

### Schattenfreud boosts the dollar

Taking pleasure in watching someone else's pain is possibly the best way to describe the latest movement in the value of the dollar after reaching its lowest value against the euro in 2009. The greenback is also picking itself up from the weakest prices against the Canadian and Australian dollars seen in around eight months. Of course some of today's gains are caused by a weakening domestic economy, which flies in the face of the optimism played out by global equity market investors. The euro having bought close to \$1.4350 earlier dropped almost two cents after a nasty reminder of just how weak its growth was in the first quarter. Europe's problems didn't stop there.

Signs of deepening worries for deflation hit the 16-member Eurozone in the April producer prices report, which fell a larger 4.6% on the month for the largest decline since the data series began in 1981. The silver lining is that the reading was made worse by declining energy prices, which have subsequently rebounded like a cornered tiger.

EU growth for the first quarter contracted by 2.5% with many components displaying their worst readings since the data series started in 1995. Household spending contracted 0.5%, which keeps a lid on expectations for a rebound in retail sales. Exports fell 8.1% while imports shrank 7.2%, while investment slipped by 4.2% for the quarter.

While the United States is solely responsible for transmitting the worst recession on record to the rest of the world, investors have recently sought sanctity in the safety of the euro. The subsequent remedial measures that the U.S. government has taken to get its economy back on a safer footing that has given rise to investors' loss of confidence in the dollar. Today's weaker than expected Eurozone GDP reading is turning out to be a tonic for the dollar.

The fallout impacts are far-reaching. It is the large issuance of treasury debt by the American government that has sent bond yields higher, threatening of course any recovery. The aim of government aid is to depress the yield curve in order to stimulate borrowing. But the vast ocean of debt has raised extreme concern by many observers that central banks around the world will soon ditch their dollar holdings and effectively doom the ambitions of the Obama administration. But today a story of some significance has emerged from Reuters, which cites unidentified sources as stating that the feeling amongst Asian central banks is that they don't have any viable alternative than to stick with the program and continue to not only

hold onto their U.S. bonds, but also to continue buying additional issuance. To do otherwise would create more uncertainty and lead to significant capital losses in a disorderly market as they turned their backs on the dollar.

Wreaking havoc in Europe this morning came two views. First, the Finnish finance minister, Jyrki Katainen expressed his views that the Eurozone's biggest and best banks need something of a tonic of their own. We wonder whether the finance minister isn't looking at the share price performance of American banks when he says that the only way to restore confidence is probe inside to see what these banks are doing, what they look like and how sound they are. Only then will confidence, trust and credibility be returned. We say hear, hear to that!

Austrian central banker and ECB governing member, Ewald Nowotny once again stirred up the hornet's nest over the amount of bonds the ECB should consider purchasing as part of its quantitative easing proposals. In a letter to Austria's Hotel Association, he said that the ECB could drive down the yield curve to stimulate lending if it stepped up its pace of covered bond purchases. The Austrian central bank noted that his views were meant to be taken in an academic context. Meanwhile the ECB meets Thursday to discuss monetary policy. Germany's governing member, Axel Weber is dead against any more purchases and there's quite a public tussle going on. The dollar meanwhile remains a beneficiary today as long as this cat fight goes on.

Getting her claws out was German chancellor, Angela Merkel who again derided the wayward quantitative policies at the Bank of England and the Federal Reserve. She invited them to return to "a policy of reason," in an act of disdain almost characterizing those nations as prodigal sons.

Finally, getting back to American shores the dollar is also on the rise today not least because of poor domestic news. On Friday the government will release May's employment report, which is expected to reveal a 9.2% rate of unemployment evoking memories of the Volcker era when the level of joblessness was last that high. On Wednesday, the traditional private sector precursor reading was released by payroll processor, ADP. It's April reading was revised down to show 545,000 private jobs were lost, while May's reading came in at a larger than anticipated 532,000. Together the take away is coyote ugly and doesn't bode well for consumption heading forward.

The U.S. dollar index is 0.9% higher at 79.19 today, while the British pound has recoiled from earlier strength and buys \$1.6395. The dollar buys ¥95.77.

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