

CHAPTER 9 – Forecasting Exchange Rates

Dollar near lows after disappointing Fed survey

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The **dollar** hovered near recent lows against the euro and the yen as investors considered a disappointing US economic survey the night before and looked ahead to more key US data.

The Federal Reserve's "Beige Book" report, an informal survey by each Fed bank of the economic conditions in its district, was peppered with words such as "sluggish" and "soft," and reported subdued consumer activity over the crucial Christmas period. Consumer activity makes up some two-thirds of US economic activity and a drop-off in spending, at a time when companies continue to rein in capital expenditure, could stall any nascent economic recovery.

US inflation figures released ahead of the market open on Thursday showed price pressures remained subdued and prompted little market reaction. A fall in weekly jobless claims, a volatile series of data, was also shrugged aside by investors. Later on Thursday, investors will compare the Philadelphia Fed's manufacturing index with an unexpected improvement in the New York Fed's survey released on Wednesday. On Friday, December industrial production numbers and the University of Michigan's consumer sentiment survey will be watched closely. The Fed itself meets to discuss monetary policy at the end of the month, but after November's half-point cut in rates, no further change is expected.

The **euro** was at USD 1.057 against the dollar by midday New York trade, close to its USD 1.0599 high reached on Tuesday. Traders said heavy options barriers at USD 1.06 were limiting the single currency's rise.

Even data showing Germany, the eurozone's largest economy, grew by only 0.2 per cent last year, did little to dent the euro as the market's attention remained firmly on the dollar.

Heavy euro buying by the Hungarian central bank was also supporting the single currency. Hungary began intervening on Wednesday to defend the upper limit of the **forint**'s trading band. The euro was hovering around the band limit at HUF 234.69 on Thursday.

The US currency was at JPY 117.9 against the **yen**, not far off Tuesday's four-month lows of JPY 117.56. Analysts said the dollar's problems were highlighted by its weakness against the yen which came in spite of ongoing fears the Japanese authorities could intervene to limit yen strength. "There does seem to be a growing belief in the marketplace that the Bank of Japan have missed the opportunity to get a couple of big figures back from the market cheaply," said Chris Furness, senior currencies strategist at 4Cast economic consultancy, commenting on the boldness of dollar sellers. "Even if we do see intervention, then it will be seen as an opportunity to sell dollars once again."

Questions

1. What fundamental factors are given attention by the Financial Times that offered clues about the future value of the USD? Explain each factor.
2. Germany seems to be growing at a very low rate. How does it affect the market's opinion about the USD?
3. Does the Hungarian forint's (HUF) trading bands affect the forecast of the HUF/EUR? Explain.
4. According to Chris Furness, many investors are forecasting a weak dollar. Do you agree with this forecast? Do you also think that the Bank of Japan missed an opportunity to buy USD at cheap prices?