



halofinancial

## *“Dollar roller-coaster*

# *begins next descent”*

published in Portugal Resident May 2005

What a difference a month makes. The US Dollar has miraculously become this spring's 'must-have' currency after a few positive data releases managed to rotate traders' heads through a neat 180° manoeuvre.

The US trade deficit reduced in March. It came in at \$55 billion rather than the \$61.7 billion that most analysts had envisaged. It is still a monstrous amount of debt but it rocked the common perception that imports were still rising in spite of the weak US Dollar environment and brought the feeling that US consumers might be feeling the pinch from high gasoline prices and more expensive imported goods. The US Dollar, which only two weeks earlier had hit a high of \$1.92 against the Pound and \$1.32 against the Euro, fell to \$1.85 and \$1.28 respectively, changing forecasts from a rally to \$2 to \$1.75 against the Pound.

This view was quickly dispelled by US retail sales data that showed sharp growth in high street spending. In fact the month on month rise of 1.4% was double the forecast and caused a wave of US Dollar buying as traders attempted to square their books, buying back the US Dollars that they had sold in the expectations of weaker levels. Once the short US Dollar trades were out of the market the mood changed considerably and buyers began another wave of US Dollar strength as the targets shifted. The Pound-US Dollar (GBPUSD) exchange rate dropped to \$1.8380 and Euro-Dollar (EURUSD) hit \$1.2630. These are very significant changes of direction from a technical perspective. EURUSD broke below the trendline that has supported the rising exchange rate since October 2002 and sterling fell through several support levels breaking below the trendline that extends back to September 2003.

There appears to be no doubt that the US Dollar is resurgent and that weaker growth within the Eurozone and slowing growth in the UK are contributing factors to the sharp downward moves on these exchange rates. Nevertheless, before we all decide that the downward path is the only way for GBPUSD and EURUSD, there are troubles on the horizon for the American economy.

There are a lot of rumours in the markets about US hedge funds are in financial difficulty. Hedge funds manage client monies and look for profit opportunities across all asset markets but the rapid rise in oil and commodity prices added to the decline in the US Dollar plus the downgrading of some US motor manufacturers bonds to 'junk' status have hit some funds hard. Many funds have been involved in something known as 'correlation trades'. If anyone can explain these to me I would be delighted as they are unfathomably convoluted but I have a sneaking suspicion that the hedge funds, who used these ultra-complex trading methods, didn't understand them either and the downgrading of the General Motors Bonds came as a huge financial shock to many of these funds. The worry is that June 30<sup>th</sup>, the next date when money can be withdrawn from hedge funds, may bring a rapid reduction in the value of some funds and the fall out from that is very negative for the US markets generally.

However, with the head of Germany's ruling Social Democrats, Franz Muentefering, calling hedge fund managers "locusts", I'm sure he is one person who won't mind them having their wings clipped.

This smudge on the horizon is accompanied by the ongoing speculation over whether the Chinese authorities will reduce the level at which the Chinese Yuan trades with the rest of the world. The Yuan 8.28 to \$1 peg is clearly unrealistic and does present an undeniable advantage for Chinese exporters over their Western counterparts, much to the annoyance of European textile companies and the US Treasury amongst a very long list of concerned parties. A revaluation in the Yuan would strengthen the Japanese Yen in the short term as they are such a close trading partner despite recent arguments over historical events. A stronger Yen leads to a weaker US Dollar but the effect should be temporary if the US trade deficit was all due to Chinese advantages. The US authorities would like us to believe that but only 18% of the \$55 billion trade gap in March was due to Chinese trade. I can't imagine the Yuan will ever be allowed to trade low enough to close that gap.



halofinancial

***“Dollar roller-coaster***

***begins next descent”***

**continued...**

In essence, the upturn in the US Dollar's fortune is likely to be a permanent feature of the coming year but it will hiccup and rattle along the tracks as traders who have become very used to selling the US Dollar over the last three years, err on the side of caution when having to buy the greenback on the downward leg of the rollercoaster ride. They should have faith that, barring a derailment, the bottom of the slope is a long way off.

***Alastair Sweetman is an FX Consultant with Halo Financial Ltd, a specialist foreign exchange company providing expert currency exchange services to both companies and private individuals. If you are at the start of buying an overseas property or in the process of buying currency to migrate, it is never too soon or too late to save money on foreign exchange. Halo Financial can be contacted on +44 (0)20 7350 5474 and their website can be viewed at [www.halofinancial.com](http://www.halofinancial.com)***