FxCurve

HEDGFX

7/12/11

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HEDGFX MODEL TRENDS

	Quote	Current Trend	Expected Trend	TF	Comment	Key Levels	
EURUSD	1.3415	↔	↓	D	↓	1.3140	1.4090
GBPUSD	1.5602	↔	↓	D	↓	1.6110	1.5340
USDJPY	0.7772	↔	↑	D	CT↑	0.7600	0.7931
USDCHF	0.9252	↑	↑	D	↑	0.9370	0.8750
USDINR	51.395	↔	↑	4H	↑	-	-
S&P500	1258.4	↑	↔	D	CT↑	1265	1150
FTSE	5568.2	↑	↑	D	CT↑	5100	5647
NIKKEI	8649.8	↑	↔	D	CT↑	8480	8950
DAX	6057	↑	↔	D	CT↑	6550	5580
NIFTY	5039	↑	↔	D	CT↑	5100	4920
GOLD	1729.10	↑	↓	D	↔	1756	1670
SILVER	32.59	↔	↓	D	↔	34.50	30.0
Crude Oil	101.40	↑	↔	D	CT↑	95	102.50

BANK RATES

USD	0.25
EUR	1.25%
GBP	0.50%
JPY	0.10%
CHF	0.00
INR	6.00%
CNY	6.56%
AUD	4.25%

ECONOMIC CALENDAR

	CCY	Forecast	Previous	GMT
Manufacturing Production m/m	GBP	-0.1%	0.2%	930
German Industrial Production	EUR	0.3%	-2.7%	1100
Crude Oil Inventories	USD	-0.8M	3.9M	1530
NZD Cash rate, Rate statement, Conf	NZD			2030

*Hedgfx Trend is based on technical analysis and may not hold in serious fundamental shifts

Euro On The Brink

It's a creepy feeling to know that we are so close to what is being billed as a financial Armageddon. The point beyond which the world ceases to exist as we know it. Where fiat currencies hyper-inflate and we would need a wheel-barrow to go shopping to buy a bagful. All the dire predictions aside lets take a brighter look at the things.

All the European problems have a simple solution – just send in Rajnikanth! Seriously, all they just need is capital and that's not much to ask because its just an electronic blip away. What they need however is, and this is where the real problem exists, is the political will to stay united in times of dire need. To put it simply, if your brother or a sister makes a mistake do you help that person out or just divorce that person to avoid problems.

What is being to called to judge for Europe at this time, is this political unity which unfortunately is becoming more fragile with every passing day and every bps rise in yields. What is now to be seen is if the prudent, and therefore rich and stable countries can help out their spendthrift friends from south.

Undoubtedly there will be some give and take. Germany and others would have to pitch in with money, while the spendthrift nations would have to give away some part of their sovereign freedom, mainly the "spending freedom." By asking for "fiscal & political union" Germany is trying achieve this oversight to ensure the budgetary catastrophes do not happen again, what it is also trying to achieve is to be able to "correct" the budgetary trajectory in the countries which go astray.

Well, isn't that the next phase of a monetary union? These "sovereign" countries have already given up their rights to their currencies, ability to set interest rates, and almost as to how they will operate their economies. Why would be reticent to Germany asking for "union" unless they dint have the faith and courage to take it to the next step. Unless they had made a mistake in the first place.

It's tough to unite

Several monetary unions have broken up in past, but EU is a class of its own. EU was a bold experiment and sometimes it is better to accept and cut the losses. It might be a good recourse for the richer countries like Germany to just let EU-end in its current shape, or put it other way, evolve into a stronger union. Any evolution sans bailouts simply means some countries will have to exit, probably including Italy. Lot of money is riding on GIIPS' lifeboats these days and the disruption will be massive.

GIIPS countries too do not have to sacrifice a lot and put its population into a decade or more of servitude. They can simply call it quits and default on the debt or restructure it, and they will be much better off. Only problem is since most of the debt is held by Germany and other rich neighbors, their "exit" may not be an easy option. It's not like you can 'unfriend' an union. Such an 'unfriending'/ exiting situation would need a popular referendum which George Papandreou tried to achieve by trying to hop out, by calling for a popular referendum. He was promptly replaced by the powers of ECB, France and Germany. Why? Because their banks hold most of GIIPS loans. Greece bailing out from union or a default would mean they would have to bailout their own too-big-to-fail too-big-to-bail banks.

Can Germany bailout?

Ignore France for now it doesn't have the clout or the balance sheet in the current scenario to make a difference. Guy with gold makes the rules, and Germany has the most. But can Germany truly bailout its neighbors and friends? Or will the economic prudence prod it to cut its losses short in this gigantic EU experiment?

Some data from Vox.org and from FT, pretty much nails this point.

Central Banks cannot raise money off thin air they can only do it when they have something to sell. CBs sell these "collaterals" and raise money for their needs. Once the collaterals or stock of 'silvers' is finished, they are pretty much at mercy of markets or will have to resort to "printing" of money.

What Vox has done is to analyze what is the current available stock with Bundesbank to understand how much it can possibly raise. Answers are interesting.

Germany's exposure to GIIPS is close to E500billion. There has been a sharp increase in loans to GIIPS, while coincidentally the assets of Bundesbank dropped E268Billion in Dec 07 to E21Billion in Oct 11.

Simply means, Germany has been cashing most of its silver to pay the GIIPS. And now there isn't much left. Not enough for a full out bailout anyway. But it could be enough if they let few peripherals exit. Peripheral exit would be a tough option as most of Germany's loans might be locked with them (chart 3)

Which also means, <u>Germany, even if it decides to help, can help only by allowing ECB to print.</u> And also that <u>it is in the interest of Germany to help see the Euro Monetary system survives.</u> So, if the push comes to shove in the summit negotiations, <u>Germany is more likely to relent – with some</u>

<u>compromises from the GIIPS and some on fiscal union – than take the system to the brink.</u> Let's see what happens.

Chart 1: Bundesbank loans to Domestic (Germany), GIIPS and others

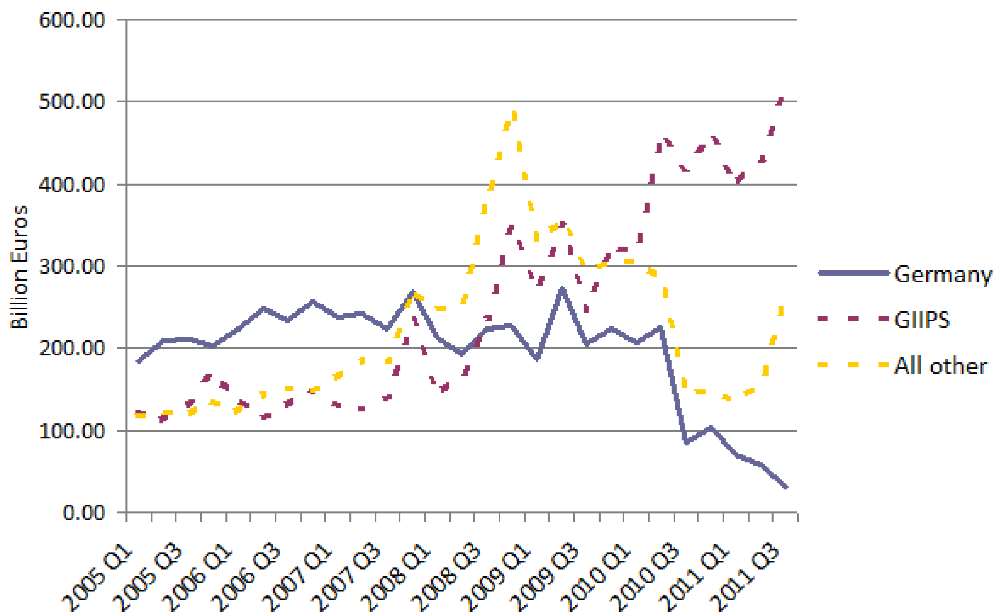


Chart 2: Bundesbank assets. Most of loans are now loans to Eurosystem

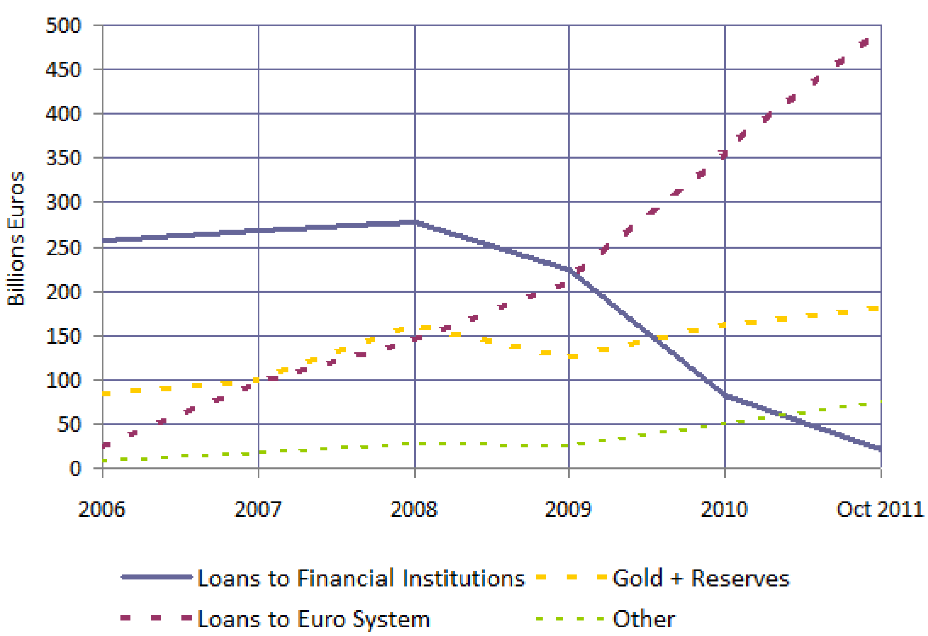
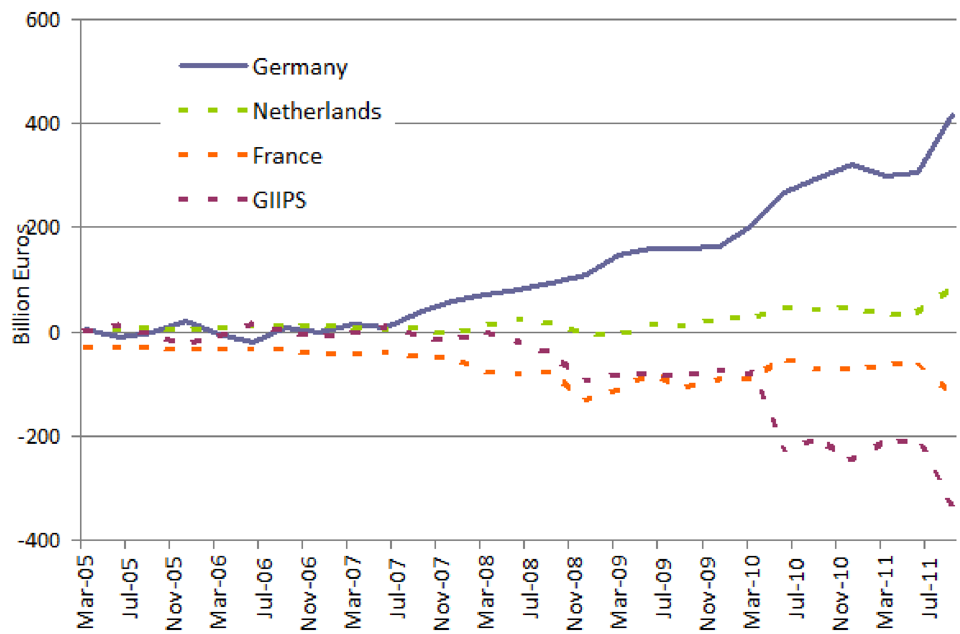


Chart 3: Claims on Eurosystem



All charts source: Vox.org

Probably not the best way to analyze the scenario due to netting effect of loans but gives a stark view that Germany is not as rich – singlehandedly – and is probably just an another Italy or Greece – individually.

In the other news:

- EFSF ratings could be cut by S&P by 1-2 levels. Ratings are likely to be released on Thursday or Friday.
- Dagong cut Italy's ratings from AA- to BBB
- BASEL committee may make changes in its norms to ease the pressures of Bank capital.
- Russia sells coastal defensive missles to Syria just when US aircraft carriers are stationed close by.
- Iran has put its systems on combat alert.

Trading Strategy: Trades should remain light ahead of the summit meetings. We would remain risk-off more due to the consistently weak price action and long term technicals. Equities, we reiterate, are stretched in terms of the bounce they have experienced off "liquidity swap lines" lows, while the broader risk assets have barely budged. The regression in equities is likely to be much sharper.

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HEDGFX TRADING CALLS									
Market	Security	Date	Strategy	TTF	Initiate	T1	T2	SL	Result
COM	Crude Oil	28/11/11	Short	-	$100	$95	$93	$102.50	Initiated
FX	EURUSD	29/11/11	Short	4H	<1.3140	1.3000s	1.2860	1.3240	
FX	USDJPY	30/11/11	Buy	8H	77.95	80.00	81.50	76.85	Initiated

HEDGFX Forex Concepts

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