

May 20th, 2011

MF Global Daily Report

FOREIGN EXCHANGE | G10

Foreign Exchange Daily Report

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Cross to watch tonight: *EUR/JPY we are initiating a new trade recommendation in this cross with a buy at 116.41 (Wednesday's high) and a target of 118.38 (50% Fib from 123.33 to 113.42). We believe the gentle turning of risk and with the potential of more easing Thursday night by the BOJ will support this cross. The unlikelihood of more fiscal stimulus in the near-term given the conflict in the Diet and greater than expected contraction in Japanese GDP increase the chance the BOJ will enlarge their Asset Purchase Program. They last increased the program at the March BOJ meeting by ¥5 trillion.*

Macro view and Friday's US session: The risk picture was mixed on Thursday. Commodities traded soft and equities played it close to the chest while higher beta currencies firmed slightly. The US economic data releases were sobering. Leading indicators dropped -.3% and the Conference Board's Ratio of Coincident and Lagging Indicators fell for the 4th straight month. The per annum rate of the ratio dropped to its lowest level since October 2009. We might also note that the ECRI has started to crest and turn lower. The move has not been confirmed but further weakness would be consistent with short term growth deceleration. Though weekly claims fell on Thursday, the Philly Fed certainly corroborated the macro soft patch as the index dropped to 3.9 from 18.5. Though the employment number was firm, the dip in the workweek was disconcerting. Moreover, shipments and new orders dropped dramatically. The weaker data coupled with Fed commentary argue that US policy is likely to remain accommodative for the foreseeable future. Fed Vice-Chairman Dudley stated that tightening would cause lower growth – a violation of the Fed's mandate.

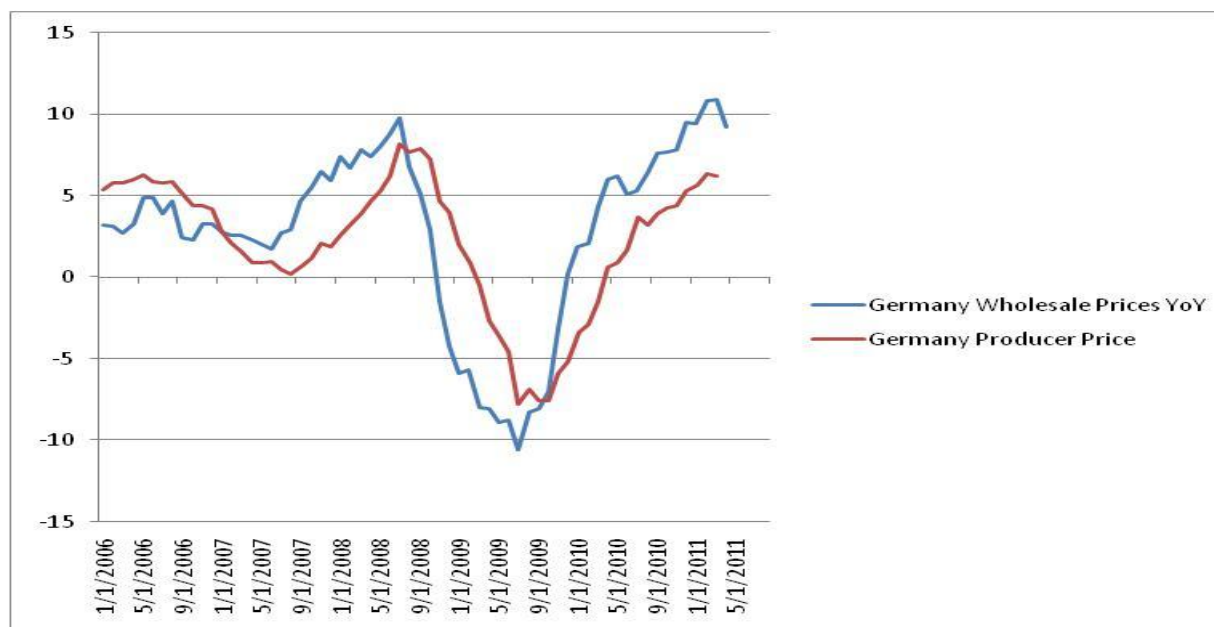
The US economic calendar is empty leaving the currency to focus on the broader market moves. Canadian CPI and Retail sales will be a mover for the loonie but there is nothing scheduled that would have a more expansive and coordinated impact on trade. Heading into the weekend, the unresolved Hellenic drama and still elevated long positioning in commodities increase the chance of a repeat of last Friday's risk off capitulation. However, a strong US equity open would lend itself to generating more risk taking behavior in high beta currencies to the detriment of the USD and JPY. We generally favor cautious risk taking behavior heading into month end.

Major Events tonight: All times in EST

19:30 – 01:00 – Bank of Japan Policy meeting: Q1 GDP fell -.9%. The annualized value fell to -3.7% and Q4 was revised lower to -3% from -1.3%. As this is the second straight quarter of contraction, Japan has now technically moved back into a recession. Private consumption and household spending were drags of -.3% each to GDP (both fell -.6% Q/Q) while net exports pulled GDP lower by -.2% (export rose +.7% Q/Q while imports rose +2%). The largest positive contributor was government consumption which added +.2% to GDP in Q1 (rose +.4% Q/Q). While the Q2 outlook is clouded by the aftermath of the earthquake, we believe external demand will be a burden in Q2. The trade surplus has been narrowing since June 2010 and the need to import reconstruction material and the decreased manufacturing capacity and power shortages will underpin imports and reduce exports. Though net exports will weigh on GDP, government stimulus will remain one of the major drivers of growth. Public investment dropped -1.3% Q/Q but we foresee this number picking up in Q2 due to government reconstruction efforts. Japan just passed a ¥4 trillion emergency budget. The Supplementary Budget will not be funded by additional bond issuance. Japan has delayed a secondary supplementary budget which was expected to be passed shortly after the

first. It appears as though it may not be passed until after the parliamentary session ends on June 22. Support for PM Kan is still low and the government does not want to breach the ¥44.3 trillion debt ceiling. A secondary budget would then be financed by an increase in the consumption tax which would clearly not be well received by the public. This is mind, the friction and red tape at the legislative level will leave the economy dependent on monetary policy and the BOJ if the Japanese economy deteriorated or worsened. Since the earthquake, the BOJ has expanded their asset purchase program from ¥5 trillion to ¥10 trillion, offered ¥1 trillion in loans to alleviate cash shortages, kept their target rate of 10bps and maintained their ¥30 lending fund. Current account balances have dropped substantially at the BOJ from ¥42.6 trillion to ¥26.6 trillion, reflecting the reduction in emergency funding. However, though the need for such capital injections has fallen, it does not rule out of likely need for more monetary stimulus. At the last meeting, BOJ member Nishimura voted to increase the asset purchase facility at the last meeting thus paving the way. The unlikelihood of more fiscal stimulus in the near-term given the conflict in the Diet and greater than expected contraction in GDP increase the chance the BOJ will enlarge their APP.

2:00 – Producer Prices MoM (Apr): .6% exp. vs. .4% prior; YoY (Apr): 6.0% exp. vs. 6.2% prior. Producer price inflation, which had been in an unbroken trend upwards since Q3 2009, began to show fatigue in March. It slowed from 6.4% to 6.2% annual growth, and the market expects this trend to continue down to 6% in April. Excluding energy prices, producer price inflation stood at 4.4% in March. Wholesale prices, which often move in tandem with producer prices, declined in April from 10.9% to 9.2% growth, further auguring a slowdown in the latter. While a slight deceleration is already baked into the trade, a large then expected reduction would take some pressure off the ECB.



New Trade Recs:

5/18/2011: Buy EUR/JPY at 116.41 (5/18 high). Stop at 116.00. Target: 118.38 (50% Fib from 123.33 to 113.42).

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Outstanding Trade Rec:

5/17/2011: Sold USD/CHF at .8800. Stop: .9000. Target .8550

Overnight Calendar:

1. Australia
 - a. 21:30 – RBA Foreign Exchange Transactions (Apr): A\$699m prior
2. New Zealand
 - a. 20:00 – Prime Minister Key speaks at post-budget lunch
 - b. 23:00 – Credit Card Spending sa MoM (Apr): -1.6% prior
 - c. 23:00 – Credit Card Spending YoY (Apr): 1.5% prior
3. Japan
 - a. BoJ Policy Meeting to set Benchmark Rate: .1% exp. vs. .1% prior
 - b. 00:30 – All Industry Activity Index MoM (Mar): -6.1% exp. vs. .7% prior
 - c. 3:00 – Convenience Store Sales YoY (Apr): 7.7% prior
4. Taiwan
 - a. 4:00 – Export Orders YoY (Apr): 14.65% exp. vs. 13.37% prior
 - b. 4:20 – Current Account Balance (1Q): \$11.5b exp. vs. \$10.1b prior
5. Thailand
 - a. 00:00 – Exports YoY (Apr): 26.5% exp. vs. 30.9% prior
 - b. 00:00 – Imports YoY (Apr): 24.5% exp. vs. 28.4% prior
 - c. 00:00 – Trade Balance (Apr): \$5m exp. vs. \$1.79b prior
6. Eurozone
 - a. 3:30 - ECB's Mersch, EFSF's Regling, Luxembourg FM Frieden, EC's Juncker, BIS's Devos speak in Luxembourg on crisis management and financial stability
 - b. 4:00 – Current Account nsa (Mar): -€9.5b prior
 - c. 4:00 – Current Account wda sa (Mar): -€7.2b prior
 - d. 7:00 – ECB's Kranjec speaks in Slovenia
7. Germany
 - a. 2:00 – Producer Prices MoM (Apr): .6% exp. vs. .4% prior
 - b. 2:00 – Producer Prices YoY (Apr): 6.0% exp. vs. 6.3% prior
 - c. 3:00 – FM Schaeuble speaks in Berlin to DIHK
 - d. 3:00 – 9:45 – Bundesbank's Weidmann speaks in Hamburg on 'Fiscal and Monetary Policy Challenges in the Short and Long Run'
8. Ireland
 - a. 6:00 – Trade Balance, first estimate (Mar): €3829m prior
9. Italy
 - a. 4:00 – Industrial Orders sa MoM (Mar): .5% exp. vs. 1.9% prior
 - b. 4:00 – Industrial Orders nsa YoY (Mar): 15.7% exp. vs. 16.2% prior
 - c. 4:00 – Industrial Sales sa MoM (Mar): 1.5% prior
 - d. 4:00 – Industrial Sales nsa YoY (Mar): 12.8% prior
10. Norway
 - a. 3:15 – Norges Bank Governor hearing in Parliament
 - b. 5:15 – Norway Oil Fund CEO Slyngstad hearing in Parliament
11. Portugal
 - a. 6:00 – BoP releases monthly Economic Indicators Report