Will The Dollar Rebound In 2010

WHILE THE DOLLAR SEEMS TO BE ON A REBOUND, OTHER CURRENCIES ARE ALSO STRENGTHENING.

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As we usher in the New Year, it is prudent to take a step back and see how major currencies performed in 2009. This can provide a global perspective as we take a stance on how they will perform this coming year.

Admittedly, the general perspective is that the US dollar was the "whipping boy" of the Forex Market in 2009. However, as we take a closer look, we notice that the US dollar actually strengthened against some currencies.

As the most-traded currency worldwide, it is important for us to understand the behaviour of the US dollar a little more.

In the current economic climate, the US dollar strengthens in two ways:

1. Good economic data from the US
2. Bad news affecting the world

Interestingly enough, the last month and a half saw BOTH these scenarios play out:

GOOD ECONOMIC DATA FROM THE US

In the first week of December 2009, traders worldwide were waiting to see the Non-Farm Payroll figures. Expectations were high. In fact, traders the world over were expecting the figures to come in between 125K to 135K. Upon release, the 11K job cuts "blew away" even the most optimistic estimations. This sent the dollar into a rally.

Additionally, the recent data for jobless claims showed that first-time claims for unemployment benefits fell to the lowest level since July 2008 last week as US businesses backed off from further cuts at the end of the year.

BAD NEWS AFFECTING THE WORLD

The recent news regarding Dubai World's potential default of billions of dollars shocked world markets. That episode saw the US dollar strengthen against most of the major currencies. The reason is attributed to the dollar's "safe-haven status" which causes traders worldwide to "sell first, buy dollars, think later."

More recently, the credit downgrade of countries like Ireland, Spain and Greece have certainly helped the dollar to extend its gains.

CLOSE OF 2009

Towards the end of 2009, it seemed that the US dollar "had turned a corner" with its impressive gains. However, it would be wise to note that what happened was a typical scenario in year-end trading. Most traders and fund managers tend to close out their positions for the year-end holidays; leaving little activity in the Forex Market.

Hence, with low liquidity, any sizeable orders would cause significant volatility swings. Additionally, at the start of the New Year, many US dollar contracts are re-initiated again which support the rise in the US dollar at the start of this year.

DOLLAR STRENGTH FOR 2010?

My overall sentiment for the US dollar in 2010 is mostly bearish against the other majors. No doubt, Bernanke and Geithner have repeatedly come out in force saying they "support a strong dollar." Additionally, recent data seems to justify that the dollar has indeed turned a corner.

However, on closer analysis, the recent strength in the dollar is not backed by fundamentals. Unemployment and budget deficits are at record highs and home prices are still falling. Debt has also shot through the roof with the government's massive stimulus spending.

Will things improve? I am sure.

In fact, based upon the Federal fund futures, the market is currently pricing in a rate hike by the U.S. central bank in the second half of this year. There is currently a 57% chance of a rate hike at the June meeting, followed by an 80% chance of a hike in August.

However, in Forex, it's always a play of "one currency versus another." There is still the probability of other currencies outperforming the dollar in 2010.

In summary, dollar strength will continue temporarily, but as risk returns, the dollar will exhibit inherent weakness against other major currencies for the bulk of 2010.

These include the Euro (EUR), the Swiss Franc (CHF) and other commodity currencies like the Aussie (AUD), Kiwi (NZD) and Loonie (CAD).

ASIAN CURRENCIES OUTLOOK IN 2010

Overall, traders will continue to pick up signs of dollar weakness and capitalize on returns in emerging markets and Asian currencies in 2010.

For 2009, many Asian currencies outperformed the dollar:

1) Indonesia; Rupiah - 16%
2) South Korea; Won - 8.9%
3) India; Rupee – 4.4%
4) Thailand; Baht – 4.1%
5) Singapore; Singdollar – 3.1%
6) Philippines; Peso – 2.8%
7) Taiwan; dollar – 2.6%

The Asia Dollar Index, which tracks the region's 10 most-active currencies excluding the yen, rose 3.1 percent in 2009.

Asia's comparatively higher interest rates and bond yields have helped attract global funds to fixed-income assets. As an example, Indonesia's benchmark rate of 6.5 percent compares with zero to 0.25 percent in the U.S. and 1 percent in the euro region.

No surprises to see traders continue to "fund carry trades" with the weak US dollar.

CHINA

This article won't be complete without talking about China. The argument that China helped the world pull out of recession is a foregone conclusion. With stunning economic figures, the latest being the Manufacturing PMI hitting an all time high, China will continue to be the driver of world growth.

In terms of its currency, China is in no hurry to appreciate its Yuan, despite numerous calls from world leaders to do so.

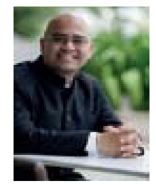
In China's current economic condition, the nation would probably be looking at the following 5 factors before it considers appreciating the Yuan:

1. Consecutive quarters of rising employment figures
2. Consecutive quarters of rising GDP figures
3. Rising Exports
4. Increased domestic consumption
5. When high inflation becomes a problem

Any early appreciation of the Yuan could derail sustainable economic recovery by attracting "hot money" and ultimately causing inflation.

The good news however, is that top Chinese officials are indirectly expressing their concerted intentions to gradually step up the tightening of monetary policies.

Hence, by the end of 2010, the Yuan should appreciate by about 2%-3% against the dollar. **SI**



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