

Fed's expected QE move weighs on dollar

GLOBAL OVERVIEW

US currency falls against sterling

Commodities battle to find impetus

By Dave Shellock

Global stocks rallied and the dollar came under heavy selling pressure amid growing expectations that the US Federal Reserve would announce a third round of quantitative easing and that Germany's constitutional court would rule in favour of Europe's new bailout fund.

The dollar index – which gauges its value against a basket of currencies – fell 0.5 per cent to below the 80 level for the first time since May.

BNY Mellon said its foreign exchange flow indicators showed that the pace of dollar outflows was now more than three times the average reached over the past year.

Both sterling and the euro touched four-month highs against the US currency.

"With the next Federal Open Market Committee meeting scheduled for Wednesday and Thursday this week, the dollar is firmly on the back foot for now," said Samarjit Shankar, global strategist at BNY Mellon.

"In addition, latest reports today that Moody's Investors Service is considering lowering the US credit rating from Aaa to Aa1, unless budgetary negotiations during 2013 reduce the debt/GDP ratio, have also

been unfriendly for the dollar."

Alan Ruskin, macro strategist at Deutsche Bank, commented: "The market view is that the Fed would

have already 'leaked' to correct expectations of QE3, were they going to disappoint."

But Steven Ricchiuto, chief economist at Mizuho

Securities USA, argued that extending the guidance over how long short-term US rates were expected to stay at their lower bound would be a more effective

policy tool for the Fed than further QE. Furthermore, he said: "The promise of QE has proven to be as effective as the actual execution."

Across the Atlantic, the focus was on the decision today in Germany over the European Stability Mechanism, the region's permanent bailout fund.

The court said yesterday that its ruling would go ahead as scheduled, in spite of a late legal challenge from a German lawmaker.

Most observers took the view that, while the court would rule the ESM legal, it would also impose conditions on its use.

"Some have suggested that the court might seek a public referendum on future bailouts, which would bode ill for Greece given opposition in Germany to granting it more time or money,"

said Jennifer McKeown at Capital Economics.

"At the very least, parliament will probably have to be fully consulted on each individual bailout or decision to buy bonds, which will make the provision of future aid less likely and more time-consuming."

Investors will also focus today on the Dutch general election.

German equities rallied sharply ahead of the court decision with the Xetra Dax index in Frankfurt rising 1.3 per cent – easily outperforming the broader FTSE Eurofirst 300's 0.3 per cent gain. In New York, the S&P 500 closed 0.3 per cent higher and was back within sight of last week's near five-year high.

Spanish government bonds also continued to rise as sentiment remained

buoyed by the European Central Bank's plans to buy the short-dated debt of troubled sovereigns.

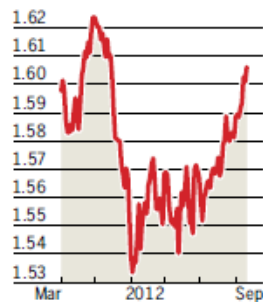
The yield on Spain's two-year debt slipped below 3 per cent for the first time since April, according to Reuters data. The yield was above 7 per cent in July.

The German Bund yield inched down 1bp to 1.54 per cent while, ahead of the Fed meeting, the yield on the 10-year US Treasury was up 4bp to 1.69 per cent.

Industrial commodity prices struggled to find momentum in choppy trading. Brent oil was up 59 cents at \$115.40 a barrel, while copper held above \$8,000 a tonne but was only fractionally higher on the day. The weaker dollar kept gold hovering near a six-month high at \$1,730 an ounce.

Sterling

Against the dollar (\$ per £)

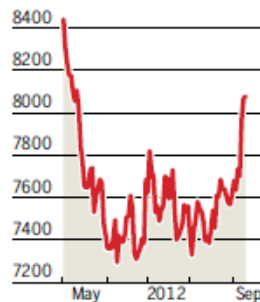


◀ Sterling reached a four-month high against the dollar above \$1.60 as the US currency fell amid growing speculation about further monetary stimulus from the Federal Reserve

▶ The price of copper held above the \$8,000 a tonne mark but struggled to make further progress ahead of a number of important events scheduled for this week

Copper

Three-month price (\$ per tonne)



Source: Thomson Reuters Datastream