

USD higher, wholesale sales rise 2.4%

- **USD:** Higher, skepticism about the EU rescue plan, wholesale sales rise, Lacker warns on rates
- **JPY:** Higher, tracking stocks, Japan may seek a debt cap, Yuan revaluation speculation
- **EUR:** Lower, concern about slowing growth, widening deficits and potential new debt downgrades
- **GBP:** Lower, political uncertainty, retail sales drop, house prices rise, industrial production jumps
- **CAD and AUD:** AUD lower & CAD higher, weaker equity and commodity markets, China rate hike threat

Overview

The USD traded higher Tuesday supported by doubt that the \$1trln EU/IMF rescue plan announced Monday will contain sovereign debt risk from spreading in Europe and in reaction to accelerating inflation in China. There are numerous concerns about the impact of the EU/IMF rescue package. In order for countries to receive aid they must adopt extreme austerity measures. The austerity measures are likely to hurt the EU recovery. There also is concern that the ECB plan to buy bonds could be inflationary. ECB officials say that bond purchases will be sterilized. The EU/IMF rescue plan may not prevent future sovereign debt ratings downgrades in peripheral European nations. EUR was also pressured by speculation that the EU sovereign debt crisis will force the ECB to maintain accommodative monetary policy. As the US economy shows signs of recovery and the Fed is likely to consider a hike before year-end, yield and growth differential are moving in favor of the USD. USD was also supported by a spike in risk aversion as equity markets trade lower and accelerating inflation in China generates the risk of further tightening of monetary conditions in China. China's inflation rate rose at its fastest pace in 18 months to 2.8%. The Shanghai index closed 1.8% lower partly on fear of tightening of monetary policy in China. The commodity currencies traded lower pressured by weaker equities and threat of tightening in China. CAD downside was limited by gains in cross trade to the EUR. GBP traded lower in volatile trade mainly pressured by UK political uncertainty as the UK political parties try to form a new coalition government. The latest report is that the Liberal Democrats and Labor Party are trying to form a coalition government. This coalition could be a negative for the UK budget outlook and may increase the risk of a downgrade in the UK sovereign debt rating. JPY traded higher supported by safe haven demand sparked by weaker equities and skepticism about the Greek rescue plan. JPY was also supported by a statement from Japan's finance minister that Japan is considering a debt cap and in reaction to the Reuters report which says China is moving closer to a decision to allow Yuan revaluation. US economic data was mixed with wholesale sales rising more than expected. USD is closely tracking risk sentiment and the direction of equities.

Today's US data:

March wholesale inventories rose by 0.4%, a rise of 0.5% was expected. March wholesale sales rose by 2.4%, a rise 0.7% was expected.

Upcoming US data:

On May 12th March trade balance will be released along with the April treasury budget. The trade balance is expected to widen to -40bln from -39.7bln last month. On May 13th April import prices and jobless claims for week ending 05/08 will be released. Import prices are expected to rise by 0.8% compared to 0.7% last month. Jobless claims are expected to fall to 438k from 444k last week. On May 14th April retail sales industrial production, capacity utilization and University of Michigan sentiment will be released along with March business inventories.

Retail sales are expected to rise by 0.3% compared 1.6% last month. Industrial production is expected to rise by 0.5% compared to 0.1% last month. Capacity utilization is expected at 73.6 compared to 73.2 last month. Michigan consumer sentiment is expected at 73.2 compared to 72.2 last month. Business inventories are expected to rise by 0.3% compared to 0.5% last month.

JPY

JPY traded higher supported by a spike in risk aversion as equity markets decline in reaction to doubt about the Greek rescue plan and in reaction to report of accelerating inflation in China. Euphoria about the EU/IMF Greek rescue plan has faded as investor's question how the plan will be paid for and whether the plan will contain contagion at risk from spreading. Acceleration in China's inflation rate generates concern that China will take additional measures to tighten lending conditions. This could be a drag on the global recovery. JPY was also supported by a statement from Japan's Finance Minister Kan that Japan is considering a cap on debt issuance. Ratings agencies have warned that Japan's sovereign debt rating could be cut if JGB bond issuance continues to rise. According to Kan Japan's the new fiscal year bond issuance should not top ¥44.3 trillion. This is close to the threshold that may trigger a downgrade of Japan's debt rating. The impact of Kans statement was partly diminished by a statement from Japan's PM Hatoyama that comments on limiting debt issuance is not official government policy. Reuters reports that a Chinese bank official says that China is ready for a Yuan move. The Reuters report said that this Chinese official referred to a basket of currencies in its monetary policy report which could mean China is moving closer towards allowing Yuan revaluation. JPY and other Asian currencies sometimes trade as a proxy for Yuan revaluation. JPY direction is expected to trade inversely to equities and risk sentiment.

On May 12th March leading indicators will be released expected at 1% compared to 1.2% last month. On May 13th March current account will be released expected at ¥2.15trln compared with ¥1.47trln last month. April money supply and bank lending will also be released on May 13th. Money supply is expected to rise by 0.1% compared to 0.2% last month and bank lending is expected to rise by 0.4% compared to 0.2% last month.

Key technical levels to watch in USD/JPY include support at 91.84 the May 10th low with resistance at 93.55 the May 10h high.



EUR

EUR traded lower pressured by concern that the EU/IMF bailout may fail to contain sovereign debt risk in Europe. The size of the EU/IMF plan is likely to offer a temporary respite to the cost of funding government debt in Europe. The cost of debt financing has dropped over the last few days. The drop in the cost of funding the EU sovereign debt may not be enough to boost demand for the EUR because of concern that EU deficits may continue to widen, growth is likely to slow and the ECB will be forced to maintain accommodative monetary policy. In order for the EU nations to qualify for aid governments must take significant austerity measures to reduce deficits. This will require large spending cuts and tax hikes. Spending cuts and tax hikes are seen as a drag on the EU recovery. Additionally the ECB has pledged to buy bonds. This is essentially a quantitative ease by the ECB. The ECB bond purchases generate concern about price stability and inflation risk. The ECB plans to sterilize its bond purchases but how the ECB will implement the bond purchase plan remains somewhat uncertain. Germany reported that April CPI contracted by 0.1% and wholesale prices rose 1.7%. The EU debt crisis will prevent the ECB from an early exit from liquidity measures and force the ECB to maintain accommodative monetary policy. This may raise credibility issues for the ECB as inflationary pressures may be building. The Fed's Lacker today said that the US recovery is on a sustainable path and that inflation is unlikely to stay low. He warned that the Fed cannot wait too long before raising interest rates. Based on the outlook for continued accommodation by the ECB and increased pressure on the Fed to normalize monetary policy, growth and yield differential is moving in favor of the USD. Focus turns to Wednesday's release of EU Q1 GDP. The EU GDP report will give a good read of how the debt crisis has impacted the EU economy.

On the 12th EU Q1 GDP and industrial production for March will be released. GDP is expected to rise by 0.4% and industrial production is expected at 1.1% to 0.9% last month. On May 13th German Q1 GDP will be released expected at 0.3%.

The technical outlook for the EUR is mixed as EUR trades above 1.2900. Expect EUR support at 1.2586 the May 7th low with resistance at 1.3803 the May 11th high.



GBP

GBP traded lower pressured by UK political uncertainty as UK political parties struggle to form a coalition government. Monday UK PM Brown said that he will stand down and resign by September. The latest reports out of the UK suggest that the Liberal Democrats and Labor Party are moving towards the formation of a coalition government. This coalition could be a negative for GBP because the coalition may not be as aggressive as needed to reduce the UK record budget deficit. Ratings agencies have warned the UK AAA sovereign debt rating is at risk for downgrade if quick action after the election is not taken to reduce the deficit. The Labor Party has expressed concern that rapid deficit reduction could hurt the recovery. It remains to be seen whether the Conservative Party can form a coalition with the Liberal Democrats. This coalition might be a modest positive for the GBP because the Conservatives have pledged to take quick action on the deficit. UK economic data was mixed with retail sales week, house prices rising and manufacturing output strong. April BRC retail sales declined by 2.3%, April RICS house price balance improved +17 from +9 in March and March manufacturing output rose by 2.3%. Monday the BOE elected to hold monetary policy steady and the level of asset purchases unchanged. The BOE is unlikely to make any new policy changes until the political situation in the UK stabilizes. The trade will continue to monitor political news from the UK.

On May 12th March unemployment, average earnings claimant count will be released. On May 13th March trade will be released expected to widen to -7.2bln from -6.2bln in March.

The technical outlook for GBP is negative as GBP trades below 1.5000. Expect near-term support at 1.4475 the May 7th low with resistance at 1.5054 the May 10th high.



CAD

CAD opened lower as risk appetite falls along with weaker equity markets. Equity markets were pressured by skepticism about the EU/IMF rescue plan and threat of tightening policy in China as China's inflation accelerates. Commodity prices were mixed with gold rising and crude prices weakening. Gold benefits from concern about fallout from sovereign debt risk in Europe. Crude prices were pressured by concern that tightening in China may slow global growth and demand for commodities. CAD turned higher supported by gains in cross trade to the EUR. CAD traded higher Monday supported by a surge in commodity prices and firmer equity markets sparked by news of a mega bailout for the EU. CAD should remain well supported on breaks by BOC rate hike speculation. Last Friday Canada reported a single monthly record rise in employment growth. Canada's unemployment rate declined to 8.1% from 8.2%. Employment growth rose by a record monthly amount of 108.7k, a 25k rise was expected. The Canadian employment report confirms that the Canadian recovery is gaining momentum. Strong Canadian employment report will likely increase the odds of an earlier BOC rate hike. How the Greek debt crisis impacts global growth outlook will be an important consideration in upcoming BOC monetary policy decisions. Based on Canada's domestic growth the BOC is likely to consider a June rate hike barring any substantial new fallout from the EU sovereign debt crisis. BOC rate hike speculation and growth outlook fuels CAD gains versus

EUR.EUR/CAD traded at a new low for the move. Focus turns to Wednesday's release of Canada's trade balance. The trade balance report is expected to show that strengthening of the global economy has increased demand for Canadian exports.

On May 12th March trade balance will be released expected at 1.7bln compared to 1.4bln last month along with March new housing price index expected at 0.3% compared to 0.1% last month. On May 14th March manufacturing shipments and new motor vehicle sales will be released. Manufacturing shipments are expected up 0.6% compared to 0.1% last month. Motor vehicle sales are expected to rise by 3% compared to 8.1% last month.

The technical outlook for CAD is mixed as USD/CAD trades below 1.0300. Look for near-term support at 1.0101 the May 3rd low with resistance at 1.0571 May 7th high.



AUD

AUD traded lower pressured by declining commodity prices and weaker equity markets. Acceleration in China's inflation rate and skepticism about the EU/IMF rescue plan dampens risk appetite and sparked selling of commodities and equities. In addition there is a Reuter's report that China may be moving closer to allowing the Yuan to appreciate. Yuan appreciation could be used as another tool by China to try to combat inflationary pressures and slow growth. The Shanghai index closed 1.9% lower and is down 20% for the year. There were no major Australian economic reports released today. Monday, Australia reported that April NAB business conditions index declined to +8 from +13 last month and Australia's April job ads declined by 1.2%. Weaker business conditions and the drop in job ads may reflect recent tightening of monetary policy by the RBA. These reports may also contribute to speculation that the RBA will pause its tightening cycle. The RBA Monetary Policy report released Friday states that the RBA believes interest rates are near average level. This suggests that the RBA

plans to soon pause in its rate hike cycle. Diminished RBA rate hike speculation is negative for the AUD. The RBA Monetary Policy statement also said that inflation pressures are rising faster than expected. This could mean that the RBA will still leave the door open for possible future rate hikes if inflationary pressures continue. AUD price direction remains closely tied to risk appetite. It remains to be seen if the EU bailout announcement will be sufficient to stop the recent deleveraging in commodities, equities and currency markets. There was little reaction to report that the Australian budget will return surplus ahead of schedule. Focus turns to Wednesday's release Australia's housing finance for March. Economic data may be overshadowed by news from Europe in regard to EU sovereign debt and the UK political landscape. USD strength versus Europe appeared to spillover into the today's AUD trade. AUD rallied from today's lows as US equities trade higher after the release of a sharp rise in US wholesale sales.

On May 12th March housing finance will be released expected at -1% compared to -1.8% last month. On May 13th April employment growth and unemployment rate would be released. Employment growth is expected at 25k compared to 19.6 K. last month. The unemployment rate is expected to fall to 5.2% from 5.3% last month.

The technical outlook for the AUD is mixed as the AUD trades above 9000. Expect AUD support at 8803 the May 7th low with resistance at 9080 the May 10th high.



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