

USD lower, service PMI expands at best pace in two years

- **USD:** Lower, ADP employment as expected, services PMI beat expectations, stocks rally
- **JPY:** Higher, Japan's finance minister says the government and BOJ will combat deflation
- **EUR:** Higher, Greece announces extra austerity measures, retail sales and PMI weaken
- **GBP:** Higher, stronger than expected consumer confidence & PMI, uncertainty about the Prudential AIG deal
- **CAD and AUD:** AUD & CAD higher, Australian GDP strong, commodity prices rally

Overview

The USD traded mixed in reaction to report that Greece has decided to take extra austerity measures to reduce its budget deficit. Greece plans to cut its deficit by a total of €4.8bln. The new Greek budget plan generates hope that the Greek fiscal crisis will be contained and that Greece will not default on its debt. EUR initially rallied in reaction to the Greek budget news but investors remain cautious and EUR gains were limited. Investors want to see if the Greek budget plans lead to EU solidarity and a plan to aid Greece. Greek officials said they will go to the IMF if the EU fails to give support. EUR upside was also limited by report of weaker than expected EU retail sales and services PMI. GBP traded higher for the first time in six days supported by report of improving consumer confidence and stronger services PMI. Commodity currencies were mixed with the AUD underperforming despite report of strong Australian Q4 GDP. CAD continues to outperform. JPY traded at its highest level since last December versus the USD supported by mixed risk sentiment and a statement from Japan's finance minister that Japan is taking efforts to defeat deflation. US jobs data was encouraging. Challenging Gray said that February job cuts were at their lowest levels since February 2006. ADP employment declined by the smallest since last February. ADP says jobs growth may return next month for the first time in two years. ADP says the service and manufacturing sector added jobs last month. February non-manufacturing PMI came in stronger than expected posting its fastest growth in two years. US equity markets rallied to the day's highs after the release of the non-manufacturing PMI and the USD traded lower. The USD traded to a new low for the day in reaction to an IMF statement the Greek budget plan is very strong.

Focus turns Thursday's ECB and BOE policy meetings and Fridays 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 declining by 50k.

Today's US data:

ADP private-sector employment fell by 20k in February. January ADP employment was revised to -60k from -22k. The ADP report was in line with expectations. February non-manufacturing PMI rose to 53, a reading of 51 was expected

Upcoming US data:

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 -50k and consumer credit is expected at -3.1bln compared to - 1.7bln last month.

JPY

JPY traded at its highest level versus the USD since last December supported by a statement from Japan's finance minister that Japan is taking efforts to defeat deflation. JPY was also supported by mixed risk sentiment as equity markets trade sideways in Europe and higher in the US. JPY gains were limited by selling cross trade to European currencies with the EUR finding moderate support from the announcement of new Greek austerity measures and GBP supported by report of improving UK consumer confidence and stronger UK services PMI. The only economic data released in Japan today was report the January cash earnings rose by 0.1%. This marked the first rise since May of 2008. The cash earnings report follows yesterday's report of an unexpected drop in Japan's unemployment rate. These reports suggest that Japan's domestic economy is strengthening. Recent JPY strength is attributed to gains versus European currencies sparked by concern about debt 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.

Key technical levels to watch in USD/JPY include support at 88.00 with resistance at 89.51 the February 26th high.



EUR

EUR traded higher supported by report that Greece has decided to take extra austerity measures to reduce its budget deficit totaling \$6.5bln. The Greek plan to reduce its deficit generates hope that Greece will not default on

its debt and that the size of the austerity measures will encourage the EU to agree to an aid plan for Greece. The Greek PM said that Greece may go to the IMF if the EU fails to give increased support. Should Greece seek IMF aid it could increase tensions between Greece and the EU and revive concern about the risk of a breakup of the European Union. EUR gains were partly limited by investor caution about the impact of the Greek budget plan as trade awaits EU reaction to the budget reduction plan. EUR gains were also limited by weaker than expected EU economic data with January retail sales reported to have declined by 0.3% in February the services PMI was revised down to 51.8 from 52 in the flash report. EUR re-rallied after the release of the ADP employment report which suggests that the US may begin to post jobs growth for the first time in two years next month. The ADP report contributes to the slight improvement in risk appetite. 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 and EU inflation remains subdued. EUR remains vulnerable to concern about EU sovereign debt risk and ECB policy outlook.

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 higher and rallied for the first time in six days supported by report of improving UK consumer confidence, stronger services PMI data and uncertainty about the Prudential AIG deal. UK February consumer confidence rose to 80 from 74. UK February services PMI rose to 58.4 from 54.5 last month. The UK service PMI expanded at its fastest pace since 2007. Part of yesterday's sharp selloff in GBP was attributed to news that Prudential made a bid for AIG's Asian insurance operation. The purchase would require significant short-term

USD demand versus the GBP. If the deal fails it would reduce the need for selling of GBP for the merger. GBP traded sharply lower Tuesday pressured by the latest UK election polls which suggest that the UK may be faced with a hung parliament and may have its first minority government since 1974. A hung parliament may prevent the UK from taking credible action to reduce 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 or downgrade. Analysts at Citigroup warn that if the UK election ends up producing a minority government that UK bond yields may rise sharply. 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.

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 mixed as GBP trades back above 1.5000. Expect near-term support at 1.4960 the March 3rd low with resistance at 1.5205 March 2nd high.



CAD

CAD traded higher supported by last weeks week's report of stronger than expected Canadian GDP and speculation that the BOC has made a modest shift in monetary policy. Last Friday Canada reported that Q4 GDP rose by 5%. This marked the fastest Canadian GDP rise since Q3 2000. Tuesday the BOC elected to hold rate policy steady as expected and reaffirmed its commitment to maintaining record low yields until June 2010. The BOC however dropped language from its policy statement that inflation risks were tilted to the downside. In dropping this language the BOC appears to be signaling a slightly less dovish policy bias. Although the BOC gave no indication that it plans an earlier than expected rate hike, change in the policy statement language in regard to inflation is a mild positive for the CAD. CAD is also supported by firmer crude oil prices as crude trades back above \$80 a barrel and improving risk sentiment as Greece takes action to reduce its deficit. Focus turns to Thursday's release of Canada's budget. 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, Ivey PMI and Canada's budget will be released. Building permits are expected at 1% and the PMI is expected at 57.

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 mixed despite positive Australian economic data, a modest uptick in risk sentiment and stronger commodity prices. As best we could tell AUD was pressured by a large sell order from an Asian bank and an uncertainty about RBA policy. Australia's Q4 GDP rose by 0.9%. Although the GDP rise was in line with

expectations the GDP report was relatively strong. In addition, February new vehicle sales were reported to have risen by 9.8%. Tuesday the RBA hiked interest rates 25bps to 4%. In the statement accompanying the RBA rate hike the RBA appeared to have a balanced outlook towards inflation, growth and future policy decisions. This has sparked speculation that the RBA may pause its rate hike cycle in April. Today's strong Australian GDP and vehicle sales report would tend to support arguments in favor of an April rate hike but uncertainty about near-term direction of RBA policy appears to be limiting demand for the AUD. In its policy statement the RBA made reference to the credit risks facing Europe. RBA concern that European credit risk may be a drag on global growth could be a limiting factor on the RBA's decision to hike rates again in April. 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 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 trades above 9000. Expect AUD support at 8935 the March 1st low with resistance at 9093 the January 25th high.



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