Presents

Forex Outlook May 2012

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Introduction

Welcome to first monthly report from Forex Crunch. This follows the previous reports: for Q1 2012 and two special updates for EUR/USD.

A dramatic month awaits Europe, which receives a lot of attention here. As always, the No. 1 economy of the world, the USA is important. This time, it is tackled through the Fed's important. In addition, the calmer situation around Iran and the sidelining of the Chinese landing are also discussed.

Specific currency outlooks follow. Each currency outlook consists of two parts: a fundamental overview and a high time-frame technical analysis. The currency outlooks end with a new feature: a **relative strength index** – a ranking of predicted currency performance. A timetable of key events in May and some extra additional notes for forex traders wrap up the report.

Following some feedback, there are some small changes in this report. As always, feedback is more than welcome. I'd love to hear your comments at yohay@forexcrunch.com. The plan is to continue with monthly reports.

Disclaimer

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Global Themes

US Slowdown

Yet again, the US economy produced strong signs at the beginning of the year, but a slowdown was seen afterwards. The general picture of slow growth (a moderate growth rate of 2.2% initially reported for Q1) will likely continue. The big question remains: Will this slow growth weigh on the dollar, or is the fact that the US is growing and some other economies aren't enough to boost the dollar?

While the chances of a third round of quantitative easing (QE3) remain low, this theme still has a strong impact on the greenback. The Fed focuses on three issues: jobs and inflation, according to its mandate, and housing, which continues to be a drag on the economy. Let's discuss these topics:

Jobs

Non-Farm Payrolls for March have disappointed with a gain of only 120K, much lower than early expectations but still a gain in jobs. The unemployment rate slid to 8.2%. These figures are mixed, but left a bad taste after a few strong months of well over +200K.

Looking deeper into the figures provided 5 signs for viewing this drop as temporary: a minor slide in the participation rate, a drop in not-seasonally adjusted unemployment rate, a drop in involuntary part time workers and of course the fact that most revisions seen so far were to the upside.

The big test is in April's figures, published on May 4th. We will see if the slower gain in jobs was temporary or a serious slowdown. Also the revision for March will be interesting to watch.

A lot has been said about the warm winter that the US enjoyed as a reason for the drop in the unemployment rate during the winter months, when looking at the seasonally adjusted figures.

Weather Effects

We are already well into springtime, and the warm weather seems to have had a significant effect also on job gains. The US gained around 242K jobs on average during the winter months of December through February. **This high rate is likely the result of the good weather**.

Other economic indicators, especially growth, don't fit this figure. Ben Bernanke said that the strength in the labor market is "surprising". When spring arrived, the figure was already much weaker. The 120K gain in March is probably a correction after these strong months.

Where is the real job growth rate? Probably somewhere in the middle: **around 175-180K.** This is the projected job gain for April, and these levels will likely continue also moving forward. This goes hand in hand with the general picture of slow, moderate growth.

Claims Cause Worries

The unemployment rate is expected to remain at the same level of 8.2%. Yet here, there is a serious warning sign coming from the weekly jobless claims. For three weeks in a row, unemployment claims stabilized on higher ground, around 388K instead of the previous range of 350-365K.

At first it seemed temporary – a result of the Easter holiday, but after three weeks, it seems more serious and could push the unemployment rate higher. The more stable 4 week moving average is above 380K.

Many analysts see the **400K level in jobless claims as the border between a rise in the unemployment rate and a drop**. This weekly figure, published every Thursday at 12:30 GMT is important to follow as an indicator for the unemployment rate for May (published at the beginning of June).

The Federal Reserve has a dual mandate: price stability and maximum employment. A rise in the unemployment rate will push the Fed for action.

Housing

Has the US housing sector reached a bottom, getting close? This is the big question, and the answer is a bit complicated.

House prices have fallen by 34% in nominal terms, or 41% in real terms (inflation adjusted). In nominal terms, we are back to 2002, and in real terms **back to 1999**. This is good enough to declare that the bubble years have been fully reversed.

So, back to normal in the US housing sector? **Not so fast**. There are still open wounds from the bubble era:

1. **Uncertainty about prices bottoming out**: The figures above don't mean that prices are about to jump. Bottoms have already been announced in the past, and many people are wary of buying a house when prices can still fall in their opinion: this is the deadly deflation spiral.
2. **Foreclosures**: Bernanke mentioned that without so many foreclosures, the situation would have been better. The foreclosed homes are weighing on prices and making it hard for them to rise and encourage more economic activity.
3. **Legal legacy**: Subprime mortgages, robo-signing and other stories from the bubble period have triggered stronger regulation, so making a loan now is much harder.
4. **Economic uncertainty**: With the slow recovery, people are less eager to lend money and banks are much more careful will lending money, when all the legal hurdles are passed. This comes despite very low interest rates and a lot of liquidity that banks have.

The result is that existing home sales are still depressed. Activity is very weak and this is a burden on the whole economy.

Yet positive signs can still be seen: housing is turning a page when it comes to new homes, that don't carry the legacy: Building permits rose to a pace of 0.75 million and pending homes sales recently leaped by 4.1%. The current level in building permits is the highest since September 2008.

Also here, skeptics "blame" the good figures on good weather, that enabled more activity, yet with real prices back to 1999 levels, some probably grab the opportunity.

All in all, the housing sector is at, or very near the bottom. Yet like the economy as a whole, the pace of recovery will probably be slow due to the heavy legacy. The Federal Reserve is worried about the situation, and could direct a potential QE3 towards this market: by buying Mortgage Based Assets (MBAs).

This option, like QE3, remains on the table, yet apart from some recovery in the housing sector and continued growth in the economy as a whole, there's still a very strong reason not to push through with QE3: inflation – a mandate of the Federal Reserve

Inflation and QE3

On a year over year basis, the consumer prices index rose by 2.7%. Yet the Federal Reserve observes Core CPI, which excludes food and energy, the most volatile components, as if Americans don't drive cars or buy food. Core CPI has risen by 2.3% y-o-y.

The Fed has explicitly stated a target rate of 2%. QE2 has pushed commodity prices higher. Perhaps this was desired: in the middle of 2010, the Fed feared that the US might sink into a Japanese-style deflation spiral, where prices are falling, consumers are reluctant to buy because they expect more falls, and the economy spirals down.

1. **No deflation**: The latest inflation numbers that are quite consistent don't look deflationary at all. Buying treasuries or MBAs would just push commodities higher.
2. **Acknowledgement**: The recent FOMC Statement saw a different wording regarding inflation: it has "picked up" instead of "subdued". This seemingly subtle difference cannot be disregarded. The Fed acknowledges the rise in prices.
3. **Damage to the economy and employment**: This would not only push inflation further away from the 2% target, but would also be

counterproductive to the economy: higher gasoline prices would curb spending and eventually weigh on employment – the other mandate of the Fed.

4. **Politics**: US elections are around the corner. An over-active Federal Reserve would get the heat from politicians especially as gasoline prices rise. As elections draw nearer, the chances are dropping.
5. **Fed already doing enough**: In the recent press conference, Bernanke said that all options are on the table, and that the Fed has tools in its disposal. He was asked: So why doesn't the Fed use these tools? The answer was simple: the Fed is already doing enough – policy is already very accommodative. Indeed, the balance sheet of the central bank is already quite large: QE2 ended in June 2010, but since then, the Fed is maintaining the size of the balance sheet – it isn't undoing the previous actions.

All in all, **inflation seems highly likely to prevent any moves from the Fed in the foreseeable future**, well beyond the next meeting. Nevertheless, Bernanke and some of his dovish colleagues are likely to keep the tone a bit soft. The goal is to keep markets believing that a rate rise will indeed be seen only in late 2014 – this keeps yields low and at least theoretically encourages lending, thus stimulating the economy.

Transition in Debt Crisis

Finally, the tables are beginning to turn in Europe. The paradigm so far was that in order to fight the debt crisis and to lower the debt-to-GDP ratio, governments must make an effort to balance their budgets by cutting their spending.

This in turn led to a deterioration in the economic situation, meaning lower GDP. This in turn yielded less revenue from taxes, actually making the debt higher. Despite the counterproductive results of this policy, the reaction was more austerity, to further cut the budget to fight the new debt, which in turn led to another worsening of the situation. This is vicious economic cycle providing no hope. And it's going on for too long.

The best example is Greece, but this policy isn't really working in Portugal or Spain. Ireland is praised for its success in implementing austerity: the country experienced some growth and saw its bond yields dropping. The Irish success story isn't such a success for its citizens: the unemployment rate remained on high ground: 14.7% as of February 2012.

Cozy Merkozy Went Too Far

And the citizens, not particularly in Ireland are fed up, as they see no light at the end of the tunnel. The "austerity only" approach was even signed on: German chancellor and French president Nicolas Sarkozy led 25 out of 27 EU members to sign the "fiscal compact" – an agreement that makes deficit and debt targets national laws, forcing automatic cuts in budgets if goals aren't met.

The treaty hasn't been ratified by all the countries yet, and it now seems that the agreement will never see the light of day, at least not in its current form. The failure of the austerity policy so far and stripping the national parliaments of their authority aren't too popular.

The criticism towards the "austerity only" approach and the lack of any program for economic growth was discussed in Forex Crunch and other places over and over again. It has now become mainstream.

Growth is necessary in order to provide hope to the citizens, to enlarge tax revenue and to break the vicious cycle.

Austerity Backlash

The countries in the limelight are Greece and France which face elections and Spain, the epicenter of the current round of the crisis. Before we dive into the situation in these countries, the shift is seen in many other places.

The Netherlands, one of the countries that preached Greece about balancing its debt, saw its government fall over planned cuts. The government of Romania, and EU member outside the euro-zone, also fell due to heated debate about austerity. The Czech government hardly survived.

The talk about growth reached the heart of the establishment, with ECB president Mario Draghi also talking about a growth compact.

Also the code words “Marshall Plan” first mentioned in July 2011 and forgotten since, are now back on the agenda: The European Investment Bank might lead infrastructure projects worth 200 billion euros in the next few years, using both public and private funds. This is still a speculation, but the agenda has clearly changed.

A dramatic political shift awaits us, and this may rock the euro as well.

Greek Elections

Greece faces its first elections since the debt crisis erupted. The previous elections resulted in a victory for the center left PASOK party led by George Papandreou. He revealed high debts, led his country through tough austerity and a first bailout, and was ousted after he suggested holding a referendum.

Papandreou was replaced by Lukas Papademos, an ex-ECB technocrat appointee who led a coalition government to the second bailout, which included a huge restructuring of debt. The terms of the bailout make it clear that bondholders have a priority to access the cash, and that more aid depends on more budget cuts for 2013 and probably for the near future.

The unemployment rate is 21%, but Greeks still prefer staying in the euro-zone. This is background for the May 6th elections. As many as 10 parties may enter the new parliament. In any likely outcome, a coalition government will be formed, and the negotiations could last for some time, leaving uncertainty high.

Mainstream Parties’ Weakness

Socialist PASOK will probably lose a lot of ground in these elections. Its leader, former finance minister Evangelos Venizelos is associated with the bailout and isn’t popular. PASOK could come out third in the elections, for the first time in history.

The main center right opposition party, New Democracy, is leading in the polls, but doesn't seem to have an overwhelming majority. Despite being full members of the Papademos government, their leader Antonis Samaras has pledged to make some growth friendly changes in the current economic plans.

The EU doesn't trust him at all, and forced him to sign a pledge to continue with the austerity programs that were prerequisites for the bailout.

Outside PASOK and ND, there is strong opposition to the austerity policy and the bailouts. This comes from both sides: from the communists to the seemingly fascist right, and everything in the middle, apart from the aforementioned parties.

What are the possible outcomes?

- **The same coalition, with a different leader**: New Democracy could lead a coalition government with PASOK and they will continue to push through the same policy. These mainstream parties are bitter rivals, and they could settle for another technocrat Prime Minister. This scenario is supported by the Greek election law, which has a minimum threshold of 3% to enter parliament. If many votes are lost on small parties that will be left out, the bigger parties will receive more seats than their actual votes. This outcome, especially if a technocrat PM is appointed, is what Brussels and Berlin are hoping for, and will be **favorable for the euro**.
- **Center-right government**: In this scenario, Samaras leads a government that includes the Independent Greeks, an anti-austerity right wing party led by a former ND member, and perhaps other parties. Such a government will create a lot of uncertainty: will it continue the current policy with minor changes? Or will it eventually blow up the whole deal? **The negotiations towards such a government and its formation may hurt the euro**.
- **Anti-austerity government**: According to some polls, the left-wing and right-wing parties opposing the bailouts might have a majority in parliament. However, being against austerity is probably insufficient for forming a government and bridging the gaps. Such a scenario would be possible if the more moderate anti-austerity parties such as the Democratic

Left, SYRIZA and the Independent Greeks (right wing) take many seats and the more extreme parties take less or remain out of parliament. The **probability is very low**, yet negotiations on this option would be enough to create a big scare: such a government would take Greece out of the euro (which could be a good thing for the euro in the long run), with significant damage to European banks and **making a euro-exit possible for other countries as well**.

French Elections

The runoff between incumbent president Nicolas Sarkozy and the socialist candidate Françios Hollande will be held on May 6th. All the polls point to a healthy majority for Hollande, of around 10%.

Hollande, who won the first round, is expected to receive support from most left wing voters and also from some of voters of extreme right wing candidate Marine Le Pen, that came third in the first round. Le Pen didn't endorse either candidate and many of her voters find it hard to vote for Sarkozy.

Sarkozy suffers a personal style that made him hated in some circles, a sluggish economy and a tight relationship with Germany and fiscal austerity policy.

Both Sarkozy and Hollande laid out their programs and in fact, the differences aren't that big: Sarkozy wants a balanced budget by 2016 and Hollande by 2017. Sarkozy leans towards budget cuts, while Hollande favors more taxes. The details of the classic left-right debate aren't too dramatic.

Nevertheless, Hollande's tone is a dramatic turn, and already has a strong influence on other countries and policymakers, before being elected. The Paris-Berlin agreements have held the EU together and pushed it forward. The cozy Merkozy relationship went towards austerity.

Hollande vowed to put changes in the fiscal compact, if not trash it altogether. German officials said that France might find itself isolated, but it seems that France might lead the change, and Germany might find itself isolated.

Hollande's election, short term and long term

The immediate reaction to the probable election of Hollande would probably be negative: the markets prefer the current policy that favors stability for bondholders. Money could flow out of the euro-zone in fear that another restructuring or collapse of the whole project could be accelerated.

After the elections, it is more likely that Hollande will be more moderate, but the winds have definitely changed and Germany will have to go with the flow. Why?

Germany Needs the Euro

Germany enjoys the euro: without the common currency, it would have a much stronger Deutsch Mark and it would continue to be the "sick man of Europe".

Some suggest that Germany might leave the euro-zone and avoid living in a "transfer union". Up to now, Germany hasn't actually transferred any of its wealth, but just provided loans. Even if Germany does transfer money to its southern neighbors, it has more to gain than to lose from a common currency in a zone that is growing again, even if debt isn't cut in the way it thinks it should be cut.

Germany also needs a stable economy at home: It's exposure to Spain is estimated at 1 trillion euros. Would it want its banks to fall with Spain? Not so fast.

The idea of promoting growth and shunning austerity is gaining traction around Europe, and could be adopted by Merkel's rivals: the socialist SPD party. If the wind in Germany begins blowing in that direction, Merkel could certainly go with the flow and find some compromises with Hollande.

All in all, **the election of Hollande will cause some pain for the euro, but in the longer scheme of things, it will probably prove a positive turning point for the common currency**.

Spanish situation

Spain is currently the epicenter of the debt crisis. The euro-zone's fourth largest economy suffers from a wide range of problems, with the unemployment rate of 24.4% being the worst.

The current government is trying to fix the two-tier labor market, but it doesn't have too much success. In the short term, the reform encourages firing, and in the long term, there is doubt that the change was really that big – perhaps Rajoy didn't go far enough.

Where the Debt Really is

Cutting the debt involved an austerity program, which is hard to implement as regional tensions mount, especially with Catalonia and Andalusia.

Is Spanish debt really that big? The debt to GDP ratio was around 69% in 2011 and is expected to rise to 80%. 80% is still lower than Germany's is currently at 81-82%.

So why does Spain pay a risk premium of over 4% over Germany? Apart from the unemployment rate, the real problem lies within the financial sector.

Spain's real estate boom and bust left many banks in a perilous situation, some of it unaccounted for. Banks aren't keen to lend as they are still carrying the burden of the bust. The current administration is trying to clean up the banking sector, but doing it too fast might be dangerous as well.

The Irish Precedent

Up to now, both the current and previous governments worked to consolidate the banking sector and to minimize the risk (even if this can create a "too big to fail" bank). It has avoided taking over banks.

Ireland had a similar case of a real estate bubble. It took over the banks' debts and found itself with a bottomless pit. Irish citizens and European bailout money is now flowing through the government to the Irish banks and to their creditors in Britain, Germany and France (among others).

Spain lent 316.3 billion euros from the ECB in March, nearly double the amount in February. The intensive lending comes despite the ECB's €1 trillion LTRO. Spain did manage to use the LTRO to raise a lot of money during that period, and the current funding already amounts to around 50% of the year's needs.

Its banks might need around 88 billion euros of injected funds. If this money comes from the government, the debt-to-GDP ratio could easily cross the 100% line and get closer to Italy's ~120%.

The fear that the Spanish sovereign will need to cover for the banking sector is one of the drivers of the higher yields and will probably rise to a higher spot on the agenda.

Foreign investors already reduced their exposure to Spanish debt. They hold only 33% of debt, lower than 44% in 2010.

What will the EU do with Spain

Spain was already labeled "too big to bail" and might escape an official bailout. With some reform and with a "growth compact", perhaps led by France's Hollande, it could continue floating and even returning to growth without aid.

As aforementioned, the bigger elephant in the room is the banking sector. Here, an agreement between the ECB and the government could **bypass a formal bailout**. The ECB already knows how to make specific demands from governments in return for aid.

If the government agrees to a significant reform that will clear the fog over the banking sector, the ECB might be able to help in extensive loans to help the banks pass the difficult times. Such a program could provide an assurance that the sovereign will avoid taking over the banks, and yields will fall to normal levels even without direct intervention.

The ECB could also buy more Spanish yields and finally act as a lender of last resort, something that currently doesn't exist in its mandate.

Lower yields mean cheaper lending and more room for stimulus, or at least less austerity. This may sound too optimistic, and it will not happen in May. Nevertheless, some thinking in that direction of tackling the banking sector, could certainly help Spain climb from the abyss. With 24.4% unemployment, how low can you go from here?

Losing Spain could prove a fatal blow for the euro-zone. Its economy is indeed too big. As aforementioned, German banks are heavily exposed to Spain. Seeing their loans denominated in pesetas will not be a pretty sight.

China's Soft Landing

There has been a long debate about China's landing from the economic boom of the last generation. Recent GDP figure have shown a lower than expected growth rate of 8.1% in Q1 2012. This is still extremely high in Western terms.

With lower demand from Europe, a real estate bust and no real shift from export to consumption, the "hard landing" scenario of weak growth and a global downturn because of China comes to mind.

This scenario doesn't seem likely, at least not now. Chinese policy makers managed to tweak the value of the yuan and the interest rate in such a manner that balances between growth and curbing inflation. Yes, it is hard to believe official data that comes out of China, but a collapse isn't coming soon.

The soft landing scenario seems more likely, and even if this hurts Australia and the Aussie dollar (probably not significantly), it will not doom global markets. At least during the month of May, this front will probably be quiet.

Geopolitical Tensions Lower

The tensions around Iran's nuclear program are lower than earlier this year. There is still a chance that things will flame up, but the current situation is much better, and this is seen in the stall in oil prices.

Iran Getting Closer to the West

The talks between Iran and the 6 powers in Istanbul did make some progress. Iran has showed more flexibility to let inspectors look into its facilities, and the US has showed more flexibility in allowing Iran to export oil to 9 specific countries.

The talks between Iran and the International Atomic Energy Agency (IAEA) are set to resume in Vienna on May 14th. In addition, talks between the 6 powers and Iran will likely continue in Baghdad on May 23rd. This timetable means that this front will remain quiet during the month of May.

This is a result of the hard economic sanctions against Iran, which included excluding it from SWIFT and the EU sanctions. It is also the result of China and India's demand for Iranian oil and the tolerance of this by the US. There were reports about India paying Iran with gold for oil, bypassing the US dollar.

Israeli leaders under heavy criticism before elections

The tables are beginning to turn also in Israel. The former head of Israel's internal security agency, Shin Bet, heavily criticized the current Israeli leadership, led by PM Binyamin Netanyahu and Defense Minister Ehud Barak. He blamed them of exaggerating the threat of Iran to the Israeli public and acting out of messianic feelings. He also said that a strike against Iran would contribute to the acceleration of its nuclear program.

This joins comments of the former head of Israel's external security agency, the Mossad, that labeled the idea of striking Iran as stupid. Criticism also comes from a senior military man currently wearing uniform: Israel's Chief of Staff, Benny Gantz that said he didn't believe Iran would develop nuclear weapons.

PM Netanyahu is also under pressure from his coalition partners. The ultra-right "Israel Beytenu" party's leader Avigdor Lieberman, said his party is no committed to the government any more. Other political parties also seem keen to head into elections as the social protests are set to resume during the summer.

The mainstream estimation among political analysts is that elections will be held in mid-October. There is talk that Israel will make a move against Iran in September, before the elections, but this is highly speculative at the moment.

Oil, US Economy and the Dollar

The current calm means that oil prices could go down. On average, gasoline prices stand at $3.81 per gallon, already below levels seen earlier in the year, and below the levels seen this time last year. When prices touched $4, the media was all over the story and this also contributed to the wariness of consumers. This issue is on the backburner at the moment.

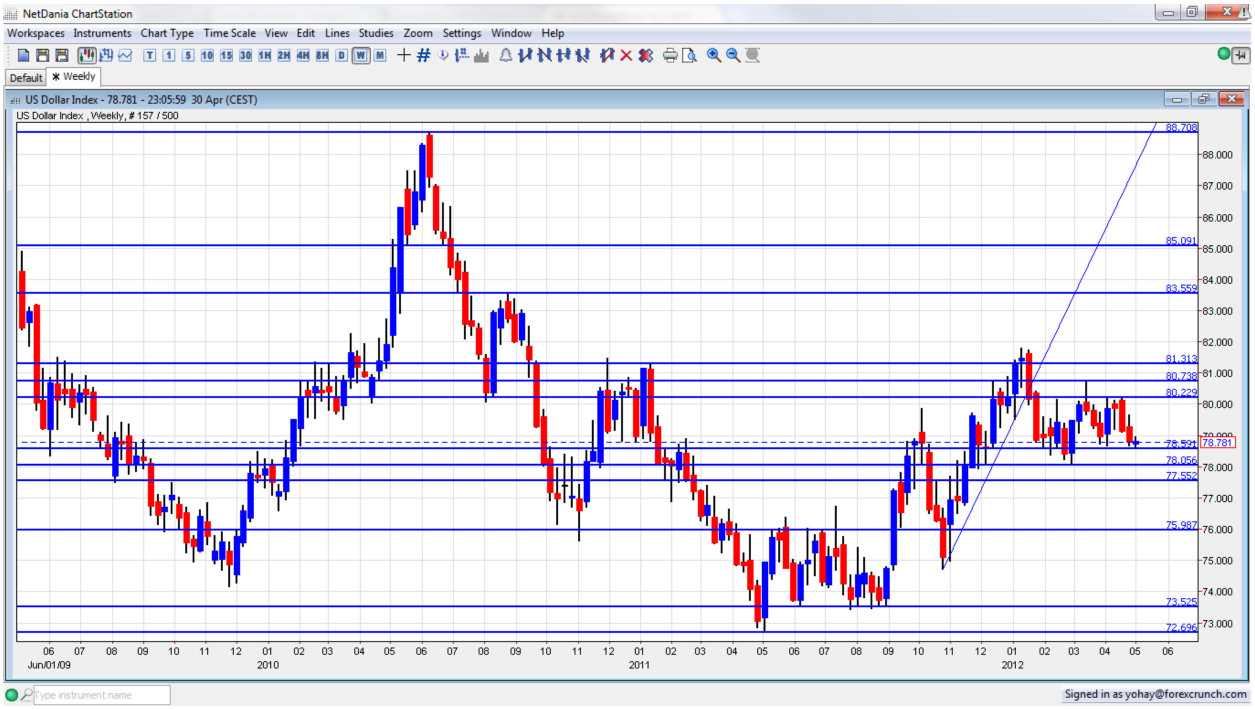
The US economy (heavily based on consumption) continued growing during this year despite oil prices which weigh on the consumer. Another drop in prices could provide some support for the US dollar in the near future.

Currency Outlooks

This section consists of a fundamental country specific outlook and a high time frame technical analysis for each currency against the US dollar. The situation in the US has already been discussed, so the first part concerning the US dollar is only technical, referring to the US Dollar Index. Also for Europe, see the in-depth fundamental coverage for more.

- All the charts are weekly charts.
- A description on the lines follows each section.
- For shorter term outlooks, please follow the weekly outlooks on Forex Crunch, linked in every section.
- If you prefer to view the charts on a web page, just click on the image.

US Dollar Index



Uptrend support was broken at the beginning of the year. Since then, the US dollar is trading in a range, and is now leaning towards the lower end.

Lines

85 is a round number that provided some support when the index was trading at a high level during 2010. 83.50 was the peak of an upwards move in the middle of 2010, before QE2 became reality.

81.31 served as peak at the beginning of 2009, at the beginning of 2010 and at the end of 2010 / beginning of 2011. This is now weaker resistance. 80.74 was a peak in December and in March, and is now a key line on the upside.

Above the round number of 80, 82.23 is another important resistance line that was tackled twice in the spring of 2012, serving as the top border of a tighter range. The bottom border of this range is 78.59, which was a cushion in April and also in January.

It is closely followed by 78, a round number which was support in February and also in December. 77.50 is the next big support line. It worked as both support and resistance in 2009.

76 capped the long range trading of the pair in 2011 and is strong support. 73.50 was the bottom border of that range.

For the major market movers, see the Forex Weekly Outlook.

Euro – Not Only the Debt Crisis

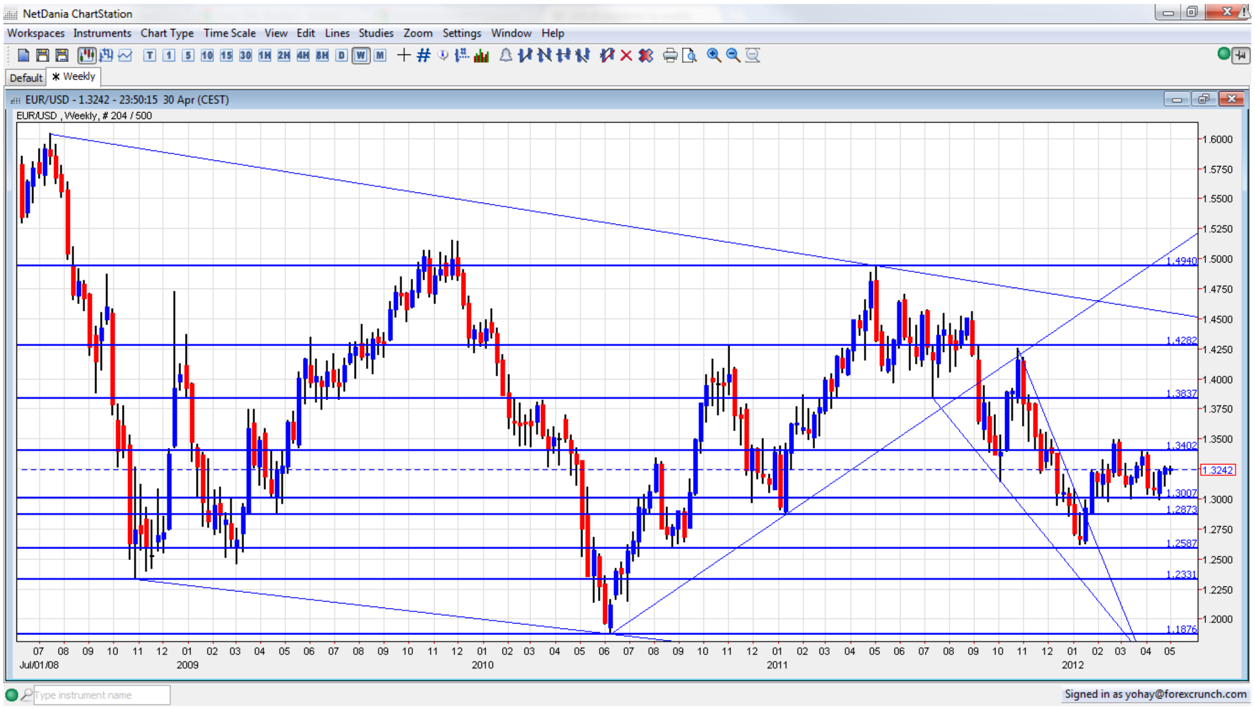
Apart from the dramas awaiting us concerning the political direction and the debt crisis, the economic indicators, which used to provide the highest volatility for the currency before the crisis, aren't looking good either.

The euro-zone's economy squeezed in Q4 2011 by 0.3% and most probably contracted also in Q1 2012, making it an official recession. Spain already reported its figures and it is in a recession.

Recent forward looking PMIs don't look too good, and also other indicators such as retail sales and industrial output point to a freeze or even worse.

The German economy also surprisingly shrank in Q4, but it could be lucky to escape recession. Business sentiment surveys have pointed to improving conditions in the euro-zone powerhouse, but the giant cannot carry the whole euro-area on its own. There's a higher likelihood that Germany will join the southern countries in a downturn than the other way around, especially if no convincing solution is available.

EUR/USD Technical Outlook



The very wide channel that begins in 2008 is trending down, and the pair remains in the middle of it. Uptrend support which accompanied the pair since mid-2010 was also broken to the downside. Also the narrow downtrend channel has been broken.

With all the broken channels, a clear sideways movement between 1.30 and 1.34 can be seen.

Lines

The 2011 peak of 1.4940 is a significant line as well on the upside. 1.4282 was the peak of the surge in November 2010

The swing low of 1.3838 seen in mid-2010 was also of important at the beginning of 2010 as a cap and as a separator back in 2008. 1.34 is the top border of the sideways range and remains strong despite a temporary breach early in the year.

The round number of 1.30 is not only a psychological line but also strong support. 1.2873 was the trough of 2011 during most of the year and remains of importance.

1.2587 is important support below after providing support during 2010. The first post crisis bottom at 1.2330 is becoming old, but still worth mentioning.

Below 1.20, the 1.1876 bottom seen in 2010 is a very strong line. The last line is symbolic: 1.17. This the launch price of the euro in 1999.

For more on the euro, see the **EUR/USD Weekly Outlook**.

British Pound

The British economy isn't doing well: the country is in recession after contracting in Q4 2011 and Q1 2012. While the recession is shallow, so was the growth beforehand. Unemployment remains high, above 8%, and consumers suffer from elevated prices that aren't falling back to target.

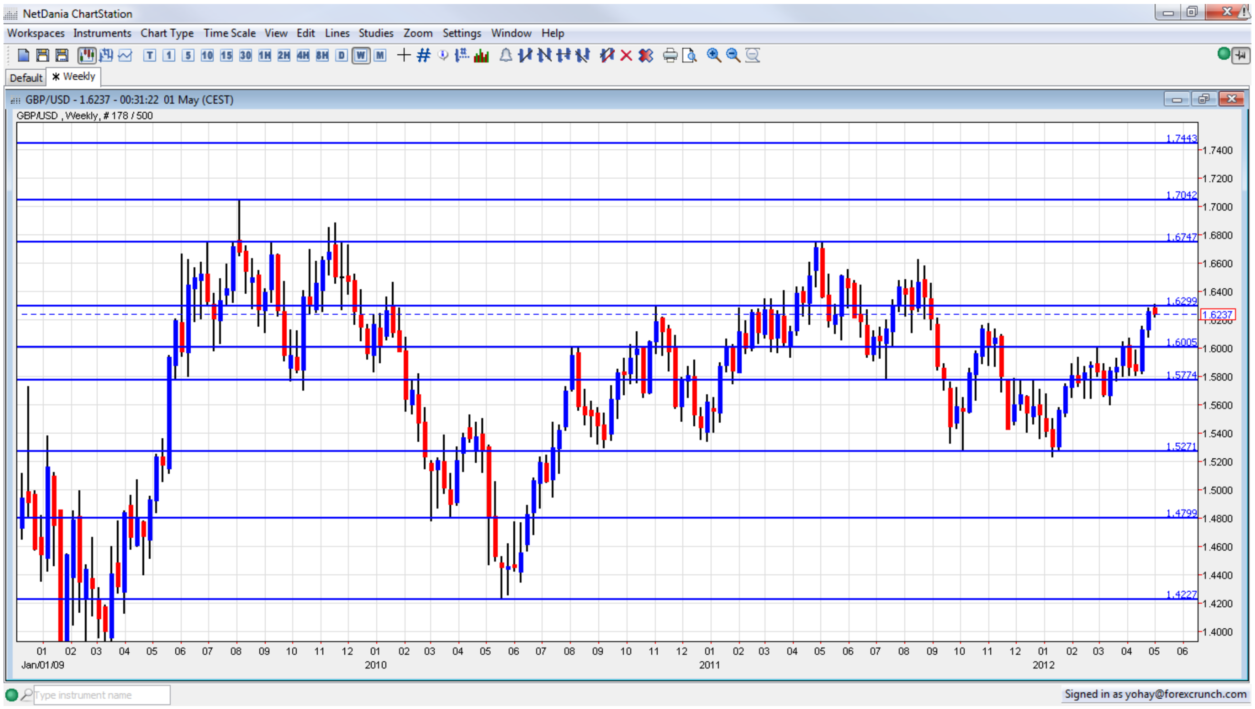
Also the improving housing sector is far from being sustainable: London is close to pre-crisis levels, while the rest of the country is lagging behind.

The pound still enjoys various factors:

- **Weakness in the US**: This helps the pound carry on.
- **European debt crisis**: British bonds became a "safe haven" as an escape from the continent's bonds. British QE is also a backwind for the bonds. The flows help the pound as against both the dollar and the euro.
- **Shift in central bankers' sentiment**: With inflation still above the 1-3% target, the MPC might need to reconsider its policy and perhaps raise rates. The historic low of 0.50% is running for three years. Adam Posen, which was the dove of the doves, already joined the majority and didn't vote for more QE.

The moderate positive sentiment will likely continue if not disaster happens, at least until the Olympic Games.

GBP/USD Technical Outlook



Pound/dollar tends to trade in ranges, and recently made a move towards the top of the range. Will it break higher from here or bounce within the new range?

1.7440 was a stepping stone on the way down during the peak of the crisis. 1.7042 is the post crisis peak reached during 2009 and never sought since. It is right above the round number of 1.70.

Below, 1.6750 was the peak of 2011 and also had a similar role during 2009. 1.63 was a peak in 2010 and later worked as a pivotal line. It is now challenged.

The round number of 1.60 also had a significant role after the pair crossed it, the move higher didn't stop, at least until the next line. The trough of 1.5780 was of high importance in 2011 and also in 2009.

The double bottom of 1.5270 seen at the end of 2011 and the beginning of 2012 is the lowest points since 2010 and remains strong.

Below the round number of 1.50, we find 1.48, which provided an important cushion at the beginning of 2010. The bottom of 2010 at 1.4227 is significant on a big downfall. Last but least, we find the post crisis low of 1.3514.

For more on the pound, see the **GBP/USD Weekly Outlook**.

Japanese Yen – No More Safe Haven?

The US has seen some softer economic figures, as it is expected to be the locomotive of global growth. So, the theme of weak economic figures boosting the dollar and the yen while stronger figures weakening these "safe haven" is making a comeback.

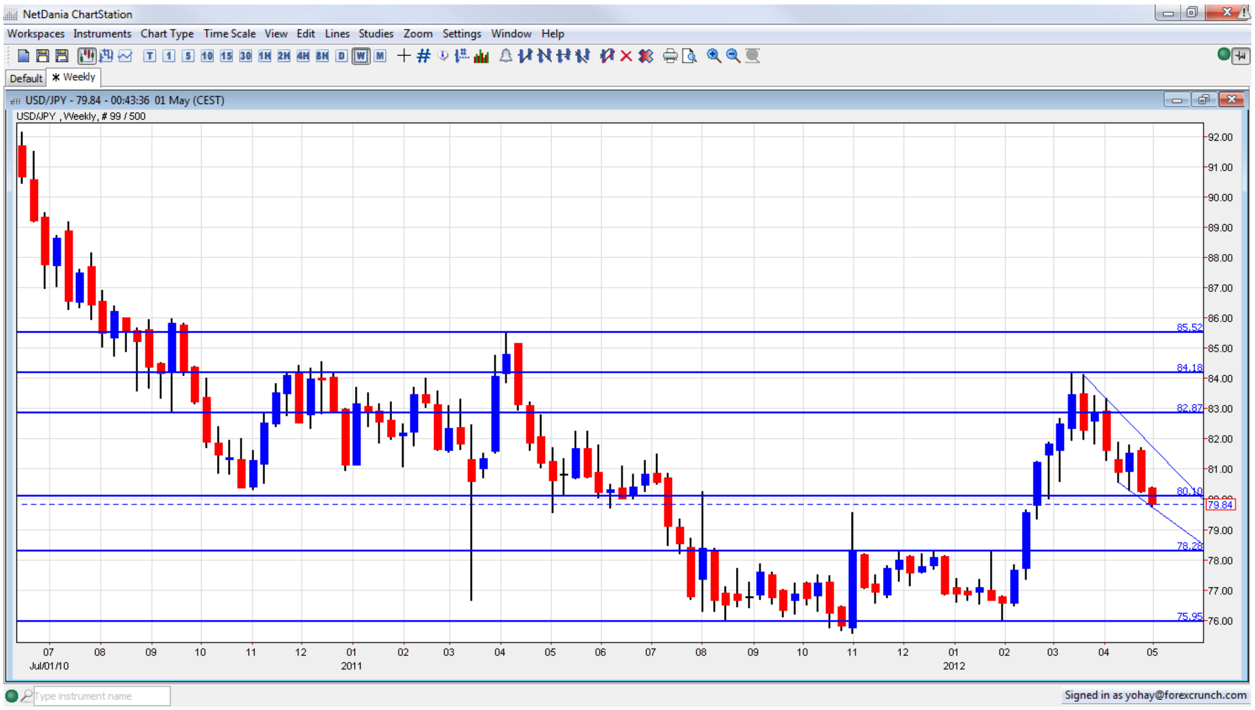
On the other hand, this US economic softness is not enough to trigger QE3, at least not now. The uncertainty about the US, together with the convincing intervention of the SNB to weaken the Swiss franc all send flows to Japan.

Despite more QE in Japan and threats of intervention, the yen is getting stronger. At this point, the safe haven yen may backfire, and May could see another intervention of the Japanese authorities to weaken the currency. Why?

- USD/JPY fell below 80.
- Pressure from politicians is becoming stronger.
- Japan's trade balance is not what it used be due to energy imports.

Up to now, interventions have been limited, and the yen weakened more when flows went out of the country and when headlines about unprecedented trade deficits were flashing. So, an intervention may have a limited long term effect, but is certainly violent.

USD/JPY Technical Outlook



Dollar/yen broke out of the low range trading, reached a peak and is now descending in a narrow channel. It is close to the bottom of this channel.

Lines

85.50 was the peak in 2011 after the coordinated intervention. 84.20 is the peak reached and challenged in March 2012.

82.87 was the line where the BOJ intervened in September 2010 and it played a role afterwards as well. It is currently a minor and pivotal line.

The round number of 80 was strongly guarded for some time and remains of psychological importance. 78.30 is an important hurdle in the shorter term. 76 was a previous all-time low and is now support in the range.

The round number of 75, in uncharted territory might test the patience of the BOJ and the low of 75.57. A failure to guard this line has a potential of throwing the pair towards 70.

For more on the yen, see the **USD/JPY Weekly Outlook**.

Swiss Franc

Switzerland is one of the richest countries in world, yet its export based economy is still suffering from a strong franc. The Swiss National Bank could find itself intervening in a strong manner once again.

1. **Deflation**: Switzerland's CPI is projected to fall by 0.5% in 2012 after hardly moving in 2011. Falling prices mean that consumers are waiting for them to fall even more, pushing them lower and economy lower.
2. **Euro-zone debt crisis**: If the crisis will move the euro lower, also EUR/CHF will fall, and the SNB might need to safeguard the 1.20 floor.
3. **New boss**: After the Hildebrand was forced to resign (due to the peg scandal), the central bank was left without a permanent head. With the appointment of Thomas Jordan, he may want to show the markets that the SNB is serious, not just in words but also in deeds. This is especially important after the pair dipped to 1.1990 for a short while.
4. **Political pressure**: 1.20 may not be enough for some exporters and some politicians and they may push for a higher floor, of 1.25 or 1.30.

Regarding Dollar/Swiss, another intervention could send the pair higher. If the SNB sits without action, the franc could slowly return to its traditional safe haven status – a status it lost with the massive successful September 2011 intervention.

USD/CHF Technical Outlook

Trading in the pair returned to normal. The narrowing channel it traded in during the end of 2011 was eventually broken to the downside and the pair fell into sideways trading.

Lines

1.09 capped the pair during 2010 and provided support beforehand. 1.0435 was support in 2010 and an area of struggle.

Just above parity, 1.0066 was an important attempt to recover, and the beginning of the downfall. 0.9783 was a double top and provides strong resistance.

The round number of 0.95 worked as support and has psychological importance as well. It is now pivotal.

0.9315 worked recently as resistance and as support beforehand. The round number of 0.90 has a similar role, just on the downside.

0.89, very close by is another significant support line that proved its strength early in the year and also back in 2011. 0.8567 is worth mentioning on the downside. It served as support on the way down and then switched to resistance.

Further below, 0.8330 was a strong line of support. 0.7820 is the final frontier before the big plunge to the all-time low at 0.7066.

For more on the Swiss franc, see the **USD/CHF Weekly Outlook**.

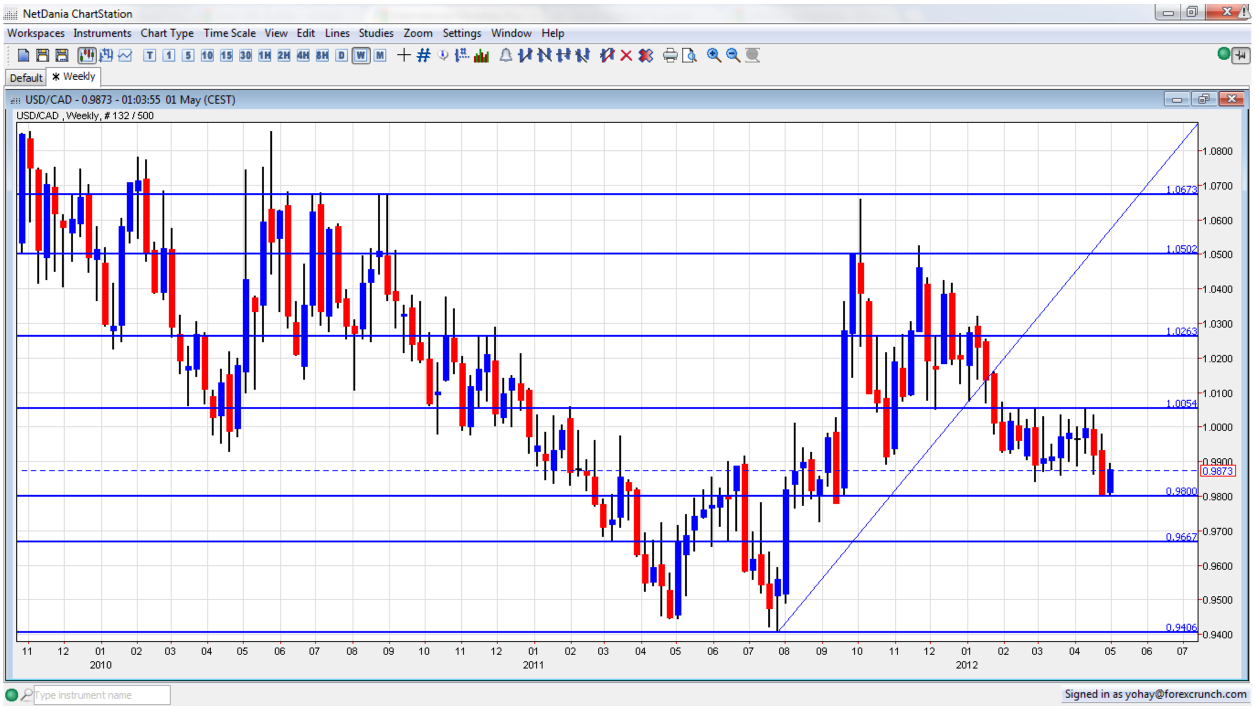
Canadian Dollar

The Canadian dollar enjoys the following advantages:

- **Healthy job market**: After a slow period, jobs are picking up once again, and the unemployment rate is falling. This is a very good sign.
- **Moderately growing US**: Even with the slowdown in its southern neighbor, consumer spending is on the rise, and this is critical for Canada, that relies heavily on US demand.
- **Oil price**: The black gold which Canada exports remains on high ground but doesn't go too high because of Middle Eastern tensions. This is the best situation for the Canadian dollar. It enjoys the income from exports without the "risk aversion" that weakens its currency.
- **Pipe reversal**: The Seaway pipeline has been sending oil northwards, from the Gulf of Mexico to Cushing, Oklahoma. The reversal of the pipeline allows for more Canadian oil to flow to refineries down south. The additional income is joined by a side effect: the gap between Brent prices and US WTI Crude oil might narrow as part of the northern oil will be shipped after passing through the refineries. This is expected to send US prices higher towards the Brent prices and benefit Canadian oil. The reversal is scheduled for mid-May.

The Achilles heel of the Canadian dollar could come from a problematic housing market. Also Canada experienced rising prices and there is intense debate about a burst of bubble. This is still to be seen.

USD/CAD Technical Outlook



After breaking uptrend resistance, the pair fell to lower ground and is now aiming to break even lower after some range trading.

Lines

1.0850 capped the pair in 2009 and 2010 and remains of high importance. 1.0677 also worked as strong resistance for many days, and was tackled again in Q3 2011.

The round number of 1.05 is now a top in the range. 1.0263 worked as resistance several times, and remains pivotal.

Above USD/CAD Parity, the 1.0050 was a much more significant cap on the upside. 0.98 is a cushion on the downside.

0.9667 is a pivotal line on the way down, after working as support. 0.9406 was the lowest post crisis level, and is the ultimate support line.

For more on the Canadian dollar, see the **USD/CAD Weekly Outlook**.

Australian Dollar

The Aussie isn't the favored currency it used to be, but it is still stronger than the US dollar. There are quite a few things weighing against it:

1. **No QE3 in the US**: Commodity currencies were fueled by rounds of quantitative easing. QE also turned on "risk appetite" which helped the Aussie. The fuel seems gone.
2. **Soft landing in China**: Chinese demand remains critical to the Australian economy. Even a soft landing means fewer exports to the economic giant. BHP commented about falling demand.
3. **Bubble?**: After a few good years, the housing sector isn't doing too well. This is best seen in the AIG Construction indicator (similar to PMI) and also in other related figures.
4. **Consumer caution**: Prices were high, and consumers are now more wary. This joins the construction slump.
5. **Rate Cuts**: With less consumption and less activity in the housing sector, prices aren't rising. This was the last straw to break the camel's back, and in this case the RBA's high rate. Apart from the highly anticipated rate cut on May 1st, more will probably follow, making the high yield of the Aussie less high and less attractive to foreign.

Australia still has a relatively strong economy, and the use of the Aussie dollar is rising, even suggesting that it may become a reserve currency. Nevertheless, in the nearer future, it is pressured to the downside.

AUD/USD Technical Outlook

Volatility is lower than it used to be, and range trading is now better seen.

Lines

The float-era high of 1.1080 is the ultimate line high in the sky. It wasn't a swing high but rather a significant hurdle. 1.0850 was a double top at the beginning of the year and now key resistance on strong upside moves.

1.06 provided support to the pair when it traded higher. 1.0480 provided support during 2011 and is now serious resistance. 1.02, which capped the pair in 2010 worked as an important cushion at the beginning of 2012.

AUD/USD Parity is an important psychological line, although not so strong. 0.9666 had a historic role in support the pair in 2010 and 2011. 0.94 is an important trough and also the cap of a long term range that lasted in 2009-2010.

The round number of 0.90 will is of psychological importance. 0.8578 was the bottom border of the aforementioned long term range and a very distinct line.

For more on the Aussie, see the **AUD/USD Weekly Outlook**.

New Zealand Dollar

The picture for Australia's neighbor is somewhat more complex.

- **Construction is doing OK**: The earthquakes in Christchurch are followed by rebuilding, keeping this sector active.
- **Food exports are stable**: New Zealand exports food to Asia. While consumption is dependent on the economic situation, this sector is more stable than iron ore.
- **Strong currency so far**: According to the RBNZ, the kiwi is strong. This has an advantage for easing inflationary pressures, but also weighs on exports. The central bank may raise rates if the economy heats up, or cut them if the currency remains strong. The current picture is quite balanced, and no rates moves are expected.

NZD/USD Technical Outlook

The kiwi had a nice ride early in the year, but after hitting 0.8470, it fell and eventually found itself in a lower range.

Lines

The float-era high of 0.8842 is the ultimate resistance line. 0.8470 was the peak in 2012 and remains key resistance.

0.8242 capped the pair on the way up and remains important within the range trading. Under 0.80, the next round number of 0.79 provides support.

0.76 was a recent cap. 0.7350 is significant on the downside. The pair got close to this line during Q4. The round number of 0.71 was a swing low earlier in the year and a break lower would be a bearish signal. Far below, 0.6560 is the low of 2010.

For more on the kiwi, see the **NZD/USD Weekly Outlook**.

Relative Strength Index

This is a new and experimental feature. Up to now in 2012, this is the ranking of currency performance of the 8 currencies, from the strongest to the weakest:

1. **NZD** (NZD/USD gained 4.79%)
2. **GBP** (GBP/USD gained 4.40%)
3. **CHF** (USD/CHF fell 3.23%)
4. **CAD** (USD/CAD fell 3.15%)
5. **EUR** (EUR/USD gained 2.38%)
6. **AUD** (AUD/USD gained 1.15%)
7. **USD**
8. **JPY** (USD/JPY gained 3.87%)

The assumption is that the picture will be different in the month of May. Here is my speculation:

1. **CAD** – Assuming the stability in oil and US demand will outshine housing.
2. **USD** – The US still enjoys a growing economy, no QE3 and safe haven flows.
3. **NZD** – No excitement from New Zealand can keep the currency strong.
4. **GBP** – Some of the pound's strength might be reversed, as the economy is still limping (and in recession).
5. **EUR** – The drama in the euro-zone will likely take its toll. Even if the pair remains in range, it still has enough room to move down. Swiss protection of the EUR/CHF floor can balance some of the pressure.
6. **JPY** – Safe haven flows will likely only partially balance an intervention (either stealth or not).
7. **CHF** – With a weakening euro, deflation and a need to show credibility, the SNB might push the franc lower.
8. **AUD** – Even without a Chinese slowdown, the economy is struggling and the rate cut on May 1st seems to be the first but not the last.

It's important to stress that this outlook is not a trade recommendation, but just commentary. This will be revisited in the next monthly outlook.

So, will AUD/CAD Short work out as a good trade for May? We shall see.

Key Events

Here are the key events that are set to impact currencies all over the world, larger than the scope of any individual country.

- May 3rd – ECB Rate Decision
- May 4th – US Non-Farm Payrolls for April – trend temporary or not?
- **May 6th – Elections in France and in Greece**
- May 10th: Australian Employment Data
- May 10th – British Rate decision
- May 11th - Canadian Employment Data
- May 12th – Mass protests planned in Spain.
- May 15th – Euro-zone GDP data released – likely to announce a recession.
- May 16th - FOMC Meeting Minutes
- May 16th – Japanese GDP (first release)
- May 23rd – Japanese Rate decision
- May 23rd – British MPC Meeting Minutes
- May 24th – British GDP (second release)
- **May 31st – US GDP (second release)**
- May 31st – Irish referendum on Fiscal Compact

Sources for this report:

- Forex Factory Calendar
- FX Street Calendar (available on Forex Crunch).

Additional Notes for Forex Traders

Here are some additional notes for forex trading during this quarter.

Choppiness

Movements in currencies aren't so wild as they were, especially in the world's most popular pair: EUR/USD. Choppy trading is likely to be seen once again, and perhaps we will see a return of sharper moves. Yet it is important to note that unknown events can surprise us anytime, also during the most boring hours of the day.

Trade with care! High leverage and wide stops can be disastrous to your trading account. When volatility is higher, reduce position sizes and minimize your risk. Don't gamble.

There are still some traders who widen their stop loss points when the trade is open. Having success with such a move can lead to more dangerous actions later on and is only more dangerous. So stop moving your stops!

Choosing a More Predictable Pair

Some pairs follow the rules of technical analysis in a better way, while others are quite unpredictable. This depends a lot on your trading system and on your style and these patterns change all the time. Nevertheless, here is an updated list of the **5 Most Predictable Currency Pairs – Q2 2012**.

Resources

General Articles

- **5 Points on When to Go Pro** – Successful at forex trading and considering of doing it full time? There are a few steps on the way.
- **How to Choose a Forex Broker in 2011** – There are quite a few tools you can use before making this important decision.
- **How About Investing in Forex?** – Foreign exchange doesn't necessarily have to involve active trading, but can be
- **Risk Factor Explained** – A deeper explanation about why the dollar falls on good figures and vice versa and under what conditions this will end.
- **Trading in Range or Catching Breakouts?** – What is your style? And what to look out for.

Recommended Sites:

- **TradingNrg** – For all you need to know about gold, oil and other commodities.
- **BO Crunch** – All you need to know about trading binary options.

- **ForexStreet.Net** – A great forex social site where you can interact with others.
- **Forex Live** – For the fastest updates on the web.

That's it! As I've mentioned at the beginning, I welcome feedback, comments, suggestions, complaints and anything you wish to tell me about this report. Please send any feedback to yohay@forexcrunch.com.

Happy forex trading!