Dollar Breaks Correlation Streak in Sign Bulls Love: Currencies
2013-03-07 10:49:26.300 GMT

(For a Currencies column daily alert: SALT FXCOL)

By Candice Zachariahs
March 7 (Bloomberg) -- For the first time in four years the dollar is participating in a rally that has sent stocks to record highs as traders in the $4-trillion-a-day foreign-exchange market bet the world's largest economy will only strengthen.
The U.S. Dollar Index showed the currency gaining to its strongest level in more than six months yesterday as the Standard & Poor's 500 Index of U.S. shares reached its highest since 2007. That's unusual because the greenback has tended to move in the opposite direction to equities in recent years as investors sought a haven from the global financial crisis, sovereign bailouts in Europe and slower growth.
"This is potentially a clear turning point for the U.S. dollar," said John Horner, a currency strategist in Sydney at Deutsche Bank AG, the world's top foreign-exchange trading firm as measured by Greenwich Associates. "We're now starting to get toward the point where good U.S. data is good for the U.S. dollar and good for U.S. markets, and that's a quite different scenario to what we've seen over the past few years."
Investor confidence in the U.S. recovery is rising as the nation's employers added back almost two-thirds of the 8.7 million jobs lost during the recession that stretched from 2007 to 2009. Led by France and Germany, international purchases of U.S. stocks in December were the most since July 2009, according to Treasury Department data. The Dow Jones Industrial Average set a record high yesterday.

Dollar Correlation

The Dollar Index and equities, which moved in opposite directions a year ago, showed the least divergence since 2008 last month. Against the MSCI World Index of stocks, the U.S. currency's 60-day correlation moved to -0.34 in February, the least negative reading since 2008, from -0.90 in December 2011.
The correlation between the Dollar Index and the S&P 500 fell to -0.20 on Feb. 19, the smallest divergence since March 2011, after reaching -0.83 in November 2011. A reading of -1 means prices move in opposite directions, while zero indicates no relationship and 1 means they move in tandem.
The dollar traded at $1.3024 per euro as of 10:45 a.m. London time, and at 94.18 yen. The Dollar Index, which tracks

the U.S. currency against six major peers, was at 82.38 after
yesterday touching 82.60, the most since Aug. 20.

Raising Estimates

Strategists are having trouble keeping up with the gains, boosting their year-end forecast for the gauge to 81.80 from a projection of 78.20 on Dec. 31, the median of estimates in a Bloomberg survey shows. Deutsche Bank sees the dollar rising to $1.20 versus the euro and 100 yen by year-end, Horner said.

The greenback's negative correlation with equities strengthened during the Federal Reserve's first two rounds of so-called quantitative easing. The policy pumped more than $2 trillion into the financial system, weighing on the dollar.

The Dollar Index fell 6.3 percent during QE1, between November 2008 and March 2010, and declined 8.5 percent during QE2, which began in November 2009 and ended in June 2011.

So far, this time is different. The dollar has gained against 14 of its 16 most-traded counterparts since Fed officials led by Chairman Ben S. Bernanke, frustrated by the slow recovery, said Dec. 12 they plan to buy $45 billion of debt securities a month until job growth shows "sustained improvement."

The central bank's moves have helped strengthen the outlook for the economy. Growth will accelerate each quarter this year, from 1.8 percent in the first three months to 2.7 percent in the fourth quarter, according to the median estimate of 70 economists surveyed by Bloomberg.

Jobs Recovering

The U.S. has recovered 5.5 million of the 8.7 million jobs lost as a result of the recession lasting from December 2007 to June 2009. The unemployment rate fell to 7.9 percent in January from a 26-year high of 10 percent in October 2009, Labor Department data show. The next report is due tomorrow.

"The U.S. economy, we think, will outperform," Mansoor Mohi-uddin, head of foreign-exchange strategy at UBS AG in Singapore said on Feb. 19. "Investors are thinking about whether the dollar should start to trade more positively again with risk sentiment."

UBS, the No. 3 trader in the Greenwich survey, boosted its dollar forecasts this week, predicting it will gain to 100 yen by year-end, from its previous estimate of 85. It now sees the greenback strengthening to $1.41 per pound, from $1.56.

Foreign Demand

Net foreign buying of U.S. stocks rose to $25.9 billion in December, the most since July 2009, Treasury Department data show, with $10.1 billion in purchases by France, $3.1 billion by Germany and $3.6 billion from the Cayman Islands.
The S&P 500 has climbed 8.1 percent this year compared with a 6.2 percent advance in the MSCI World Index of stocks.
The smallest U.S. trade deficit in almost three years helped overcome the biggest slump in military spending since the final years of the Vietnam War era.
More reductions are slated after President Barack Obama ordered the start of $85 billion in spending cuts on March 1, beginning a potentially decade-long wave of belt-tightening. The measures come after Congress on Jan. 1 let the payroll tax that funds Social Security revert to 6.2 percent from 4.2 percent, and boosted the levy on top income earners.
Foreign-exchange traders have signaled they aren't concerned about the impact of the spending cuts and higher taxes as the labor market improves.

Hedge Funds

Futures indicate hedge funds and other large speculators are poised to reverse positions and begin betting on a gain in the U.S. dollar for the first time since July, according to data from the Washington-based Commodity Futures Trading Commission.
Aggregate net positions wagering on declines in the U.S. currency against the yen, euro, pound, franc, Mexican peso and the dollars of Australia, Canada and New Zealand fell to 10,304 contracts on Feb. 26, the least since July 31, when there was a so-called net-long position of 19,771.
Growth is strong enough that the Federal Open Market Committee is debating when to curtail its bond-purchase program, potentially removing a headwind for the dollar.
Policy makers indicated in December an "exceptionally low" target interest rate is appropriate as long as inflation isn't forecast to rise to more than 2.5 percent and unemployment stays above 6.5 percent.
The jobless rate will fall to 6.7 percent on average in 2015, according to a Bloomberg survey.

'High Risk'

"Premature rate increases would carry a high risk of short-circuiting the recovery, possibly leading -- ironically enough -- to an even longer period of low long-term rates," Bernanke said in a March 1 speech. "Only a strong economy can deliver persistently high real returns to savers and investors."

The Dollar Index's positive correlation with equities eroded after reaching 0.58 in August 2008 and turned increasingly negative from October of that year, as Lehman Brothers Holdings Inc.'s collapse led to record Fed easing. Investors preferred higher-yielding assets as the Fed's bond purchases pushed U.S. rates negative after accounting for inflation. Treasury Inflation Protected Securities maturing in 10 years yielded -0.65 percent and have been negative since January 2012.

"We don't believe that the dollar will sustain a large rally until real rates come out of negative territory in the U.S., so we're still some time away," said Richard Grace, the Sydney-based chief foreign-exchange strategist and head of international economics at Commonwealth Bank of Australia.

QE Bets

The Fed will end QE this year, according to 18 of 44 economists polled by Bloomberg, with UBS's Mohi-uddin saying it will be the first among major central banks to exit "unconventional policies." The program will conclude next year, 21 analysts predict.

The Dollar Index may gain to 84.10, matching its highest level since July 2010, after completing a "bullish outside month," closing at 81.95, Citigroup Inc. wrote Feb. 28.

"For a fair time now, improving economic data in the U.S. has had no impact on rate expectations because the Federal Reserve wants much, much better growth before changing tack," said Kit Juckes, head of foreign-exchange research at Societe Generale SA in London. "A debate is beginning about when the Fed will unwind QE and think about higher rates. It's very early days, but that is allowing bond yields to edge higher. And that helps the dollar, even in risk-on days."

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