Deutsche Bank

12 November 2010

FX Daily

How Has the World Changed from Yesterday?

George Saravelos
Strategist
(+44) 20 754-79118
george.saravelos@db.com

The day so far has been dominated by risk reduction, but what is different from yesterday?

The G20 Communiqué

More than 10 pages long, it is one of the longest in the history of G20 statements. The two key pieces of information for FX markets are:

-A more explicit framework and timeline to identify and address global imbalances. The G20 call on a "Framework Working Group" together with the IMF to develop indicative guidelines "with progress to be discussed... in the first half of 2011." The first such assessment will be undertaken during the French Presidency next year. This initiates a slow-moving, but coordinated discussion process and is positive for global economic governance. But tensions leading up to and around this meeting point to the challenges behind getting anything concrete out of this next year, and progress will be slow.

-A repeat of the commitment to avoid "excessive volatility and disorderly movements" and "refrain from competitive devaluation of currencies." The key piece of new news is that a tolerance for capital controls in EM is now implicitly acknowledged: "in circumstances where countries are facing undue burden of adjustment, policy responses in emerging market economies with adequate reserves and increasingly overvalued flexible exchange rates may also include carefully designed macro-prudential measures." This is a head-nod to Brazil and other EM countries that have been trying to deal with the influx of capital. At the very least, it means that the West will refrain from openly criticizing capital controls, so long as this is accompanied by EM tolerance for further currency appreciation. But it could mean that other EM countries are encouraged to follow suit.

The European Finance Ministers Statement

This is arguably more important than the G20 in the near term, and was also released overnight by the German, French, Italian, Spanish and British finance ministers. It is a direct response to Eurozone peripherals turmoil, making the most explicit commitment yet that talk of an orderly crisis resolution scheme does not apply to current or issued debt up to 2013: "whatever the debate within the euro area about the future permanent crisis resolution mechanism and the potential private sector involvement in that mechanism we are clear that this does not apply to any outstanding debt and any programme under current instruments." This is good news for Eurozone peripheral bondholders. It does not remove long-term debt sustainability concerns, but it does remove a good deal of uncertainty surrounding the implications of current European discussions on orderly restructuring beyond 2013.

Where does that leave us?

Even though the EU news has been positive, talk of further tightening from China and a sharp drop in Chinese equities has set a risk-reduction tone to the day. The market's largest positions have been hit: AUD and SEK are the worst performers in the G10, and $/Asia is suffering from a broad sell-off. But looking ahead, the key thing to watch is whether the EU finance ministers' statement will be sufficient to reverse the collapse of peripheral Eurozone bond markets, and whether there any signs of the ECB stepping in with more aggressive purchases. Italy comes in with new bond supply at 10am, an auction which markets will pay attention given the new wides in Italian-German spreads yesterday.

For EUR/USD, 1.3550 is the medium-term level we have been mentioning over the last few days. In yesterday's FX weekly, we wrote that there are tentative signs of contagion, but this morning there are increasing signs of stress in both money markets and financials, with the EUR/USD basis, one of the key indicators we have been watching, significantly wider. A break below 1.35-1.3550 on the back of a failure of peripherals to stabilize would be a clear and significant setback to our view that EUR/USD will make new highs this year, exceeding the typical 3%-5% pullbacks. But if we hold and the week finishes on a more positive note for peripherals, buying EUR/USD with a tight stop below 1.35 looks tempting

. george.saravelos@db.com

Earlier this week we introduced two measures of systemic money market risk in the form of the EUR/USD basis as well as demand for euro liquidity in the ECB's weekly tenders. The basis remains well-behaved, but this Tuesday's ECB tenders saw higher than expected demand for cash and a modest move lower in EONIA rates. This may be distorted by the expiry of EUR 36bn of 6-month cash, and we will be watching the take-up in today's extraordinary 6-day bridging operation to gauge whether overall precautionary demand for euro cash is rising. We are also monitoring Eurozone financial stocks, swap spreads and the iTraxx financials index for signs of market stress beyond the periphery. All of these indicators saw some weakness as the peripheral sell-off accelerated yesterday afternoon, but remain within recent ranges providing tentative, if any, indications of market stress. In the meantime, we note that both Spanish and Italian sovereign spreads remain below their summer highs.

Overall, the evidence therefore still leaves us bullish EUR/USD for year-end, though admittedly we remain cautious on entering fresh longs over the next few days given the ongoing volatility in Eurozone peripherals. Our year-end view of new highs will be re-evaluated in the event that Spanish and Italian spreads start breaking out more significantly, or should we break 1.3550 levels to the downside. A break below there would exceed the typical 3%-5% corrections seen during EUR/USD uptrends, and would likely make the EUR/USD picture more technically challenging. george.saravelos@db.com .

Appendix 1

Important Disclosures

Additional information available upon request

For disclosures pertaining to recommendations or estimates made on a security mentioned in this report, please see the most recently published company report or visit our global disclosure look-up page on our website at http://gm.db.com/ger/disclosure/DisclosureDirectory.eqsr**.**

Analyst Certification

The views expressed in this report accurately reflect the personal views of the undersigned lead analyst(s). In addition, the undersigned lead analyst(s) has not and will not receive any compensation for providing a specific recommendation or view in this report. George Saravelos

Deutsche Bank debt rating key

CreditBuy (“C-B”): The total return of the Reference Credit Instrument (bond or CDS) is expected to outperform the credit spread of bonds / CDS of other issuers operating in similar sectors or rating categories over the next six months.
CreditHold (“C-H”): The credit spread of the Reference Credit Instrument (bond or CDS) is expected to perform in line with the credit spread of bonds / CDS of other issuers operating in similar sectors or rating categories over the next six months.
CreditSell (“C-S”): The credit spread of the Reference Credit Instrument (bond or CDS) is expected to underperform the credit spread of bonds / CDS of other issuers operating in similar sectors or rating categories over the next six months.
CreditNoRec (“C-NR”): We have not assigned a recommendation to this issuer. Any references to valuation are based on an issuer’s credit rating.

Reference Credit Instrument (“RCI”): The Reference Credit Instrument for each issuer is selected by the analyst as the most appropriate valuation benchmark (whether bonds or Credit Default Swaps) and is detailed in this report. Recommendations on other credit instruments of an issuer may differ from the recommendation on the Reference Credit Instrument based on an assessment of value relative to the Reference Credit Instrument which might take into account other factors such as differing covenant language, coupon steps, liquidity and maturity. The Reference Credit Instrument is subject to change, at the discretion of the analyst.

Regulatory Disclosures

1. Important Additional Conflict Disclosures

Aside from within this report, important conflict disclosures can also be found at https://gm.db.com/equities under the "Disclosures Lookup" and "Legal" tabs. Investors are strongly encouraged to review this information before investing.

2. Short-Term Trade Ideas

Deutsche Bank equity research analysts sometimes have shorter-term trade ideas (known as SOLAR ideas) that are consistent or inconsistent with Deutsche Bank's existing longer term ratings. These trade ideas can be found at the SOLAR link at http://gm.db.com.

3. Country-Specific Disclosures

Australia: This research, and any access to it, is intended only for "wholesale clients" within the meaning of the Australian Corporations Act.
EU countries: Disclosures relating to our obligations under MiFiD can be found at http://globalmarkets.db.com/riskdisclosures.
Japan: Disclosures under the Financial Instruments and Exchange Law: Company name - Deutsche Securities Inc. Registration number - Registered as a financial instruments dealer by the Head of the Kanto Local Finance Bureau (Kinsho) No. 117. Member of associations: JSDA, The Financial Futures Association of Japan. This report is not meant to solicit the purchase of specific financial instruments or related services. We may charge commissions and fees for certain categories of investment advice, products and services. Recommended investment strategies, products and services carry the risk of losses to principal and other losses as a result of changes in market and/or economic trends, and/or fluctuations in market value. Before deciding on the purchase of financial products and/or services, customers should carefully read the relevant disclosures, prospectuses and other documentation. "Moody's", "Standard & Poor's", and "Fitch" mentioned in this report are not registered as rating agency in Japan unless specifically indicated as Japan entities of such rating agencies.
Malaysia: Deutsche Bank AG and/or its affiliate(s) may maintain positions in the securities referred to herein and may from time to time offer those securities for purchase or may have an interest to purchase such securities. Deutsche Bank may engage in transactions in a manner inconsistent with the views discussed herein.
New Zealand: This research is not intended for, and should not be given to, "members of the public" within the meaning of the New Zealand Securities Market Act 1988.
Russia: This information, interpretation and opinions submitted herein are not in the context of, and do not constitute, any appraisal or evaluation activity requiring a license in the Russian Federation.

Risks to Fixed Income Positions

Macroeconomic fluctuations often account for most of the risks associated with exposures to instruments that promise to pay fixed or variable interest rates. For an investor that is long fixed rate instruments (thus receiving these cash flows), increases in interest rates naturally lift the discount factors applied to the expected cash flows and thus cause a loss. The longer the maturity of a certain cash flow and the higher the move in the discount factor, the higher will be the loss. Upside surprises in inflation, fiscal funding needs, and FX depreciation rates are among the most common adverse macroeconomic shocks to receivers. But counterparty exposure, issuer creditworthiness, client segmentation, regulation (including changes in assets holding limits for different types of investors), changes in tax policies, currency convertibility (which may constrain currency conversion, repatriation of profits and/or the liquidation of positions), and settlement issues related to local clearing houses are also important risk factors to be considered. The sensitivity of fixed income instruments to macroeconomic shocks may be mitigated by indexing the contracted cash flows to inflation, to FX depreciation, or to specified interest rates – these are common in emerging markets. It is important to note that the index fixings may -- by construction -- lag or mis-measure the actual move in the underlying variables they are intended to track. The choice of the proper fixing (or metric) is particularly important in swaps markets, where floating coupon rates (i.e., coupons indexed to a typically short-dated interest rate reference index) are exchanged for fixed coupons. It is also important to acknowledge that funding in a currency that differs from the currency in which the coupons to be received are denominated carries FX risk. Naturally, options on swaps (swaptions) also bear the risks typical to options in addition to the risks related to rates movements.

David Folkerts-Landau
Managing Director
Global Head of Research

Stuart Parkinson
Associate Director
Company Research

Marcel Cassard
Global Head
Fixed Income Research

Europe	Asia-Pacific	Germany	Americas
Guy Ashton Regional Head	Fergus Lynch Regional Head	Andreas Neubauer Regional Head	Steve Pollard Regional Head

Principal Locations

Deutsche Bank AG
London
1 Great Winchester Street
London EC2N 2EQ
Tel: (44) 20 7545 8000

Deutsche Bank AG
New York
60 Wall Street
New York, NY 10005
United States of America
Tel: (1) 212 250-2500

Deutsche Bank AG
Hong Kong
Level 55
Cheung Kong Center
2 Queen's Road Central
Hong Kong
tel: (852) 2203 8888

Deutsche Securities Inc.
Japan
2-11-1 Nagatacho
Sanno Park Tower
Chiyoda-ku, Tokyo 100-6171
Tel: (81) 3 5156 6770

Deutsche Bank AG
Frankfurt
Große Gallusstraße 10-14
60272 Frankfurt am Main
Germany
Tel: (49) 69 910 00

Deutsche Bank AG
Aurora business park
82 bld.2 Sadovnicheskaya street
Moscow, 115035
Russia
Tel: (7) 495 797-5000

Deutsche Bank AG
Singapore
One Raffles Quay
South Tower
Singapore 048583
Tel: (65) 6423 8001

Deutsche Bank AG
Australia
Deutsche Bank Place, Level 16
Corner of Hunter & Phillip Streets
Sydney NSW 2000
Tel: (61) 2 8258 1234

Deutsche Bank Dubai
Dubai International Financial Centre
The Gate, West Wing, Level 3
P.O. Box 504 902
Dubai City
Tel: (971) 4 3611 700

Subscribers to research via email receive their electronic publication on average 1-2 working days earlier than the printed version.

If you would like to receive this or any other product via email please contact your usual Deutsche Bank representative.

Publication Address:
Deutsche Bank AG London
1 Great Winchester Street
London EC2N 2EQ
United Kingdom
(44) 20 7545 8000

Internet:
http://gmr.db.com
Ask your usual contact for a username and password.

Global Disclaimer

The information and opinions in this report were prepared by Deutsche Bank AG or one of its affiliates (collectively "Deutsche Bank"). The information herein is believed to be reliable and has been obtained from public sources believed to be reliable. Deutsche Bank makes no representation as to the accuracy or completeness of such information.

Deutsche Bank may engage in securities transactions, on a proprietary basis or otherwise, in a manner inconsistent with the view taken in this research report. In addition, others within Deutsche Bank, including strategists and sales staff, may take a view that is inconsistent with that taken in this research report.

Opinions, estimates and projections in this report constitute the current judgement of the author as of the date of this report. They do not necessarily reflect the opinions of Deutsche Bank and are subject to change without notice. Deutsche Bank has no obligation to update, modify or amend this report or to otherwise notify a recipient thereof in the event that any opinion, forecast or estimate set forth herein, changes or subsequently becomes inaccurate. Prices and availability of financial instruments are subject to change without notice. This report is provided for informational purposes only. It is not an offer or a solicitation of an offer to buy or sell any financial instruments or to participate in any particular trading strategy. Target prices are inherently imprecise and a product of the analyst judgement.

Foreign exchange transactions carry risk and may not be appropriate for all clients. Participants in foreign exchange transactions may incur risks arising from several factors, including the following: 1) foreign exchange rates can be volatile and are subject to large fluctuations, 2) the value of currencies may be affected by numerous market factors, including world and national economic, political and regulatory events, events in equity and bond markets and changes in interest rates and 3) currencies may be subject to devaluation or government imposed exchange controls which could negatively affect the value of the currency. Clients are encouraged to make their own informed investment and/or trading decisions. Past performance is not necessarily indicative of future results. Deutsche Bank may with respect to securities covered by this report, sell to or buy from customers on a principal basis, and consider this report in deciding to trade on a proprietary basis.

Unless governing law provides otherwise, all transactions should be executed through the Deutsche Bank entity in the investor's home jurisdiction. In the U.S. this report is approved and/or distributed by Deutsche Bank Securities Inc., a member of the NYSE, the NASD, NFA and SIPC. In Germany this report is approved and/or communicated by Deutsche Bank AG Frankfurt authorized by the BaFin. In the United Kingdom this report is approved and/or communicated by Deutsche Bank AG London, a member of the London Stock Exchange and regulated by the Financial Services Authority for the conduct of investment business in the UK and authorized by the BaFin. This report is distributed in Hong Kong by Deutsche Bank AG, Hong Kong Branch, in Korea by Deutsche Securities Korea Co. This report is distributed in Singapore by Deutsche Bank AG, Singapore Branch, and recipients in Singapore of this report are to contact Deutsche Bank AG, Singapore Branch in respect of any matters arising from, or in connection with, this report. Where this report is issued or promulgated in Singapore to a person who is not an accredited investor, expert investor or institutional investor (as defined in the applicable Singapore laws and regulations), Deutsche Bank AG, Singapore Branch accepts legal responsibility to such person for the contents of this report. In Japan this report is approved and/or distributed by Deutsche Securities Inc. The information contained in this report does not constitute the provision of investment advice. In Australia, retail clients should obtain a copy of a Product Disclosure Statement (PDS) relating to any financial product referred to in this report and consider the PDS before making any decision about whether to acquire the product. Deutsche Bank AG Johannesburg is incorporated in the Federal Republic of Germany (Branch Register Number in South Africa: 1998/003298/10). Additional information relative to securities, other financial products or issuers discussed in this report is available upon request. This report may not be reproduced, distributed or published by any person for any purpose without Deutsche Bank's prior written consent. Please cite source when quoting.