mixed batch of data should allow the dollar more breathing room before the Group of Seven meeting of industrial nations in Florida next month, where the dollar's broad-based weakness is widely expected to be a major topic.

EUROPE'S CONCERNS

The dollar also garnered support even as more European policymakers expressed dismay over the euro's rapid ascent, up 41 percent against the dollar over the last two years.

German Economy Minister Wolfgang Clement urged for broad international support for stable foreign exchange rate system. Clement, speaking to reporters in Berlin, said the euro's current level is just about tolerable. But he noted that if the single currency continues to rise swiftly, it would pose a problem for European economies.

French Finance Minister Francis Mer said in the same press briefing that the euro's volatility was a cause for concern.

But even with stronger rhetoric from Europe, some analysts believe that the final G7 statement will not deviate sharply from the last meeting's call for flexible exchange rates.

"I don't think there would be any strong statement out of the G7," said Bob Lynch, currency strategist at BNP Paribas in New York.

"The U.S. so far has not voiced any concern over the way the dollar has moved against any other currencies. Japan certainly has not voiced concern, although they have stepped up their intervention. And they can just say that last year the yen was at 116 yen, now it's at 106. So there has been some adjustment," he added. (Additional reporting by Gertrude Chavez in New York)

Questions

1. Explain the comments of Mr. King, trader at Commerzbank in New York,
2. Calculate the CHF/EUR exchange rate based on the USD/EUR and CHF/USD exchange rates.
3. Explain the effect of good U.S. economic data on the USD/EUR exchange rate.
4. Explain the economic effects of the 41% appreciation of the EUR against the USD. Should Europe be concerned about a further drop in the USD?
5. Usually, the Bank of Japan, the Japanese Central Bank, buys USD when the USD depreciates against the JPY. Using a basic supply and demand graph, show the effect of the Bank of Japan's actions on the JPY/USD exchange rate.