

Depressed dollar to drive US growth

The weakness of the US dollar is expected to continue, which may give some of the other majors some ground to continue their recent rallies, writes **Sachin Patki**.

US president Barack Obama may have won the Nobel Peace Prize, but do not expect him to be awarded for improving the economy. His plummeting popularity ratings have indicated that his measures on health and social reform may have not found a positive resonance within the larger population. The rising unemployment rate, the renewed slump in retail sales and consumer sentiment all indicate that optimism for the future is not yet on the rise. Globally, we are seeing a mere handful of countries indicating that 2009 will end with positive GDPs, with most countries seeing varying degrees of social costs due to a collapse in financial systems and economic opportunities.

The first round of stimulus packages was designed to hold the economy back from the brink of collapse and anarchy in the corporate sector. The intervention by the US administration in participating by assuming risk as a provider of capital to private enterprises was the first such move in a capitalist economy. Short-term high visibility campaigns like cash for clunkers were meant more for raising the visibility of the administration than for damage control, as we can see from the drop in car sales in September after the end of this programme.

The US government spent around US\$490 billion during the 2009 fiscal year bailing out financial and car industries and taking over mortgage lenders like Fannie Mae and Freddie Mac. This has left the government with a deficit of US\$1.4 trillion, the highest since 1945. This figure is around 9.9 per cent of the GDP, thrice that of 2008. The fall in income is also seen in the drop of 17 per cent in income tax, with a drop of 20 per cent in corporate taxes. Now we are hearing talk of another round of stimulus packages to ensure that the pick up in the economic trajectory continues in the same vein. The Federal Reserve has

begun to register its sense of discomfort with the current low interest rates leading up to long-term inflationary pressures, which may be difficult to contain. The market has started seeing this in the sharper slopes of the US treasuries yield curve, which indicates that higher inflation is expected. We may see the Fed being driven to raise interest rates, though it may hurt the economy in the short term.

The higher yields in the medium- to longer-term bonds and improved returns from US equities may attract some capital to the US. The current lip service from the US Treasury secretary on wanting a strong dollar seems to have very little action to bear it out. The markets continue to see the interest rates in other markets carry a higher spread, especially in Australia and Canada, making these currencies strong against the US dollar. Also, with the rising prices of gold and other industrial commodities, we may see these currencies rise further. To curb potential inflation from growth in these countries, the central banks in both countries are expected to tighten monetary policy ahead of the Fed.

The euro has been rising on the pure interest rate differential play, and we see this also coming through in the yen's rise. The recent comments from European Central Bank president Jean Claude Trichet support the view that the economies across the common zone may not have such a deep dip as earlier estimated, as the economy is seen to be stabilising. This was seen in economic data releases like the German industrial output, which expanded 1.7 per cent in August after a 0.9 per cent drop in July. The better-than-estimated results from some corporations like Alcoa and from the commodity sector indicate an uptake on commodities, a precursor to an eventual lift in all major economies. This time, we may see an earlier pick up

in some of the emerging market regions like Southeast Asia and South America, where consumer demand may give corporations a natural base on which to grow overseas.

The weakness of the US dollar is expected to continue, which may give some of the other majors some ground to continue their recent rallies. The euro looks to rally further towards 1.4880, which on a clear break yields 1.5330, 1.5415, 1.5665 and 1.5780, with the potential to touch the previous high of 1.6030. Only a weekly close below 1.4500 gives us 1.4220, 1.4110, 1.3860, 1.3745 and 1.3500.

The sterling has seen some peaking in its recent rally, and we can look for this currency to correct down to 1.5540, 1.5325, and 1.5110, which should see some buying come in. On the upside, look for 1.6430, 1.6050, 1.6680 and 1.6740. The sterling/euro cross looks to continue on the downside with a break of 1.0580, giving us 1.0500 and 1.0415. Potential exists in the momentum to see the previous low of 1.0200.

The commodity currencies have broken their recent consolidation and the rally still looks ready to continue as the commodity prices continue to be on a bullish trend. The Australian dollar has rallied from 0.8500 to 0.9130 and has the previous high of 0.9850 in its sights, with resistance around 0.9245 and 0.9500. Parity is possible, though we may see some profit taking coming from the Australian dollar long positions. Near-term supports are in the region of 0.8870 and 0.8650, and only on a clear break below could we see 0.8200 and 0.8010. The commodity prices would really set the trend, which in turn are depending on the global GDP growth. HMM

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Views expressed are the author's and not necessarily those of Mashreq. Data and comments are as of October 13, 2009.