

## Economic News

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### Current G7 stance should put dollar bears at ease

Not that anyone ever bought into a coordinated G7 intervention scenario post-G7, but there is always room for surprise in the Fx world and the tone of the communiqué should put dollar bears at ease. Indeed, while Friday's communiqué suggests that the G7 expects more (and soon) from China on the exchange rate policy front (in vain?) the mere fact that the dollar, the euro and the yen were not specifically mentioned will be seen as a green light for dollar bears. Our year-end 1.45 eur/dlr target is within reach, if anything sooner rather than later.

#### April-October G7 communique: when it comes to Fx, it is a similar message

*"Although risks remain, the global economy is having its strongest sustained expansion in more than 30 years and is becoming more balanced. In our economies, U.S. economic activity remains solid even as domestic demand moderates to a more sustainable growth path. The euro-area is experiencing a healthy upswing. UK growth remains robust and Canadian growth is accelerating. Japan's recovery is on track and expected to continue. We remain confident that the implications of these developments will be recognized by market participants and will be incorporated in their assessments of risks".*

*"We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. We continue to monitor exchange markets closely, and cooperate as appropriate. In emerging economies..., especially China, it is desirable that their effective exchange rates move so that necessary adjustments will occur".*

**G7 Statement, Washington, April 13<sup>th</sup> 2007**

*"The global economy is in its fifth year of robust growth. Recent financial market turbulence, high oil prices, and weakness in the US housing sector will likely moderate this growth. Nevertheless, our overall economic fundamentals continue to be strong and emerging markets are providing critical impetus to the strength of the world economy".*

*"We reaffirm that exchange rates should reflect economic fundamentals. Excess volatility and disorderly movements in exchange rates are undesirable for economic growth. We continue to monitor exchange markets closely, and cooperate as appropriate. We welcome China's decision to increase the flexibility of its currency, but in view of its rising current account surplus and domestic inflation, we stress its need to allow an accelerated appreciation of its effective exchange rate".*

**G7 Statement, Washington, October 19<sup>th</sup> 2007**

The first three sentences of the paragraph on Fx are identical to those cited in the April statement, with excess Fx volatility unwelcome and 'exchange rates should reflect economic fundamentals'. We have heard it all before and it has clearly not been enough to deter dollar bears so far. US Treasury Paulson may have reaffirmed that a strong US dollar is in the US interest but he also added that exchange rates only play a limited role in reducing global imbalances and the strong dollar policy message has become a non-event over the past few months. Meanwhile, MoF's Nukaga may have stressed that the yen should reflect Japan's economic recovery, but this is not more threatening than the usual Japanese MoF policy language. Note that Germany's Fin. Min Steinbrueck's suggestion that given Germany's competitive improvement of the past three to four years, the euro trading level is 'irrelevant' is also a clear green light for euro bulls, notwithstanding the well-known French concern over a strong euro. As we pointed out before, until Europe endorses one position/view on a rallying euro, intervention threats will be perceived as weak, at least until EU officials judge Fx moves **as being 'disorderly'**.

As for China, there was a change in wording: it would appear that the G7 is keen to see a **speed-up** in the exchange rate adjustment process, this could prove in vain though.

**It is all very much back to square one after this weekend's G7 Meeting as with Fx intervention apparently not on the agenda at this stage, the time may have come to refocus on interest rates and risk appetite. At a time when fresh doom and gloom US housing sector headlines have rekindled equity market jitters and Fed October 31<sup>st</sup> rate cut talks are becoming a topic of discussion, the dollar looks vulnerable again – across the board. In turn, a weaker equity market and associated rising risk aversion leave carry trades out of fashion, for now.**

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