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Daily Forex Report

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USD lower, Bernanke says rates to stay low, stocks rally

- **USD:** Lower, new home sales declined by 11.2%, Bernanke says rates to stay low for an extended period
- **JPY:** Higher, exports rise, safe haven demand as Asian equities decline
- **EUR:** Higher, EU industrial orders rise,ECB's Gonzalez-Paramo downplays risk of contagion from Greece
- **GBP:** Mixed, BOE's Posen said he expects UK inflation to remain subdued, QE will be expanded if needed
- **CAD and AUD:** AUD & CAD higher, China tells commercial lenders to restrict lending to local governments

Overview

The USD traded mixed to lower Wednesday with the EUR rebounding supported by report of better than expected EU industrial orders and speculation that Bernanke will signal that US interest rates will remain at zero for some time. The GBP continues to underperform pressured by a dovish statement from the BOE's Posen. Posen said that the BOE will expand quantitative ease if necessary. Commodity currencies opened lower pressured by weaker Asian equity market trade and report that China took action to curb lending. China's regulators told its commercial banks to restrict lending to local governments. Commodity currencies turned higher in US trade, tracking a rally in US equities sparked by Bernanke's testimony. JPY traded higher for the fourth day in a row supported by report of a jump in Japan's January exports. In his testimony before Congress Fed Chairman Bernanke said the economy still needs help, a sustained recovery remains in question and interest rates will stay low for an "extended period." Bernanke went on to say the Fed will have to tighten at some point to prevent inflationary conditions but he gave no clue when that point might be. Bernanke's testimony was seen a bit more dovish than expected as he confirmed the Fed extend period language. Some analysts have suggested that the Fed's discount rate hike last week would be a prelude to the Fed dropping the extended period language from its next communiqué. This seems less likely after today's testimony. The Fed's Bullard said rates may stay near zero for all of 2010 and the USD trades lower as stocks rally. US economic data was weak with new home sales reported down by a record 11.2%.

Today's US data:
January new home sales came in at 309k, a reading of 360k was expected.

Upcoming US data:
On February 25th January durable goods will be released expected at 1.5% compared to 1% last month along with initial jobless claims for the week ending 02/20 expected at 460k compared to 473k last week. On February 26th Q4 preliminary GDP will be released expected at 5.5% compared to 5.7% in the original report. February Chicago PMI and final Michigan sentiment will also be released on February 26th. The PMI is expected at 60 compared to 61.5 last month and Michigan consumer sentiment is expected at 74 compared to 73.7 last month. Finally on February 26th, January existing home sales will be released expected at 550k compared to 545k last month.

JPY
JPY traded higher for the fourth day in a row supported by safe haven flows as Asian equity markets decline and in reaction to report that China has taken further action to curb lending. China's regulators told its commercial banks to restrict lending to local governments. This action follows recent moves by China to raise its reserve ratio

requirements to try to curb lending to slow China's rapid expansion of growth and rise in asset prices. JPY was also supported by report that Japan's trade deficit turned to a surplus of ¥82.5bln in January with exports reported to have risen by 40.9% and imports rose by 8.6%. The improvement in Japan's export sales generates speculation that Japan's economy may be nearing a bottom. Japan's corporate service price index for January declined by 0.4%. The decline in the corporate service price index confirms that deflationary pressures continue in Japan. The BOJ's Deputy Governor Yamaguchi said that Japan's central bank will do everything it can to defeat deflation but with rates near zero there is not much that the BOJ can do. Yamaguchi said that downward pressures on prices are likely to continue. Analysts at J.P. Morgan Chase forecast JPY will trade at 87 next month as traders reduce bets that the Fed will raise interest rates sooner than expected.

On February 26th January CPI will be released expected at -0.2% compared to -0.5% last month along with January industrial output, retail sales, housing starts and construction orders. Industrial output is expected at 2.2% compared to 0.7% last month. Retail sales are expected to fall by 1.2% compared to 0.2% last month. Housing starts are expected to rise by 3.3% compared to 2.5% last month and construction spending is expected to rise by 0.6% compared to 24.5% last month.

Key technical levels to watch in USD/JPY include support at 89.57 the February 11th low with resistance at 91.30 the February 23rd high.

EUR

EUR traded higher supported by report of stronger than expected EU industrial orders and speculation that the Fed will maintain interest rates near zero. EU December industrial orders rose by 0.8%. The rise in EU industrial orders report suggests that the improving global economy is generating demand for EU exports. EUR gains were limited by report that German Q4 GDP was flat with private consumption reported to have dropped by 1% and German March GFK consumer confidence declined for the fifth month in row. Tuesday the Fed's Bullard said that US interest rates may remain near zero through the end of the year and Bernanke said that rates will remain low for an extended period. EUR was supported by statement from the ECB's Gonzalez-Paramo that the EUR decline is not totally unjustified and that he does not see a contagion from Greece if the other countries abide by the rules of the stability pact. EUR also supported by short covering. We noted in a special report Tuesday that negative sentiment towards the EUR is approaching an extreme and that the EUR is technically oversold. EUR remains vulnerable to concern about EU sovereign debt risk and speculation that the US economy will recover faster than the EU.

On February 25th EU business climate will be released expected at 98 compared to 97.1 last month. On February 26th EU January CPI will be released expected at 1.2% compared to 1.1% last month.

The technical outlook for the EUR is negative. Expect EUR support at 1.3425 the May 18th low with resistance at 1.3692 the February 23rd high.

GBP

GBP traded mixed with gains limited by dovish comments from the BOE's Posen. Posen said that he expects UK inflation to remain subdued and that the BOE will expand quantitative ease if needed. Posen’s comments follow a statement from BOE Governor King Tuesday that it may be necessary to expand quantitative ease. King made his comments in testimony before Parliament and his comments followed Tuesday's report of weaker than expected January UK mortgage lending. Weaker UK mortgage lending may be a sign that the recovery in UK housing sector has slowed. The UK housing sector has been one of the main bright spots in a slow UK economic recovery. GBP was also pressured in cross trade to the EUR with the EUR supported by report of better than expected EU industrial orders data and downplaying of the contagion risk from the Greek debt crisis. Analysts at UBS said that GBP could fall below parity with the EUR and 1.05 versus the USD if the UK government prematurely withdraws stimulus and tightens fiscal policy. EUR/GBP cross is currently trading at 0.8790 and GBP at 1.5414. GBP last traded at 1.05 in the mid-1980s. Focus turns to Friday's release UK Q4 GDP. This report will be key to investor perception of the strength of the UK recovery and the outlook for BOE policy. Recent UK economic data has been mixed with January CPI rising to the high end of the BOE's 1 to 3% inflation target. January CPI rose by 2.9%. The rise in UK CPI and signs of slowing of UK recovery is a challenge to the BOE and an improvement in UK GDP could reduce the risk that the BOE will be soon expanding quantitative ease.GBP remains vulnerable to concern about UK debt, economic outlook and possibility of an expansion of the BOE's quantitative ease. This week's main focus will be Friday's release of UK GDP. An upward revision in GDP could help to slow the rate of the GBP decline.

This week's UK economic calendar includes the February 26th release of Q4 GDP expected at 0.2% compared to 0.1% in the prior report. January GFK survey and nationwide home prices will also be released on the 26th. The GFK is expected unchanged at -17 and house prices are expected to rise by 0.4% compared to 1.2% last month.

The technical outlook for GBP is negative as GBP trades below 1.5000. Expect near-term support at 1.5345 the February 19th low with resistance at 1.5683 the February 18th high.

CAD

CAD traded mixed with gains limited by report that China took further action to try and curb lending. According to a Reuters report China's banking regulator told banks to restrict funding to local governments. China raised its bank reserve requirements by 50bps twice this year to try to curb lending. Tightening in China contributes to recent weakness in global equity and commodity markets and has generated a reappraisal of risk appetite. Tightening in China may discourage demand for commodity-based currencies if the tightening leads to slower global growth. The impact of the news from China was partly offset by speculation that the Fed will maintain interest rates near zero for most of 2010. There were no major economic reports released from Canada today. The next major focus for CAD trade will be the BOC policy meeting scheduled for March 2nd. The BOC has pledged to maintain record low yields through June of 2010 provided inflation remains in check. Last week Canada reported above expectation inflation with CPI rising close to the 2% BOC target. Despite the rise in Canada's inflation the BOC is expected to maintain steady rate policy. The BOC's decision to maintain steady rate policy could be a mild negative for CAD. Recent Canadian economic data including improvement in retail sales, housing and employment suggest that the Canadian domestic economy is rebounding. The trade will be looking to see if the BOC makes any adjustments in its policy outlook because of the recent improvement in Canadian economic data and rising inflation.

On February 26th Q4 current account will be released expected at -8.75bln compared to -13.12bln last quarter

The technical outlook for CAD is mixed as USD/CAD trades above 1.0500. Look for near-term support at 1.0426 the February 23rd low with resistance at 1.0595 the February 24th high.

AUD

AUD traded mixed initially pressured by China's tightening of credit and in reaction to weaker Asian equity market trade. AUD traded to the day's lows in reaction to report of a sharp decline in US new home sales. The drop in the new home sales generates concern about the US and global recovery. AUD turned higher for the day as stocks rallied in reaction to Bernanke's statement that rates will remain low for an extended period. As noted above China's banking regulator told commercial banks to restrict new credit to local governments. The latest tightening in China generates concern about the outlook for the global recovery and demand for commodities. AUD downside was limited by positive Australian economic data and RBA rate hike speculation. Australia's Q4 wage price index rose by 0.6%% and Q4 construction work done rose by 2.6%. These reports confirm that the Australian domestic economy is improving. Tuesday RBA Deputy Governor Battellino said that a strong AUD helps to contain inflationary pressures. His comments are seen as an endorsement of recent tightening of RBA monetary policy. Last week RBA Governor Stevens said that interest rates are still 50 to 100bps below average and that future policy changes will be made if the economy improves as expected. RBA Deputy Governor Lowe said that the outlook for the Australian economy is positive and he expects interest rates return to more normal levels. Lowes' comments follow last Tuesday's release of the RBA minutes which suggest that the RBA is considering future rate hikes. RBA watcher McCrann said that he expects the RBA to hike interest rates 200 bps this year with a 25bps rate hike expected in March. Today's tightening in China may cloud the outlook for RBA policy. The RBA was widely expected to hike rates in February but refrained from hiking rates. One of the reasons the RBA decided not hike rates in February was tightening of policy in China. AUD should remain well supported on breaks by RBA rate hike speculation and improving outlook for the Australian domestic economy.
On February 26th January private sector credit will be released expected unchanged at 0.3%.
The technical outlook for the AUD is mixed as the AUD failed to hold above 9000. Expect AUD support at 8858 the February 24th low with resistance at 9093 the January 22nd high.

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