FX & Gold weekly outlook January 07 - 11: US, Europe: 2013 will be better than 2012?

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ARTICLE (January 07, 2013) : The world financial market did survive, albeit meekly, a scary 2012. The Eurozone sovereign debt crisis that went through a long phase of struggle before making a recovery appears to be in a better shape and China, which was struggling to make a strong comeback, is now on a recovery path. And then finally a last minute patch-up by the US Congressmen did not allow 'fiscal cliff' to overstep the deadline last week. But this does not ensure that there will be economic hiccups as the massive US deficit remains an unresolved issue. Some of the Republican hawks are not happy with a tax hike; they are demanding more reduction on spending. But due to immense pressure, the agreement was reached on mutual understanding between the two parties. Their body language indicates that it is not going to be an easy journey for the Obama administration when the Congress meets next month to raise USD 16.4 trillion Federal Borrowing Limit to pay bills. Another important event that was keenly watched was Fed's December FOMC meeting announcement to determine the mood of its 12-member committee on future quantitative easing policy. It should not be very shocking that some of the members wanted an end to bond purchasing earlier than December 2013. It has become quite clear that there is a difference of opinion on Fed's bond purchase policy and some of the Fed members do not want to expand the size of its balance-sheet to USD 1 trillion through its monthly purchase of USD 85 billion US bonds. Therefore, there is a high probability of rising inflation. Therefore, the fate of FED's extremely easing policy will largely depend on the US economic numbers. On the US economic front, all indicators are pointing towards improved economic condition after FED's four successive quantitative easing (QE) announcements that have helped create more job opportunities, which is well off its 10 percent peak. Friday's US payroll data reiterated that the US economic growth may not be a temporary phenomenon, but it still has to make a long struggle and the economy cannot afford to lose its upside momentum. Economic data to watch is the US housing sector, which is doing well. It's a healthy sign that the US real estate is showing a constant growth that has picked up after 5 difficult years. It is the boom in construction area that always creates job opportunity. Consumer spending data is another key indicator that needs to show continuation of its rising trend that will further confirm strength of the US economy. GOLD @ $1655.50 = Genuine strength of gold is largely dependent on consumer demand and Central Bank's interest. Investors buying yellow metal as safe haven were seen quickly liquidating it after easing of tension in Europe. Two things that still go in favour of gold is China's economic recovery that could spur domestic demand and growth in agriculture sector in India because India's farmers are physical buyers of gold against cash purchase. Total consumer demand for gold in both the countries is nearly 55 percent. But in recent times, it was the US quantitative easing (QE) that is one of the major factors behind gold support. December FOMC minutes released last week gave a big jolt to gold bulls suggesting that many of the FED members do not support continuation of easing policy. Not only has it reduced the QE5 chances, some of them even want to discontinue Fed's bond purchase programme. Such development makes me less excited about gold as improved US data may not be good news for gold and could hurt the buyers unless there is an increase in demand for gold. I am expecting offloading of gold portfolio by the portfolio managers on the rise and anything beyond USD 1720 looks risky to buy - at least in the present scenario. I'm not a $1800-$1900 gold fan in this calendar year and suspect that any move around $1720-40 should be an opportunity to take profit or sell gold unless $1750 breaks. I'm looking for a fall and break below $1608 that will open gates for $1580 and break of $1520 could possibly see a test of $1491. This week, bias for gold is on the downside. Prefer to pick the top and sell. EURO @ 1.3068 = US Dollar could not rally after better than expected payroll data probably because market is aware that the economy on a monthly average needs around 175,000 plus jobs for a faster recovery, but the current pace of growth is not disappointing. The Hurricane Sandy may have distorted the US economic numbers in the last quarter of 2012, but a $60 billion relief package passed by the Senate is good enough to keep the ball rolling. While Eurozone economy has been struggling and there are no indications of growth revival anytime soon, which reduces the risk of inflation and therefore, the European Central Bank could lose its patience and slash rates that could make European currency less attractive. All indicators are pointing towards a weaker Euro, which may not have strong enough nerves to test the new highs, which should encourage Euro sellers to pick the top. Euro should find top around 1.3150-80 zones and unless it surpasses 1.3250 convincingly, see risk for a drop and a break of 1.2970 that will pave way for a test of 1.2850. Range for the week: 1.2850 - 1.3180; GBP @ 1.6067 = Cable should struggle to move beyond 1.6180. On the downside, a break of 1.5770 will encourage for a test of 1.5910. A break here would see a sharp fall towards 1.5850. Range for the week: 1.5880-1.6220; JPY @ 88.15 = Yen's weakness is not here forever. The Japanese currency lost almost 14 percent of its value in last 100 days on expectations that PM Abe could do anything to weaken Yen. Currency market do not determine direction on statements; it's the demand and supply and the economic factor that matters most. Quantitative easing (QE) is not something new to Japan, as they were the first amongst the developing nations to take a QE initiative. It is also important to understand that if we look at the currency composition of foreign exchange reserves, USD is 62 percent and Euro is 24 percent, which means both are heavily traded as international currencies, both have a larger role in global debt market. Although Yen's share is a mere 4.1pct, it has the highest debt to GDP ratio of 225 pct, but majority of its investors are Japanese. Therefore, there is a high probability of a sharp correction. Market has a strong tendency to check the seriousness of Central Bank and hence, they will surely test Abe and BOJ's commitment. It is extremely difficult to pick the bottom but as we are getting closer to 90 Yen, global importers/investors should evaluate the situation carefully from the perspective of a hedging strategy. I will not mind hedging half of my yearly portfolio around 90-92 levels and take a chance to cover other half around 95-96 if seen as I do not rule out a drop to 80.-82 zones this year. Range for the week: 86-90; AUD @ 1.0477 = This is one currency that has a potential to bounce back. A strong USD will provide good buying interest on dips. A strong support is around 1.0370-80. Only a break risk for a minor fall, but again find buyers around 1.0310. However, a threat of challenging 1.0550 appears to be a strong possibility. Range for the week: 1.0310-1.0570.