

USD mixed, Hoenig says zero rates not sustainable

- **USD:** Lower, risk appetite improves as stocks rally, hope for Greek aid
- **JPY:** Higher, unemployment unexpectedly declines, government call for the BOJ to target inflation/buy JGB's
- **EUR:** Lower, supported by short covering ahead of Wednesday's Greek budget announcement
- **GBP:** Lower, construction PMI falls, election polls point to a hung parliament
- **CAD and AUD:** AUD & CAD higher, RBA rate hike, strong retail sales, BOC refers to higher CPI

Overview

The EUR and GBP made new lows for the year in overseas trade pressured by concern about sovereign debt risk in peripheral European nations and UK debt. Despite ongoing uncertainty about the Greek fiscal outlook there was limited follow through selling of the EUR and the USD traded lower in the US session. Greece is expected to outline its budget plans Wednesday. Anticipation that Greece will announce significant austerity measures sparked a short covering rally in the EUR. If Greece takes credible action to reduce its deficit it will increase the likelihood of EU aid for Greece. GBP continued to underperform. The latest UK election polls point to a hung parliament which generates concern that the UK government may not have the political backing to cut the UK deficit. The AUD traded higher supported by the RBA's 25bps rate hike. CAD continues to rally in reaction to yesterday's release of stronger than expected Canadian Q4 GDP and a slightly less dovish bias from the BOC. The BOC elected to hold rate policy unchanged as expected but dropped language in its policy statement that inflation risk is "tilted to the downside." JPY edged higher supported by better than expected January unemployment and report that Japan's finance minister calls on the BOJ to consider targeting inflation. USD experienced light short covering ahead of tomorrow's Greek budget plan announcement. USD downside was limited by hawkish comments from the Fed's Hoenig. Hoenig said that zero rates are not sustainable and the Fed must be prepared to hike rates while unemployment rate is still high. Hoenig is seen as a minority voice on the FOMC but his comments helped to limit today's USD selloff.

Focus turns Thursday's ECB and BOE policy meetings and Friday's release of US unemployment. The ECB is expected to remain on hold and there is uncertainty about whether the BOE will maintain its current level of asset purchases. US February unemployment is expected to post a modest rise with nonfarm payrolls unchanged from last month.

Today's US data:

There was no top-tier US economic data released in today's trade. Domestic auto sales were mixed.

Upcoming US data:

On March 3rd February ADP employment will be released expected at 10k compared to -22k last month. February manufacturing ISM Index will also be released on March 3rd expected at 51 compared to 50.5 last month. On March 4th initial jobless claims for week ending 02/27 will be released expected at 490k compared to 496k last month. Q4 productivity, unit labor costs, January pending home sales and factory orders will also be released on March 4th. Q4 productivity is expected unchanged at 6.2%, unit labor costs are expected unchanged at -4.4%, factory orders are expected unchanged at 1% and pending home sales are expected at 98.4 compared to 96.6 last month. On March 5th February unemployment and nonfarm payrolls will be released along with January

consumer credit. The unemployment rate is expected to rise 0.1% to 9.8%, nonfarm payrolls are expected unchanged at -20k and consumer credit is expected at -3.1bln compared to - 1.7bln last month.

JPY

JPY edged higher supported by report of an unexpected drop in Japan's unemployment rate and in reaction to call from Japan's Finance Minister Kan for the BOJ to consider targeting inflation. Last Friday Japan reported that CPI fell by 1.3% in January. This marks the 11th straight monthly decline for Japan's CPI confirming continuing deflationary pressure in Japan. Japan's January unemployment rate declined to 4.9%, a reading of 5.2% was expected. January household spending however fell by 1.3%. Japan's Finance Minister Kan said that the decline in the jobless rate was a good sign and he wants Japan to get out of deflation this year. Reuters reports that the Japanese government would like the BOJ to consider buying JGB's as a way to boost growth and combat deflation. Recent JPY strength is attributed to gains versus European currencies sparked by concern about that default risks in Europe, repatriation flows ahead of Japan's fiscal year which ends on March 31st and rising risk aversion sparked by uncertainty about the global recovery. The IMF says JPY is line with fundamentals.

On March 3rd Q4 capital spending will be released expected at -18.4% compared to -24.8% last month

Key technical levels to watch in USD/JPY include support at 88.55 the February 4th low with resistance at 90.33 the February 25th high.



EUR

EUR traded at new low for the year in overseas trade than rebounded to trade higher in the US session. The EUR has been pressured by concern about sovereign debt risk in Greece. Former ECB official Issing says that Greece should go to the IMF not the EU for aid. The WSJ reports that Greece will outline its proposed budget cuts Wednesday. If the Greek budget cuts are seen as credible the announcement could spark a relief rally in the EUR. EUR traded as low as 1.3435 after the release of an unexpected decline in EU inflation. EU February inflation dips to 0.9%, compared to 1% rise last month. Concern about sovereign debt risk in Europe coupled with weaker EU inflation will encourage the ECB to maintain steady rate policy at Thursday's ECB policy meeting. Lack of inflationary pressure in the EU would allow the ECB cover to maintain a dovish bias. The IMF says that the EUR is closer to fair value but there is mixed opinion about where the EUR may be headed with analysts at Deutsche Bank suggesting the EUR could decline to 1.2750 pressured by speculation that the Fed will hike rates before the ECB. Analysts at Royal Bank of Scotland however suggest that the EUR could rise to 1.4000 if the EU announces a plan to aid Greece. There is significant debate as well as to whether the record short spec position in the EUR on the IMM makes the EUR vulnerable to a technical correction or if the spec positioning is confirmation of increasing negative sentiment towards and the negative sentiment will continue to pressure the EUR. Focus turns to Thursday's ECB policy meeting. No policy change is expected as the ECB is restricted by concern that the sovereign debt risk in Europe will be a drag on the EU recovery. EUR remains vulnerable to concern about EU sovereign debt risk and ECB policy outlook.

On March 3rd EU February services PMI will be released expected at 52.3 compared with 52.5 last month along with January retail sales. January retail sales are expected at 0.2% compared to flat last month. ECB policy meeting will be held on March 4th, no change is expected. The technical outlook for the EUR is negative. Expect EUR support at 1.3435 the March 2nd low with resistance at 1.3693 the February 23rd high.



GBP

GBP traded at a new low for the year pressured by UK election polls which point to a hung parliament and in reaction to report of an unexpected decline in UK construction PMI. UK election polls released Monday suggest increasing risk that the UK Parliament will be facing gridlock and the new government will not have the political backing to cut the UK deficit. Rating agencies have put the UK on notice that if credible action is not taken to reduce the UK deficit the UK AAA sovereign debt rating is at risk for downgrade. Analysts at Bank of Tokyo have cut their GBP forecast to 1.4000 because of the election polls show the UK in may find itself with a minority government. UK's Mandelson said that deficit cuts will come only when the UK the economy returns to secure growth. UK February construction PMI dipped to 48.5 from 48.6 last month. The weaker UK construction PMI follows Monday's report of weaker than expected mortgage approvals and lending data. These reports may encourage the BOE to consider expanding its asset purchase program to try and boost UK growth. This week's main focus will be Thursday's BOE policy meeting. The BOE is expected to hold rate policy unchanged and may consider expanding quantitative ease. Concern about the UK government debt outlook and uncertainty about the UK's recovery may encourage the BOE expand quantitative ease. Last week a number of BOE officials including BOE King said the BOE may expand quantitative ease if needed. GBP remains vulnerable to concern about the rising UK budget deficit, the UK recovery and speculation that the BOE may be considering expanding quantitative ease. It's a close call whether the BOE will elect to expand quantitative ease at Thursday's meeting. Most analysts expect the BOE to take a continued wait and see approach leaving the door open for more quantitative ease if necessary. This GBP downside was limited by a rebound in risk appetite as global equity markets rally.

On March 3rd February consumer confidence index will be released expected at 68 compared to 69 last month along with February services PMI expected at 54 compared to 54.5 last month. BOE policy meeting will be held on March 4th, no policy change is expected but there is increased pressure on the BOE to expand quantitative ease.

The technical outlook for GBP is negative as GBP trades below 1.5000. Expect near-term support at 1.4702 the April 30th low with resistance at 1.5000 the range breakout.



CAD

CAD traded higher supported by Monday's report of stronger than expected Q4 GDP growth, firmer equity markets and a slightly less dovish bias by the BOC. Canada reported that Q4 growth was 5%. The trade had expected a reading of 4.1% for Canada's Q4 GDP. The Canadian GDP rise was the strongest quarterly growth since Q3 2000 supported by strong consumer spending and an uptick in exports. Exports rose 3.7% and consumer spending rose by 0.9%. The BOC elected to hold rate policy steady as expected at 0.25%. CAD extended its gains after the BOC policy announcement. In its policy statement accompanying the rate decision the BOC made reference to the fact that core inflation has been slightly firmer than unexpected and the BOC reaffirmed its commitment to maintain the current level of interest rates until the end of the second quarter 2010. The BOC said that the increase in core inflation reflected a higher level of economic activity and the risk inflation is balanced with the main downside risk a more protracted global recovery and strength of the CAD. The BOC statement dropped language that inflation risk is "tilted to the downside." The dropping of this language sent the CAD to new highs for the day in reaction to a less dovish bias by the BOC. Canada will release its federal budget on March 4th. Canada is expected to forecast a deficit of less than 3% of GDP and confirm relatively strong financial conditions in Canada. Canada's fiscal outlook stands in stark contrast to rising fiscal deficits in Europe, Japan and the US.

On March 4th January building permits and Canada's budget will be released.

The technical outlook for CAD is positive as USD/CAD trades below 1.0500. Look for near-term support at 1.0249 the January 19th low with resistance at 1.0443 the March 2nd high.



AUD

AUD traded higher supported by today's RBA hike and in reaction to the report of strong Australian retail sales. The RBA hiked rates 25bps to 4% as expected. In the statement accompanying the rate hike the RBA said that the global recovery is growing and Asian growth is strong. The RBA went on to say that unemployment rate has peaked and that it is appropriate for rates to rise closer to the average. The RBA also noted some of the credit risks facing Europe and that recovery in some countries may be more difficult. According to the RBA sovereign debt troubles in Europe could hurt the global recovery. Australian January retail sales rose by 1.2%. The strength of the retail sales was partly offset by report of a 7% decline in Australian building approvals. Building approvals were expected to have risen by 0.8%. Q4 public spending rose by 3.8%. AUD gains were partly limited by the report weaker buildings approval data and in reaction to a statement from RBA watcher McCrann that the RBA is likely to pause its rate hike cycle in April. McCrann however still expects the RBA to hike rates to 5% by year end. AUD price direction will focus on risk sentiment in the direction of equity markets.

On March 3rd Q4 GDP will be released expected at 0.3% compared to 0.2% last quarter. On March 4th January trade balance will be released expected at -2.5bln compared to -2.25bln last month.

The technical outlook for the AUD is positive as the AUD failed to trade above 9000. Expect AUD support at 8935 the March 1st low with resistance at 9093 the January 25th high.



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