

# Searching for a new hero

The flight to safety continues. The US dollar is benefiting from it, but gravity may soon begin to exert itself, cautions **Sachin Patki**.

The US unemployment rate has risen to 8.1 per cent, the highest since 1983, with 654,000 unemployed joining the list in February. The unemployment rate is expected to climb to 9.4 per cent by the end of this year, with the economy shrinking by 2.5 per cent. Some of the larger corporations in the US, like the automakers, are currently on the brink of collapse, surviving purely on government bailout funds. Wal-Mart, whose business model is based on low costs, is one of the few corporations to show more business as consumers shift to lower-cost options in order to survive.

The lack of a savior has been seen in the flight to safe haven areas like gold and precious metals, which have risen to their near-term highs in recent months. The US dollar strength continues to be partly due to this flight to safety, although gravity may soon begin to exert itself.

The Eurozone has seen a central bank with limited options when it comes to assisting a diverse set of economies. The European Central Bank (ECB) has used a non-traditional method of deposit rates, as opposed to its benchmark refinancing rate of 1.5 per cent to pump funds into the economy. The new Euro Overnight Index Average, currently at around 0.85 per cent, is the rate at which banks have been placing funds with the ECB. The interbank market has dried up amidst questions about the credit rating of the counterparty post-Lehman collapse.

Industrial production for Germany, the EU powerhouse economy, was down 7.5 per cent in January. Factory orders are down 38 per cent from a year earlier, with the economy expected to shrink by around 3.7 per cent this year – the highest post-World War II.

At some point, the huge jump in money supply in the EU will start to impact inflation, although it may not be enough to stimulate growth. The euro looks to attempt lows near 1.2470 and 1.2330, with some oversold triggers seeing a potential reversal of up to 1.2800, 1.2970 and possibly 1.3210 and 1.3350. The lack of a sharp reversal higher from the lows near 1.2470 will make the euro vulnerable again.

The euro does, however, have some potential strength against the sterling. The sterling/euro cross looks to give up some of its recent gains from the 1.0800 region to near 1.0630, 1.0455 and 1.0210 – the low seen last December. A failure to break this low may indicate a time of reversal for the cross, but a failure to get an oversold signal may mean this cross is headed south for a while.

The UK economy is even worse than the Eurozone. The sterling reflects this circumstance, but has more downside to go. Lows of 1.3500 are being broken for a test of 1.3315, 1.3250, 1.3180 and 1.2970. We may see some buying in the early 1.3010 area, but the sterling may also eventually give up ground against the US dollar and the euro.

The Japanese economy stands on the brink of yet another lost decade. The GDP shrunk by 12.1 per cent in the last quarter

of 2008. Some of the export-led industries are collapsing with no business orders. Pacific Holdings Co. (real estate) has filed for bankruptcy, while Toyota Motor Corporation (Japan's largest automaker) will be cutting its production by more than half this quarter. The Bank of Japan and its related agencies have received approximately US\$40 billion worth of emergency funding requests.



In the first two months of 2009, the dollar/yen saw some reversal of the yen strength seen until the end of 2008, but the 100.00 level seems to be providing a strong barrier. Any softness in the US dollar will look to take the yen back to 95.70, 94.35, 92.80 and 91.10, with the longer-term target in the region of 87.15. The euro/yen has seen a test of 125.80, and a reversal from this level may take this cross up to 121.50 and 120.25. A break of 120.25 will see the cross make another attempt of the January 2009 low of 112.15.

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*Views expressed are the author's and not necessarily those of Mashreq. Data and comments are as of March 14, 2009.*