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Forex Outlook June 2012

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Introduction

Welcome to second monthly report from Forex Crunch. This follows the previous reports for May and quarterly reports beforehand.

After a dramatic month in Europe, as expected, we will probably see another one in Europe and elsewhere. Apart from the worsening situation in Spain, a second round of Greek elections, the Fed's "Operation Twist" ends in June 2012. Will leaders finally step up, do something and reverse the trends? These are the main themes at the beginning of the essay.

Specific currency outlooks follow. Each currency outlook consists of two parts: a fundamental overview and a high time-frame technical analysis. A timetable of key events in June 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.

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Global Themes

Spanish Bailout?

The pressure on Spain is mounting. The banks and the autonomous regions ("comunidades") are practically shut out of money markets. Spain still has market access, but as it injects money into banks and regions, yields go up and are getting close to the "bailout barrier" level of 7%, at which other countries received bailouts.

Banks

The trouble in the Spanish banking system discussed in detail in May's outlook became harsh reality. During this month, the Spanish government first announced that its €4.5 billion loan to Bankia would turn into an investment. Only two weeks later, it announced an injection of an additional €19 billion.

Spain clearly made the Irish choice and not the Icelandic one.

Ireland was forced to take a bailout after taking over its banks.

Bankia is a merger of 7 "cajas" – banks that specialized in mortgages. Spain's housing market continues deteriorating with a year-over-year drop of around 12% and accelerated falls in Q1 2012.

The lightness in which the government decided on bailing out the bank angered many Spaniards after this money was cut from social budgets. Rajoy's government will have limited political room to move in, and Bankia may not be the only bank in trouble.

The Greek elections and the speculation that also Spain may leave the euro-zone have sparked a mini bank run, or jog if you wish. Over €30 billion euros left the country in April. The figures for May will probably be much worse. They will be published at the end of June.

This capital flight joins the real estate issues and could hit more vulnerable banks in Spain.

More Economic Pain

The banks are now in the limelight, but Spain has many more problems:

- **Regions**: Catalonia asked the Spanish government for help after being shut out of the markets. More regions could also add their requests soon. Valencia and Asturias are the most vulnerable ones at the moment. The story in Catalonia is more complex, as it is a large and quite an industrial region. The economic troubles pile on existing tensions between Catalonia and Spain: the support in separation from Spain is gradually rising and many Catalans feel they are mistreated by the central government.
- **Unemployment**: Spain has a huge unemployment rate in which nearly every fourth Spaniard and every second Spaniard under 30 is unemployed. A weaker euro helps Spanish exports and eventually lowers unemployment, but it takes a lot of time for such a move to be felt in the markets.
- **Deep recession**: Growth projections have been lowered again and again and forward looking PMIs continue sinking. The bottom isn't near.
- **LTRO Backfire**: The Long Term Refinancing Operation made by the ECB lowered Spanish yields – banks lent money cheaply from the central bank and bought local bonds, hoping to enjoy the higher yields – an arbitrage. However, the higher yields just became higher as the LTRO effect faded away. Some banks used leverage to buy these bonds, and now they are in trouble.

Solutions anyone?

There are reports that the German leadership already pressured Spain to accept a bailout program, and that Madrid refused.

There are at least 4 possible solutions:

1. **Classic Bailout**: Following the footsteps of Greece, Ireland and Portugal, Spain could get aid from the IMF and the European temporary bailout fund, EFSF. The money would be used by the banks, like in Ireland and more

austerity would be enforced on the Spanish people. Spain is seen as "too big to bail" due to its big size. It's hard to see where the money would come from. So the size of the bailout would probably be limited, and the program would probably fall short.

2. **ESM Bailout** :The "permanent" bailout fund could be used for the first time on Europe's fourth largest economy. There are talks that it will be ready in July. This could be a bigger bailout, yet the ESM hasn't been ratified yet. So, also this has limited scope.
3. **European wide bank guarantee**: As the problem is mostly with the banks, providing defense to deposits could stop the capital flight. The chances seem low.
4. **ECB action via the SMP**: The ECB bought Spanish bonds in the past and managed to stabilize yields. After the launch of the LTRO, the ECB limited the program until it came to a full stop. Buying more bonds would cause a "moral hazard" – no incentive for Spain to make reforms. In the current situation, having Spain shut out of markets could be an even harsher moral hazard. When push comes to shove, the German objection to such a move could be lifted and the ECB could use its unlimited firepower to lower the yields. If the move is strong enough, other market participants would join and the yields would fall even further, even stopping the capital flight. This is the fastest solution and it also avoids an official bailout.

German interests

It's very important to remember that Germany has a lot of interest to stabilize Spain and not see it fail and exit the euro-zone.

- **Private sector exposure**: German institutions are exposed to Spain, which is much bigger than Greece. A failure of Spain could cause significant damage to German banks.
- **ECB exposure**: the central bank is exposed to Spain through Target2 imbalances, ELA lending and it also holds some Spanish bonds.
- **Euro without Spain?**: It's hard to imagine the existence of the euro without the fourth largest economy. An exit of Spain (sometimes called Spexit)

would trigger a much stronger domino effect than a Greek exit. And Germany needs the euro.

Germany prospered since the middle of the 2000s and also after the crisis erupted. If Germany would have used the Deutsch Mark, it would have been much higher than the value of the euro. This gave a huge boost to Germany's exports. It didn't enjoy the large trade surplus that it enjoys now.

A Spexit means an end to German prosperity. This provides hope that Germany will eventually do something to help Spain, actually helping itself.

Greece – Grexit Wheels are in Motion

The highly anticipated Greek elections on May 6th ended in a stalemate that led to the announcement of new elections on June 17th. The political stalemate didn't translate in a stalemate in the markets. Money is leaving the country in various forms and even if a pro-bailout government is elected with a big majority, it may already be too late for the current bailout program to run its course, only 3 months after it began.

Money in Motion in Greece

The situation in Greece was bad also before the May 6 elections: unemployment crossed the 20% line, industrial output fell and even tourism was running low.

And after the elections, money began leaving the country:

- **Bank jog / run**: Pictures of lines at banks are less common nowadays – this can be done using the internet. Yet there's evidence that Greeks are pulling money out of banks. The size isn't clear, and there's some logic in limiting the talk about it, as it can manifest itself. So, it's hard to call it an outright "bank run", but money is leaving.
- **Tax run**: Greeks are deferring tax payments, wherever they can. Why pay someone who is going to go bankrupt? This adds to the pressure on the Greek state.
- **Companies moving money out of the country** :There are reports that international companies such as Vodafone and Heineken are moving

money out of the country on a daily basis, fearing a the dreaded Grexit. Yet again, fear of trouble causes more trouble.

- **Energy problems**: PPC, which was supposed to collect the hated property tax (part of the austerity measures) doesn't really collect them, as it fears that customers will not pay electricity bills. The company is already in trouble. Other companies, which rely on natural gas, are having troubles paying their international business partners. Controlled blackouts cannot be ruled out in some parts of Greece.

Greek banks did received €18 billion from the EFSF as part of the bailout program. This is only a temporary relief in the current environment.

Election Scenarios

Assuming that Greece will not exit the euro-zone before the general elections are held, they will have a huge impact on the euro and other currencies.

After 5 years of recession, Greeks abandoned the two mainstream and pro-bailout parties: PASOK (left) and New Democracy (right). Parties that were on the sidelines in previous elections won many seats, and the SYRIZA party emerged as the strongest of them all.

New King: Alexis Tsipras

SYRIZA, is a coalition of radical left parties, led by the young and charismatic Alexis Tsipras. Tsipras clearly stated that his party will abandon the bailout program, known as the memorandum in Greece.

He also said that Greece will stay in the euro-zone, as a Grexit would inflict a lot of damage on Europe. It's hard to see that happening: if Greece doesn't have money, it will need to print a new currency.

In the current situation, leaving the euro-zone, not paying debts and starting with a weak currency could eventually benefit Greece, as other examples show. Yet this will definitely hurt European banks and the euro, and could start a domino effect.

Election Run Up

In the weeks that passed since the date was set, opinion polls have been mixed, with some putting SYRIZA in the lead and others putting New Democracy up front.

One thing is clear: these elections are a choice between continuing the current path of austerity and obeying international creditors, or choosing a different path of abandoning the program and the euro. The two parties gained against all the rest.

The publication of polls is forbidden in Greece in the last two weeks before the elections, but "secret" polls will surely leak and impact the euro.

According to Greece's political system, the party that wins gets an extra 50 seats in parliament, or one sixth of the 300 seats. So in order to get an absolute majority, one third of the votes are needed.

An absolute majority isn't necessary to form a government: SYRIZA could make a coalition with the Democratic Left which opposes the bailout program but is more pro-European and has a softer stance. New Democracy could form a coalition with PASOK.

What's important is who comes first, but a third scenario is also on the cards.

1. **SYRIZA wins**: This scenario has high chances as the party is gaining momentum in the current gloomy environment. This will escalate the capital flight out of the country and could bring the country out of the euro-zone before Tsipras makes any decision as Prime Minister. It could also trigger action from world leaders convening in Mexico on June 18th. The immediate reaction will likely be a big drop in the euro and a stronger dollar (and yen).
2. **New Democracy wins**: This scenario is certainly on the cards. The reasoning is that many Greeks voted to smaller parties as a protest, and will now "come back home" to mainstream parties. In this scenario, the euro will leap in the morning after, but this doesn't solve Greece's problems. A third

bailout and more restructuring will probably be necessary. A temporary relief will result in the focus shifting to other countries.

3. **Another Deadlock**: This scenario has low chances, but if the parliament is fragmented once again with no party gaining even 20% (like in the first round), a third round of elections will be scheduled, but things will continue deteriorating. June 30th is the deadline for passing 77 measures. This is a prerequisite for more aid, and it's hard to see that happening by a caretaker government.

All in all, this is a major risk event that impacts the entire world.

Trading the Event

Trading the Greek elections is similar to trading the Greek exit. One way is "bet" on the outcome and take a position on Friday, yet this is a very risky tactic, as nobody really knows how Greeks will vote.

Another option is to wait for the market to open, when the result is already known and to catch the move. It's important to remember that markets tend to overreact and a violent correction will likely follow the initial move. This is a big event, and this means that very strong technical lines could be easily overrun. Trade with care.

For more, see how to trade the Grexit.

Italian Elephant

Italy replaced Berlusconi with a technocrat prime minister: an ex Goldman Sachs banker: Mario Monti. Monti has been quite successful in following the austerity path: the Italian parliament approved many reforms. Monti also took the time to criticize Spain.

The big achievement is that Italy's yields are lower than Spain.

Apart from that, the situation is worsening:

- Yields are still high – a recent auction of 10 year notes resulted in yields above 6%. Where are the fruits of austerity?

- Fast contraction: Italy's economy squeezed by 0.8% in Q1, far worse than the European average of 0%.
- The unemployment rate leaped above 10%.

The debt to GDP ratio of Italy isn't much better than Greece's: around 120%. Italy is the euro-zone's third largest economy. If Spain is too big to bail and there are doubts if the euro-zone could survive without Spain, it's clear that there's no euro-zone without Italy.

If Italy gets to a point where it needs a bailout, it's game over. So far, Italy managed to hide behind Spain. If things get worse, a comprehensive solution must include some ring-fencing for Italy.

The minimum is the renewal of the bond buying scheme by the ECB. Some debt restructuring cannot be excluded.

More Bailouts for Portugal, Ireland and Cyprus

Portugal and Ireland are both under the cosh of the bailout / austerity programs. Portugal is complying rather well and suffering quite badly. Unemployment in Portugal is forecast to rise to 15.5% in 2012 and 16% in 2013.

Ireland is considered a "success story" – it saw some growth and its bond yields falling. Ireland thought of exiting the bailout program and returning to the markets sooner than later. On the other hand, unemployment remained high in emerald isle also during the better times. If Spain doesn't go fully Irish, Ireland could ask a change in bailout terms.

Current conditions in markets and the economies don't point to an Irish comeback to the markets.

Also Portugal will probably stay out. If no market access is available, new bailout programs are the answer according to the current policies. This isn't likely to happen soon, but it's on the cards and adds pressure.

Cyprus, a member of the euro-zone, is also struggling – the exposure to Greek debt is the main issue of the banking system. The sovereign itself got some help in the form of a bilateral loan from Russia. The country is very vulnerable and any shock, either from Greece or from anywhere else, could lead to a bailout.

Cyprus is a very small country. Nevertheless, having to deal with another bailout means more trouble.

The US Situation

US Still growing but no locomotive

Also the traditional locomotive of the global economy is not a locomotive of growth. For a third year in a row, the beginning of the year was optimistic, with nice job growth and encouraging indicators.

The picture has dampened.

- **Jobs**: The job report for May was a huge disappointment, with a gain of only 69K jobs and downwards revisions. In the past, revisions were mostly to the upside. June could be even worse, and a downwards revision of May's numbers will not leave too many gains.
- **Manufacturing is slower**: the ISM and Markit PMIs still show growth, but slower than beforehand. The Chicago and Philly indices were already much worse.
- **Housing:** The housing sector did show some encouraging signs of late, and it seems that the sector has reached the bottom. Yet there are no real signs that it is climbing above the bottom. Prices aren't rising and the number of deals is stagnant.
- **Other indicators are weak as well**: Durable goods orders, retail sales and consumer confidence don't look good.
- **Drop in oil prices**: This is a bright spot for the US consumer, but it isn't fully felt yet. Lower gasoline prices leave more money in the pockets of Americans. However, with the gloomy mood, the tendency to spend will likely be limited.

Q1 growth was revised to the downside: a pace of only 1.9%. This is too weak. In Q2, the pace will likely be closer to stall speed.

Fed decision – 4 scenarios

Despite the worsening picture, the chances of an announcement of QE3 in the June 20th meeting is still low. Why?

- **Growth**: there is no evidence that the economy stopped growing or began contracting. This might happen in the future, but while there's there still growth, the Fed isn't likely to expand the balance sheet even further.
- **Housing**: Apart from jobs, also the housing market is on the Fed's mind. Yet, also here, the situation isn't bad enough for an intervention via buying Mortgage Based Assets.
- **Inflation**: The goal of QE2 was to prevent deflation – a situation where prices are falling, consumers are reluctant to buy, prices continue falling, etc. Even with the drop in gasoline prices, headline inflation is still above 2% and so is core inflation which the Fed cares about much more.
- **Low yields**: The goal of QE1 and also QE2 was to lower long term interest rates in order to encourage lending. With the current crisis, yields on long term bonds are at historic lows. More bond buying will have little impact.
- **Differences within the Fed**: Quite a few voices within the Federal Reserve object QE3 for all these reasons. Their voices are heard.

What could push the Fed to action despite all these reasons?

- **Europe**: the worsening situation in Europe was stated as a cause for worry in the Fed. In case of a Greek exit or even a Spanish bailout, the Fed might act, even alone, to provide more liquidity. A bigger European blow up is needed for Fed action, and the Fed will likely act in coordination with other central banks.
- **Image**: The Fed might want to be seen as "doing something" – to show it is active and ready to do even more, even if its actions haven't little impact.

There was a lot of political pressure against the Federal Reserve's QE programs, and the closer we get to elections in November, the lower the chances for QE3. However, a significant deterioration in Europe will certainly remove such political barriers, so the Fed might still act closer to the elections.

"Operation Twist", announced back in September, is ending soon. The program's goal was to twist the yield curve, lowering long term interest rates without changing the size of the balance sheet – without printing more dollars.

What can the Fed do?

1. **Nothing**: There is a good chance that no new policy decisions will be announced in June. QE3 or more twist will have little impact in the current situation, and the Fed can pass the ball to the politicians' court, especially as the "fiscal cliff" is getting closer. In this case, the dollar will strengthen across the board. Doing nothing at this meeting still leaves the door open for coordinated action or QE3 in the next meeting.
2. **More Twist**: The Fed could renew the program, stating it was a success, even if the fear in the markets had a much stronger impact than the Fed's operations, at least in recent weeks. Such a move will significantly lower the chances for QE3 in the near future, and will boost the dollar even more than no action at all.
3. **QE3**: Chances are low for all the reasons stated above. In this case, the dollar will fall.
4. **Coordinated Liquidity Boost**: The Fed decision comes as G-20 leaders meet in Mexico. An announcement for coordinated action could come at this point. In this case, the dollar will plunge. See the details below. The chances are low.

Time for Leadership

In 2008, banks were in trouble, yet governments were able and ready to act. Immediate decisive action in the US and the UK stabilized the banking system after Lehman Brothers collapsed.

This was followed by a coordinated effort at the beginning of 2009. In addition, China continued growing strongly, and together with other Asian markets, the gap was somewhat filled.

The current crisis finds the world in a shabby situation. Western governments are much poorer now after deploying lots of resources to help the economies and the banks.

Chinese Slowdown

China is showing more and more signs of slowing down.

- The unofficial HSBC PMI is digging lower in contraction territory, with scores moving further away from the 50 point mark.
- China's non-manufacturing sector is also slowing down, yet still in growth territory.
- A shift to internal consumption was supposed to gradually happen, replacing exports. There are no signs of this happening.
- House prices continue falling – this is part of the lower demand of commodities.
- External signs, such as electricity consumption also point to an even deeper downfall.

It's clear that China will not be the global locomotive.

However, China will likely avoid a "hard landing". The economic giant is facing a regime change this year, and the outgoing leadership will make an effort to portray a picture of stable growth, even exceeding the official expectations. An economic plunge will wait for now.

No Leadership

The world is currently divided. There are divisions between and within countries.

- **China** is not only slowing down, but also refusing to step up and lend some aid to Europe.
- **US**: The current slowdown in the US (detailed beforehand) means that the US will not be a growth engine. The political situation is difficult: the Congress is controlled by the Republicans, while the White House and the Senate are controlled by the Democrats. In late 2008, the chambers were split as well, but there was a much higher will to cooperate. The debt

ceiling debacle in 2011 showed that the ability of the US to act and lead is quite limited.

- **UK**: David Cameron's coalition government is still sticking to austerity and getting further away from Europe.
- **Europe**: Germany's Angela Merkel and France's Françios Hollande are split on policy. Merkel still insists heavily on austerity while Hollande wants prospects for growth. In reality, the differences may not be that big, but the current split means that Europe lacks leadership in the worst hour.
- **Central Banks**: The ECB also suffers from the split between the Germans and most of the rest. Draghi is undoubtedly less stubborn and braver than his predecessor, but his ability to act is limited. Switzerland and Japan are busy in interventions to weaken their currencies. The US and British central banks are more willing to act, but this may not be enough.

There's always hope

This lack of leadership is very worrying at these troubled times. The hope is that we are at the darkest hour, which is just before dawn: that when the different leaders are pressed to the wall, they will find leadership skills and act.

The leaders of the Group of 20 (G-20) will convene between June 18th and June 20th in Mexico. This is followed by a meeting of central bankers at the end of that week and additional meetings between leaders, just after the Greek elections (see the key events).

Will the 20 heads of state step up and act? Will central bankers cooperate?

Hopefully, they will find a way. A global coordination, like at the beginning of the crisis, can change the picture.

What can leaders do?

- Decide on guaranteeing bank deposits on a global level.
- Boost the coffers of the IMF
- Plan for debt restructuring in many countries, not only Greece, and support institutions that will be hurt.

- Cut interest rates

These are some ideas that are easier said than done. The whole world is mired in debt. This debt is causing a lot of suffering. Currently, leaders don't seem to be willing and able to act to improve the situation. They might step up now. If not, the Gordian Knot of debt will have one solution: cutting it loose – hitting the Reset button.

Some coordinated action will not solve all the problems, but will definitely impact currencies: the dollar and yen will fall, and all the rest will rise.

Unfortunately, the hopeful scenario has low chances of becoming reality. There's a much greater chance that we will see more of the same – the same trends will continue in June.

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

The US Dollar Index has been trading in a wide uptrend channel since the middle of 2011. It recently broke out of the range and moved sharply higher.

Lines

We begin from high ground this time. 89.62 is the post financial crisis high and is the final frontier on top. 88.70 is another peak, seen in May 2010, when the Greece received the first bailout.

86.87 is a minor line, serving twice as resistance in the early stages of the crisis. 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 and is now closer. 81.80 served as support in 2010 and as resistance in early 2012 and now switches to support.

80.74 was a peak in December and in March, and is now a key line on the downside. Above the round number of 80, 82.23 is another important support 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. 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 – Recession Reaching Germany

The current situation in the euro crisis has been detailed above. Some still see the euro through the biggest economy, Germany.

The country escaped an official recession and grew strongly in Q1: 0.5%. This growth rate actually saved the whole euro-zone from an official recession. Things are looking much worse now.

- Purchasing managers' indices are worse, especially in the manufacturing sector. German manufacturing PMI is at levels last seen at the peak of the global financial crisis.
- The debt crisis also takes its toll through business confidence: after a few positive months, the two main indicators, from ZEW and IFO, began falling.
- Also the effects of the LTRO are now gone: the amount of money in circulation stopped its rapid expansion and is slowing – it could turn into contraction.

This negative trend likely worsened in May and will be reflected in June's numbers. The situation will probably worsen in June as well.

The debt crisis and the struggling economies are racing to the bottom, pushing each other down on the way. Even if things don't worsen regarding the debt crisis, the economic situation in itself definitely weighs on the euro.

EUR/USD Technical Outlook

The pair fell sharply and broke a few important lines. The very wide channel that begins in 2008 is trending down, and the pair now leans to the bottom of it. Uptrend support which accompanied the pair since mid-2010 was also broken to the downside.

More importantly, the pair is now in a rather steep downtrend channel that began in late 2011 and was formed at the beginning of 2012. This channel is highlighted in the graph.

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 resistance. It was strong support and its break triggered a big fall. 1.2587 is now minor resistance after the break. It provided support during 2010.

The first post crisis bottom at 1.2330 is no in focus. Despite being an old line, it is of importance. 1.2150 played an important role in May 2010 as a clear separator. It also worked as resistance back in 2006.

Below 1.20, the 1.1876 bottom seen in 2010 is a very strong line. The next line is symbolic: 1.17. This the launch price of the euro in 1999. It is closely followed by 1.1670, which was a trough in the middle of the 2000s.

Even lower, important lines are the round numbers, as these levels were visited a long time ago.

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

British Pound – Bears are back

The situation in Britain has worsened, and it still isn't fully reflected in the price of the pound.

- Britain is officially in a recession, with negative growth in Q1 worse than initially reported.
- The euro crisis had a mixed impact on the pound so far: on one hand, money is fleeing Europe to the safety of Britain. On the other hand, the economic ties mean that contagion to the UK is clear. This hasn't fully played out yet.
- The higher value of EUR/GBP is also a factor that weighs on British exports to the old continent.
- Employment has been OK so far in 2012, not as bad as expected. However, the deterioration in Europe will likely be reflected in the job market as well.
- The Bank of England seemed to have ended the expansions of the QE program, with the most dovish member lifting his support from more moves. This has materially changed: the recent inflation reported expressed a lot of concern and left the door open for more QE. The impact

of more bond buying at this point will be minimal, as British bond yields are extremely low. Yet like in the US, the central bank will want to be seen as "doing something". It will not be surprising if more easing is announced.

All in all, it seems that there is a lot of room for more falls, and that the pound will fully return to being a "risk currency" after temporarily flirting with the "safe haven" status.

GBP/USD Technical Outlook

Pound/dollar tends to trade in ranges, but after losing two ranges, it hasn't stabilized in a new range yet. This trending will likely continue before it returns to ranging.

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. The failure to break above this level ignited the fall.

The round number of 1.60 also had a significant role in the past, but it is weaker now. The trough of 1.5780 was of high importance in 2011 and also in 2009.

Quite close by, 1.56 had an important role as a support line in 2012, and the break below this line is significant. 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 – How Safe is it?

The Japanese yen was the big winner of May, against the will of Japanese authorities. Japan continues maintaining its safe haven status, despite quite a few factors that point to the lack of safety.

- Japan stopped using nuclear energy. It is now reliant on imports of oil and coal for energy. This changes the trade balance and means that more money leaves Japan.
- Japan has a debt mountain that is set to reach 239% of GDP. This is far worse than Spain, Italy or Greece. This mountain is considered safe as it isn't held by foreigners but rather by domestic investors. However, pension funds are becoming net sellers of Japanese debt, as they need the money to pay an aging population.
- Downgrade: The credit rating of Japan was lowered by Fitch and more downgrades could follow.
- Intervention: So far, the BOJ or the MOF haven't intervened in the markets to weaken the yen. If a stealth intervention was made, its effects weren't seen. An intervention could happen in June, although Japan needs to fight very strong market forces, and this is no easy task.
- Economy: The impact of a stronger yen and the global slowdown weighs on the economy, and some signs could be seen in June.

All in all, Japan is far from being safe, and some day, the "safe haven" status will disappear instantly. In the current environment, this day doesn't seem close, and safe haven flows will likely outweigh any other forces.

USD/JPY Technical Outlook

Dollar/yen continued descending in a narrow channel and is at a critical juncture, close to returning to the previous low range.

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 resistance line.

The round number of 80 was strongly guarded for some time and remains of psychological importance. The break below is significant. 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 – How Many Euros Can it Take?

Apart from a temporary blitz, EUR/CHF traded very close to the 1.20 floor that the Swiss National Bank put in place. This is an effective peg, which makes USD/CHF a mirror of EUR/USD.

Switzerland needs a weaker franc in order to fight deflation, which is weighing on its economy, and to help exports.

The euro crisis pushes investors to the safety of Swiss assets, and the SNB is under growing pressure. Buying too many euros and euro assets is quite dangerous in current conditions. In June, we could see a diversification of the SNB's investment policy out of euros and into other currencies.

The SNB could also introduce negative interest rates in order to discourage buying of assets and weaken the franc. More creative steps could be launched in June.

A Greek exit of the euro or another major event will test the SNB's strength. There's always a chance that the dam will break and the franc will rally. Yet so far, the SNB maintains its credibility.

There's also a chance that coordinated central bank action or any other surprising magical solution will reverse the current trends and move investors away from Switzerland, but this doesn't seem close.

All in all, there are good chances that the EUR/CHF rate will remain unchanged, and that USD/CHF will trade in tandem with EUR/USD.

USD/CHF Technical Outlook

Recently, trading USD/CHF was almost 100% to trading EUR/USD. Nevertheless, the lines are still relevant.

Lines

1.17 was an important and stubborn peak in 2010 and remains an important cap above. 1.11 worked as support at the end of 2007 and also a cap in 2009 and 2010.

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.

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 – Other Places are Worse

The loonie lost ground in May, but it stood out among its commodity currency peers. The picture is a bit more mixed in June, but still remains positive:

- US Demand: Canada relies on demand from its big southern neighbor, more than on oil. Growth in the US helped Canada and the Canadian dollar. The worrying signs seen recently from the world's No. 1 economy now weigh against Canada.
- Weathering oil prices: The price of oil fell by 17% in May. Nevertheless, the impact on the Canadian dollar wasn't that strong. This shows that the C$ is resilient.
- Housing: There was a lot of talk about the bust of Canadian housing bubble in 2012. It's impossible to say that housing is strong, but it is far from a disaster as well. This will continue supporting the loonie.
- Employment: This was a very bright spot in April and March, with big gains in jobs – full time jobs, and a lower unemployment rate. The report for May could be different, even if the only reason is a correction of the superb reports seen earlier. This could weigh on the loonie.

All in all, the Canadian dollar could enjoy relative strength.

USD/CAD Technical Outlook

USD/CAD clearly bottomed out and moved to higher ground. It is still unclear if it will stabilize at these levels or continue higher.

Lines

1.1130 is an old line dating from 2009. It is still high. 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 and can be challenged in the near future.

The round number of 1.03 was a battle line, and it seems that the pair overcame it. Above USD/CAD Parity, the 1.0050 was a much more significant cap on the upside.

0.98 is an important cushion on the downside, where the pair bottomed out. 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 – Tables turned against it

The RBA surprised with a big rate cut of 0.50% in May, and there are enough reasons to believe that more cuts are coming, in June and beyond:

- Outside the mining sector, the economy continues struggling: retail sales, manufacturing and housing (as recently reflected in building approvals) are all weak.
- The mining sector's is not that shining: the Chinese slowdown is already impacting Australia's thriving sector. While this is still a growth factor, it isn't as shining as it used to be.
- Employment: This was a positive point in May, but in the current environment, it's hard to believe that we will see job growth.

In good days, the A$ draws flows looking for high yields. This process was reversed in May, and there's still more to go. The "risk currency" status is certainly weighing on the Aussie.

AUD/USD Technical Outlook

Volatility returned big time, and this definitely helps the pair become more predictable for technical traders.

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 is now resistance on strong upside moves.

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. The last line in the bottom is the 2010 low of 0.8066.

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

New Zealand Dollar – Not Set to Repeat the Free-fall

The kiwi had a horrible month in May due to its role as a risk currency. Investors fled to the US dollar and away from high yielding currencies such as the kiwi.

But it wasn't only Europe: the slowdown in China, which usually has a strong impact on the Australian dollar, took its toll also on the kiwi. New Zealand's advantage is that it relies on the more stable food exports.

Looking closer to home, the situation in New Zealand could have been better. The unemployment rate disappointed and jumped to 6.7%. Manufacturing dropped to contraction territory and retail sales plunged.

The central bank, which expressed worries about the high value of the currency, doesn't need to worry any more. No action is expected from the RBNZ during June (unless it's coordinated action). Without a rate cut, the kiwi will likely be a bit less vulnerable.

The tone of the rate statement and the tone of other communications from the central bank are of high importance, even more than the GDP report for Q1, which is released relatively late.

NZD/USD Technical Outlook

The kiwi erased the strong gains early in the year and fell three ranges lower.

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 now switches to resistance.

0.7670 capped the pair on recovery attempts and also worked as resistance in 2009. 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 in 2011 and a break lower would be a bearish signal. Under the round number of 0.70, the next line of support is 0.6815, which worked as such in early 2010.

0.6560 is the low of 2010 is another significant line. Historic support appears at 0.62. For more on the kiwi, see the **NZD/USD Weekly Outlook**.

Relative Strength Index

May Revisited

This is the second time this experimental feature appears. Let's first examine the performance in May, with the US dollar being the anchor:

1. **JPY** – USD/JPY fell 1.8%.
2. **USD**
3. **CAD** – USD/CAD rose 4.3%
4. **GBP** – GBP/USD fell 4.9%
5. **CHF** – USD/CHF rose 6.4%
6. **EUR** – EUR/USD fell 6.5%
7. **AUD** – AUD/USD fell 6.6%
8. **NZD** – NZD/USD fell 7.8%

This was the speculation from the month of May:

1. **CAD** – Assuming the stability in oil and US demand will outshine housing. – Indeed, the Canadian dollar was relatively strong, despite the fall in oil prices.
2. **USD** – The US still enjoys a growing economy, no QE3 and safe haven flows. – Indeed, the US dollar enjoyed huge safe haven flows.
3. **NZD** – No excitement from New Zealand can keep the currency strong. – Wrong, data from New Zealand was weak and it reversed the year's early gains.
4. **GBP** – Some of the pound's strength might be reversed, as the economy is still limping (and in recession). – Indeed, sterling didn't shine, but didn't fall so bad.
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. – Indeed, the euro crisis dragged everybody down, even if the euro itself wasn't the weakest.

6. **JPY** – Safe haven flows will likely only partially balance an intervention (either stealth or not). – Wrong, safe haven flows were so strong that the BOJ probably remained out of the market.
7. **CHF** – With a weakening euro, deflation and a need to show credibility, the SNB might push the franc lower. – The SNB's EUR/CHF floor turned into a full peg.
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. – Indeed, while the Aussie wasn't the weakest, it was quite close to the bottom.

In the monthly outlook for May, there was a speculation about shorting AUD/CAD. So, the pair lost 253 pips during the month, falling from 1.0295 to 1.0042, after bottoming out at 0.9956.

June Predictions

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.

The main narrative is that the pain of the European crisis will be felt in Europe more than elsewhere. And, this outlook assumes that coordinated action will not be sufficient to reverse the trends.

1. **USD** – Assuming no QE3, that some expect after the weak NFP. A surprising introduction of QE3
2. **JPY** – The yen is still attractive, but the flows will find limits.
3. **CAD** – After the loonie managed to weather the drop in oil prices, it can still stay relatively strong.
4. **NZD** – The worst performing currency in May might enjoy relative stability. This depends on GDP and no rate cut.
5. **AUD** – The Aussie has more room for falls, especially with a rate cut.
6. **GBP** – the proximity to Europe and more QE weigh on the pound.
7. **CHF** – The effective peg to the euro means that the franc will trade in tandem with the euro. The SNB maintained it quite well, and it isn't likely to break soon.

8. **EUR** – Assuming that even coordinated action won't do wonders, the euro will suffer badly from the deepening crisis and also a euro exit.

So, shorting EUR/USD is the preferred trade? This yielded 877 pips in May, and the trend isn't over yet, unless, as aforementioned, magical central bank coordination does wonders. It can do wonders to stabilize the situation, but not necessarily the value of the euro.

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. There is a lot of focus on European events, which have a huge impact. The period between June 17th and June 23rd is the most critical period, and could prove to be the most volatile.

- June 1st: US Non-Farm Payrolls – Only +69K, a higher unemployment rate of 8.2% and downwards revisions all dampened the global atmosphere.
- June 5th – Australian rate decision – Another surprising cut?
- June 5th – Canadian rate decision – outlook could worsen.
- June 6th – Australian GDP report
- **June 6th – Euro-zone rate decision – a critical event.**
- June 7th – British rate decision – more QE?
- June 7th – Ben Bernanke testifies – first time after bad NFP and last major appearance before the FOMC meeting.
- June 8th – Canadian employment data
- June 10th – First round of French parliamentary elections. Hollande needs a majority in parliament in order to promote his agenda.
- June 11th – IMF publishes report on Spanish banks.
- June 13th – New Zealand rate decision – a dovish is the minimum, if not a cut.
- June 14th – Swiss rate decision – more hints about the peg or more measures (negative rates) could be introduced.
- June 15th – Japanese rate decision.
- **June 17th – Greek general elections**

- **June 18-20 – G20 summit in Mexico. Heads of state will meet immediately after the Greek elections.**
- June 18th – Spanish bank stress results are published.
- June 19th – Spanish 10 year bond auction – first after Greek elections.
- June 20 -21 – ECB meeting. No announcement is planned, unless emergency actions are taken.
- **June 20th – FOMC meeting, including a press conference. Speculation about QE3, more twist or anything else will end.**
- June 20th – New Zealand GDP.
- June 21st – Eurogroup meeting in Brussels.
- June 22nd – European mini summit in Rome including the four largest countries: Germany, France, Italy and Spain.
- June 23rd – Central bankers meeting in Basel – includes Mario Draghi and Ben Bernanke.
- June 28-29 – European summit. Growth will be on the agenda, as well as current events.
- June 29th – Italian bond auction.
- June 30th – Greek deadline for executing 77 austerity measures – a prerequisite for getting more aid from the IMF and the EU.

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.

Volatility is back

Currencies returned to strong movements in May. While crazy sharp moves weren't seen, the overall movements were certainly significant and trends were strong and clear.

June will probably see more strong movements, and could also see very sharp and surprising leaps or plunges. A Greek exit of the euro is one scenario that could make volatility more extreme, and is not the only one in a very uncertain environment.

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** – 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!