

Dollar Gains Amid Sovereign Debt Concern, Attractive Treasury Note Yields

By Catarina Saraiva and Allison Bennett - Dec 18, 2010

The dollar rose for a second week against the euro as Treasury yields reached a seven-month high on stronger-than-forecast economic data and concern Europe's debt crisis will spread boosted demand for the U.S. currency.

The greenback touched an almost three-month high against the yen this week as Treasury yields lured buyers and President Barack Obama signed into law an \$858 billion tax cut bill. The euro dropped to a two-week low against the dollar on concern an agreement reached at the European Union summit this week won't contain the region's debt problems. Two reports next week are forecast to show U.S. sales of existing and new homes picked up in November.

"The positive U.S. cycle is beginning to accelerate and it's good for the U.S. dollar," said Andrew Busch, a global currency strategist at Bank of Montreal in Chicago. "On top of that, we get bad news for Ireland and Greece. The positive things for the dollar are there."

The dollar rose 0.3 percent to \$1.3188 per euro, from \$1.3226 Dec. 10, and touched \$1.3133, the strongest since Dec. 2. The greenback gained to 83.98 yen from 83.95 last week and reached 84.51 yen, the highest since Sept. 24. The euro added 0.3 percent to 110.77 yen, from 111.04 yen.

The Dollar Index, which tracks the greenback against the currencies of six major U.S. trading partners including the euro, yen and pound, rose 0.4 percent to 80.362, from 80.070 Dec. 10. The euro has gained 1.6 percent versus the greenback this month and the yen has dropped 0.4 percent.

Economic Indicators

Treasury yields touched weekly highs as reports signaling stronger U.S. economic growth damped demand for the perceived safety of the debt. U.S. retail sales, producer prices and industrial production rose more than forecast in November. Philadelphia-region manufacturing expanded this month at the fastest pace since April 2005.

Treasury 10-year note yields reached 3.56 percent Dec. 16, the highest since May 13. U.S. 30-year bond yields reached 4.6 percent, the highest since April 30.

"The dollar has gained strength ever since the bond market topped out," said Yu-Dee Chang, who oversees \$130 million in assets as chief executive officer of ACE Investment

Strategists LLC in McLean, Virginia. “The higher interest-rate country tends to have a stronger currency.”

EU leaders met Dec. 16-17 in Brussels, where they agreed to amend the bloc’s treaties to create a permanent crisis- management mechanism that takes effect in 2013, while the leaders struggled to bridge divisions about immediate steps to stabilize bond markets.

Germany’s Role

Germany, the biggest contributor to Europe’s bailouts of Greece and Ireland, pushed through a proposal that would allow financial aid “if indispensable” to underpin the euro and may force bondholders to bear some costs of future rescues.

German Chancellor Angela Merkel ruled out putting more money on the table, retooling the post-Greek rescue European Financial Stability Facility to enable it to buy troubled government bonds, or further entwining Europe’s economies through joint bond sales.

“We’re a little bit disappointed at their inability to approach the broad solution to the sovereign debt crisis that’s clearly needed,” Steven Englander, head of Group of 10 currency strategy at Citigroup Inc. in New York, said in an interview on Bloomberg Radio’s “Bloomberg Surveillance” with Tom Keene. “The market is afraid of a financial rupture in the euro zone.”

Moody’s Steps

Moody’s Investors Service yesterday cut Ireland’s credit rating by five levels to Baa1 after the government was forced to ask for external aid last month, staggered by losses in the banking system. The ratings company Dec. 16 placed Greece’s Ba1 local and foreign currency government bond ratings on review for possible downgrade.

Europe’s sovereign debt crisis took hold at the end of 2009 after a new government in Greece said the budget deficit was twice as big as the previous administration disclosed. The region’s nations assembled a rescue fund in May, which Greece and Ireland have tapped.

The euro has fallen 9.7 percent this year in a measure of the currencies of 10 developed nations, according to Bloomberg Correlation-Weighted Currency Indexes. The yen has gained 10.9 percent, while the dollar is down 1 percent.

The dollar dropped against most of its major counterparts after the Federal Reserve said after its Dec. 14 meeting that it will maintain its asset-buying program in an effort to bolster the U.S. economy.

Benchmark Rate

The Fed left its benchmark interest rate unchanged at zero to 0.25 percent, where it has been since December 2008.

The pound was the worst performer against all of its major peers. Sterling weakened 1.7 percent to \$1.5533 and lost 1.4 percent to 84.91 pence per euro.

Lloyds Banking Group Plc, a British bank that's 41 percent government owned, said yesterday it expects to report an increased impairment charge of 4.3 billion pounds (\$6.7 billion) because of Irish loan losses.

The Swiss franc climbed against all of its major counterparts. It added 1.3 percent against the dollar to 0.9686 and touched 0.9559 yesterday, the strongest since Nov. 5. It rose 1.5 percent to 1.2785 per euro and reached a record of 1.2721 yesterday.

The Bank of Japan will meet Dec. 21 to set its benchmark interest rate.

U.S. existing home sales rose to a 4.75 million annual rate in November, the National Association of Realtors will report Dec. 22, according to a Bloomberg News survey of 59 economists. A separate survey indicated the Commerce Department on Dec. 23 will report November new home sales rose to a 300,000 annual rate from a 283,000 rate in October.

Past performance is not necessarily indicative of future results. The risk of loss exists in futures trading.