

Forex Update: Which Central Banks are Still Raising Interest Rates?

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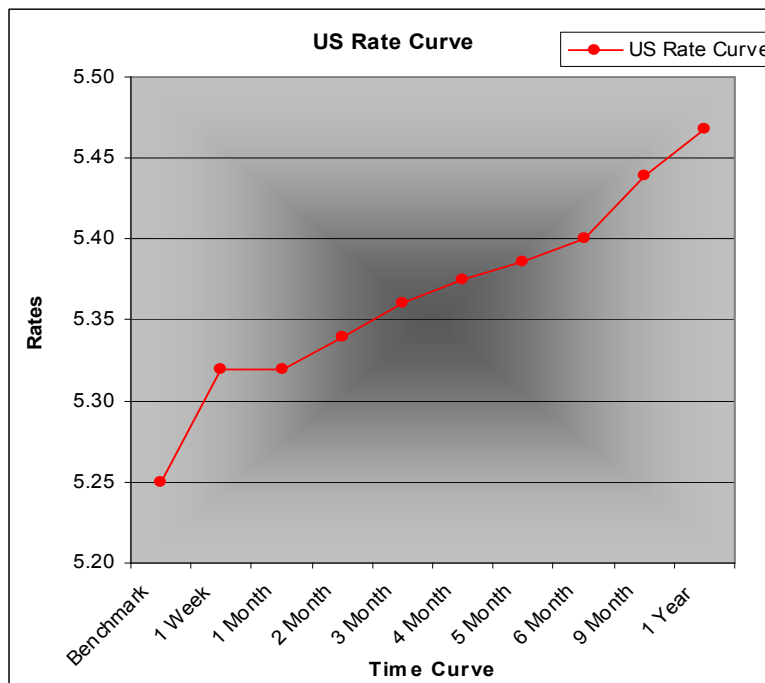
Interest rates have a huge impact on forex trading, and currently, central banks appear anxious to enact rate hikes as inflation pressures persist globally. This is perhaps most clear in New Zealand, where the RBNZ unexpectedly raised rates to a record high just a few days ago. This is also evident in Canada, as the BOC has signaled policy tightening in July, the result of a major economic turnaround that has been in the works over the past three months. At a time when high yielding currencies run a high risk of being liquidated if the stock market continues to tumble, knowing which central bank are still on track to raise interest rates and which are not will be key in determining which currencies under or outperform.

The chart below highlights which central banks we consider to have the most severe tightening bias and more importantly, which are the most likely to increase interest rates in the near term. While all of them have demonstrated a more hawkish stance, certain factors pertinent to their respective economies leave banks, such as the Bank of Canada, prone to earlier action.

Central Bank	Current Target Interest Rate	Next Policy Meeting	Bias
Federal Reserve	5.25%	6/28/2007	Neutral-Hawkish
European Central Bank	4.00%	7/5/2007	Neutral-Hawkish
Bank of England	5.50%	7/5/2007	Neutral-Hawkish
Bank of Japan	0.50%	6/14/2007	Neutral-Hawkish
Reserve Bank of Australia	6.25%	7/3/2007	Neutral-Hawkish
Reserve Bank of New Zealand	8.00%	7/26/2007	Hawkish
Swiss National Bank	1.75% - 2.75%	6/14/2007	Hawkish
Bank of Canada	4.25%	7/10/2007	Hawkish

Federal Reserve – Expectations of a Rate Cut Come Unraveled

US Interest Rate Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
USD	5.25	5.320	5.320	5.360	5.400	5.468

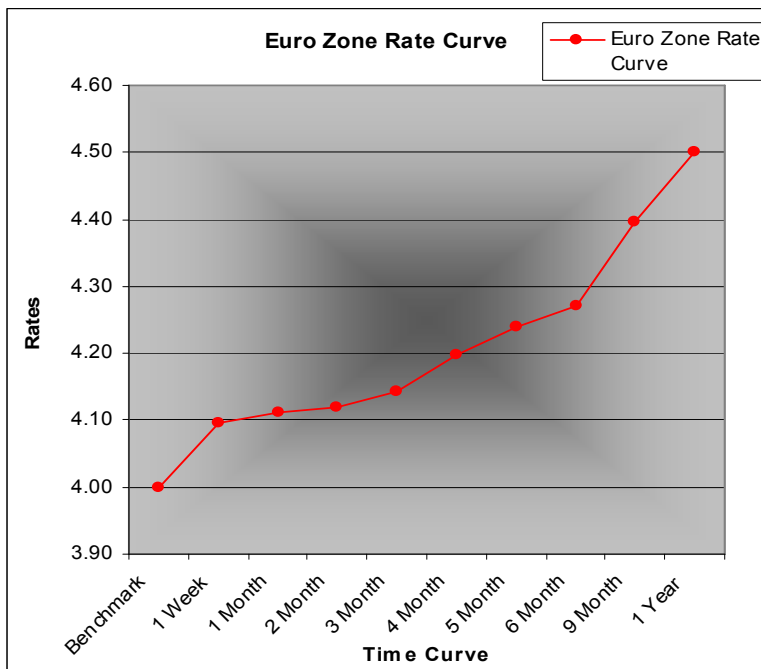


US Dollar: Zero Rate Hike

Staying true to its consistent neutral policy and hawkish warnings, the Federal Open Market Committee voted to keep interest rates unchanged on May 9th at 5.25 percent. The subsequent release of the policy statement remained status quo, though it did acknowledge that the weak housing sector helped contribute to a sharp economic slowdown. Over the past week, Federal Reserve Chairman Ben Bernanke reiterated this issue, saying that the dismal housing conditions would prove to be a drag on the economy for "somewhat longer" than expected, but remained confident that the slump has not seeped into other sectors. Nevertheless, with inflation risks remaining the primary concern for other central banks and bond yields spiking around the world, the Federal Reserve's hawkish stance is well warranted. However, with economic expansion grinding to a halt and very few indications that the woes of the housing sector have yet to let up, it is also easy to see why Bernanke and his fellow policy makers have refrained from tightening rates. The interest rate curve is not pricing any tightening at the end of the year, but at the same time, it is not pricing in an easing either.

European Central Bank – Has The Tightening Cycle Come to an End?

Euro Zone Interest Rate Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
EUR	4.00	4.097	4.112	4.143	4.272	4.500



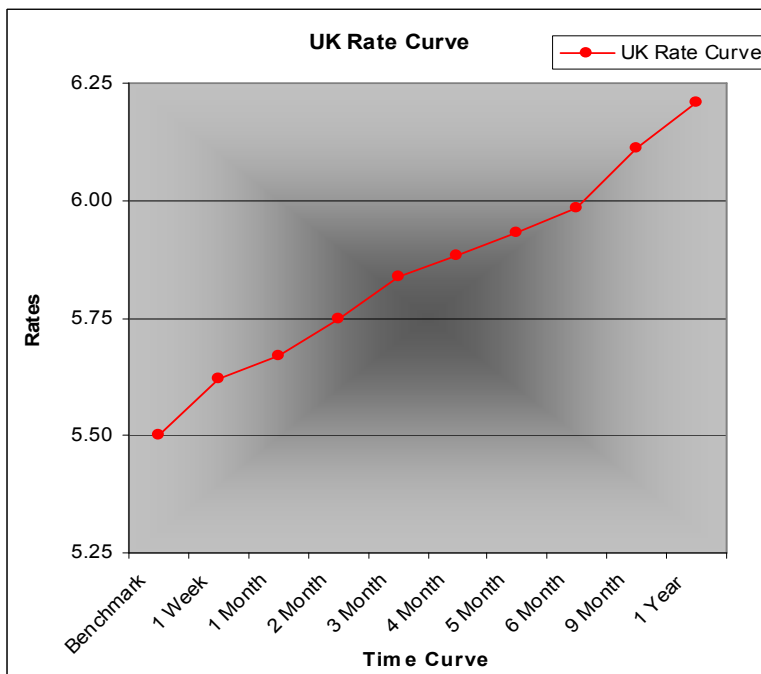
Euro: Chance for 25bp Hike by December

As was widely expected, the European Central Bank raised the area's overnight lending rate by 25 basis points on June 6th to 4.00 percent. However, markets were more interested in the subsequent press conference by European Central Bank President Jean-Claude Trichet, during which he signaled that the central bank would likely stay on hold until the fourth quarter. The first piece of evidence was the elimination of "strong vigilance," Trichet's preferred key phrase used to signal an impending rate hike. While the head of the ECB did note that policy is still on the accommodative side - a decidedly hawkish implication - a softer inflation outlook for the next few months indicates that another round of policy tightening is out of the question in the short-term. Contrary to popular belief the interest rate curve is actually not pricing in a 100% chance for another 25bp hike this year.

Nevertheless, with record low unemployment creating risks that "wage deals will be bigger than expected" and the potential that inflation may "rise at year end", there is a chance for another hike towards the end of 2007.

Bank of England – Next Move Will Be Higher, But When?

UK Interest Rate Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
GBP	5.50	5.620	5.668	5.838	5.984	6.209



British Pound: 25bp Priced in, 6% Rates Possible

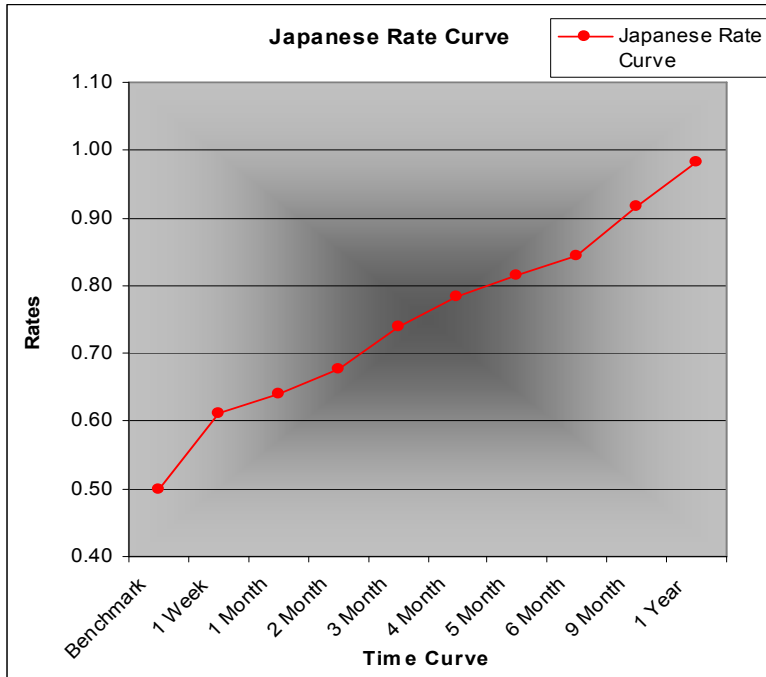
As was widely expected, the Bank of England left rates steady at 5.50 percent on June 7th after hiking 25 basis points in May.

Recent hawkish comments from Bank of England Governor Mervyn King and his fellow policy makers suggest that interest rates could hit 6 percent this year. At the last monetary policy meeting, the committee debated between a 25bp and a 50bp hike, but the central bank wanted to take a more cautious route by waiting to gauge the effects of prior rate increases. This has already worked in the bank's favor, as CPI in the month of May eased back to 2.5 percent from 2.8 percent.

As a result, the Bank of England will probably leave rates steady in July in order to see if inflation slackens once again when the June CPI report is released. However, given the bank's tightening bias, if June CPI fails to fall sufficiently close to the 2.0 percent target, markets are likely to witness a 25 basis point increase when the monetary policy committee announces their decision on August 2nd.

Bank of Japan - Looking For A Hike, But Will The Summer Elections Be A Problem?

Japanese Interest Rates Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
JPY	0.50	0.613	0.641	0.740	0.844	0.984



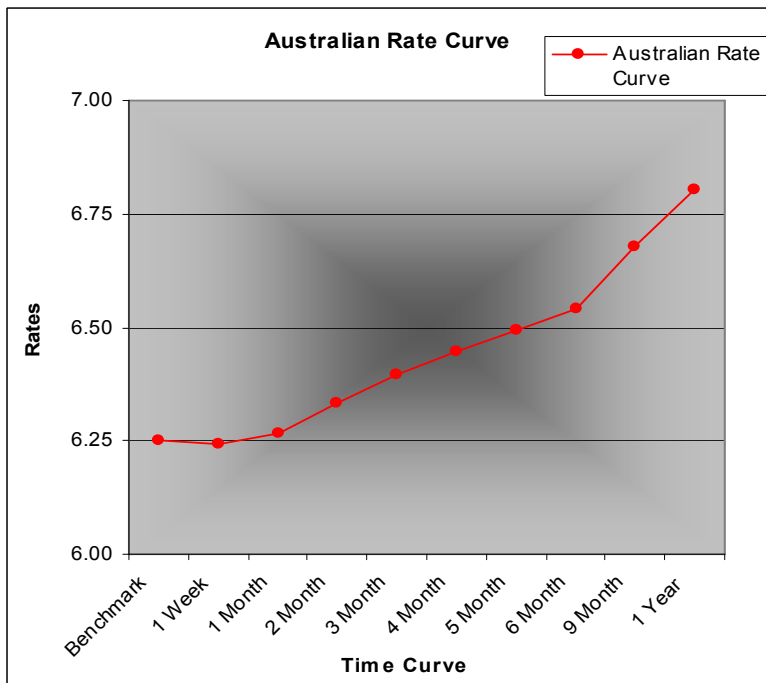
Japanese Yen: One 25bp Rate Hike

For the past four months, the Bank of Japan has kept interest rates unchanged at 0.50 percent - by far one of the lowest overnight lending rates amongst developed countries - after hiking the benchmark 25 basis points back in February. The Bank's neutral stance has not been entirely surprising after CPI has consistently indicated that the Japanese economy is still in deflation. In fact, Tokyo core CPI (excluding fresh food and energy) fell -0.2 percent on an annual basis, marking the third consecutive month of contracting prices.

Nevertheless, BOJ Governor Toshihiko Fukui said after the May monetary policy meeting, "We will adjust interest rates gradually based on the pace of improvement in the economy and prices." The interest rate curve is pricing in one rate hike by the end of the year.

Reserve Bank of Australia – A Consistent Hawk But No Hike

Australian Interest Rate Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
AUD	6.25	6.243	6.265	6.395	6.541	6.803



Australian Dollar: Chance for 25bp Hike

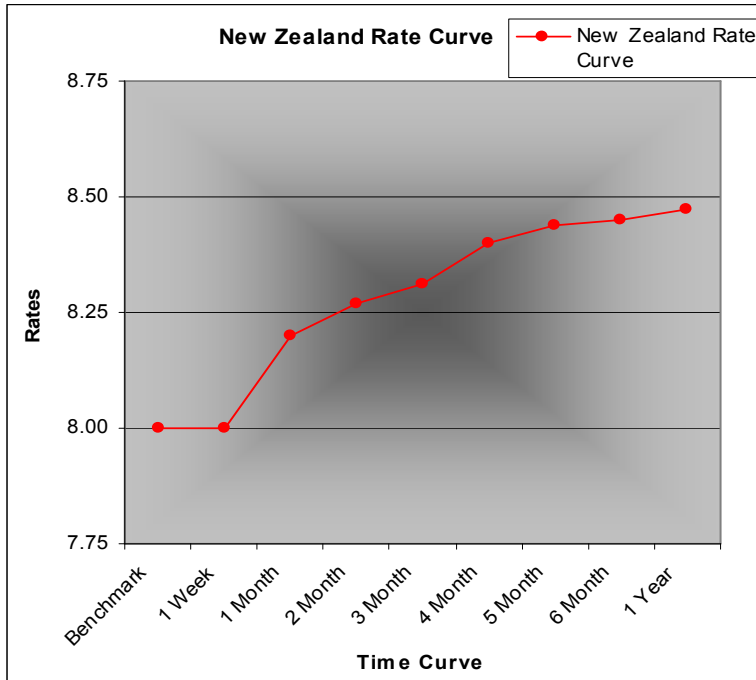
The Reserve Bank of Australia kept the nation's benchmark lending rate unchanged at its 6-year high of 6.25 percent on June 5th. This was the sixth consecutive meeting in which officials left the benchmark rate untouched. Since the policy group headed by Governor Glenn Stevens is charged with keeping price growth within a 1 to 3 percent band, the RBA did not find it difficult to keep lending rate where they were since annual CPI cooled to a 2.4 percent pace in the first quarter. However, despite the central bank's neutral policy position for the first half of 2007, the market is clearly leaning towards a hawkish move from the RBA before the end of the year.

When and if another 25 basis points is on the menu will likely be decided by a combination of inflation and growth. While inflation has cooled in its standard consumer-level gauges, the possibility of a rebound is high. What's more, a strong economy will help bolster inflation. The Australian economy grew 1.6 percent in the first quarter, the most in three years. Taking the lead, consumers are stoking the fire with the help of a 33-year low jobless rate. Though a hike is not expected for the immediate future, the RBA is still a favorite for a steady hawkish outlook.

Reserve Bank of New Zealand – Up to 50bp More This Year

New Zealand Interest Rate Curve

Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
NZD	8.00	8.000	8.200	8.310	8.450	8.473



New Zealand: 25bp Priced in, Chance for 50bp

The Reserve Bank of New Zealand surprised economists when they lifted interest rates 25 basis points to a new nine-year high of 8.00 percent last week. This was the third consecutive rate hike, taking the country's rates to the second highest levels in the industrialized world – second only to Iceland. The increase caught economists off guard, but confirmed what the markets had expected.

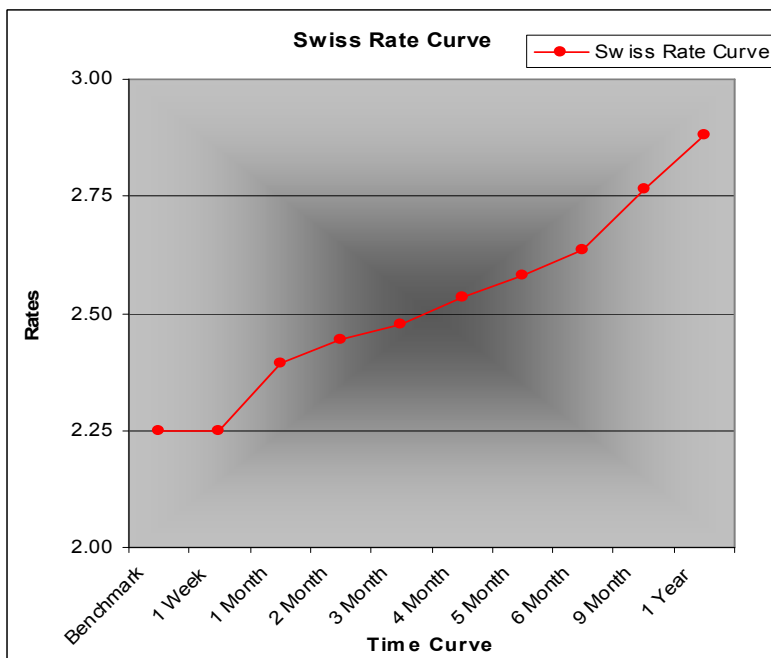
Looking to the next meeting on July 26th, projections are once again diverging. Analysts seem highly skeptical of a fourth consecutive boost in interest rates but the interest rate curve is almost fully pricing in a 25 basis point boost by followed by a good chance of another 25bp hike over the next 12 months.

The policy statement after the June 7th meeting clearly left the door open for another hike citing the threat that consumer spending and housing demand poses for inflation. Given the RBNZ's efforts to deflate the national currency through intervention, it is clear that they are willing to take alternative paths from the monetary policy playbook in order to keep the pressure on inflation.

Swiss National Bank – 25bp Rate Hike on Thursday

Swiss Interest Rate Curve

Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
CHF	2.25	2.250	2.395	2.477	2.636	2.881



Swiss Franc: 25bp Priced in By End of Year

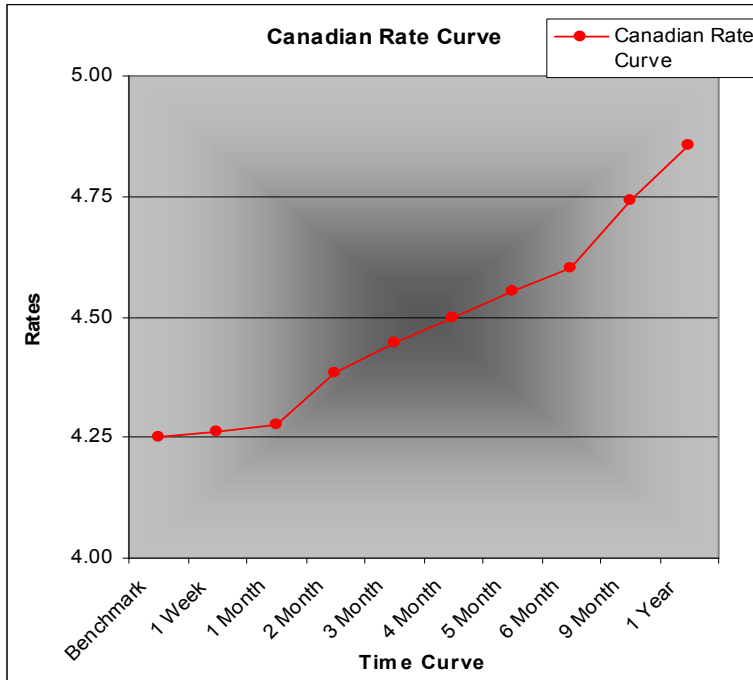
On March 15th, the Swiss National Bank voted to raise interest rates by 25 basis points to a 1.75 to 2.75 percent spread.

In the *Monetary Policy Assessment* that accompanied the decision, officials said the Swiss economy was 'in excellent shape,' signaling that more rate hikes were to come. Since then, government officials have also vocally complained about the weakness of the Franc. This paves the way for another 25bp rate hike on June 14th, which would bring the average rate up to 2.50 percent. According to the interest rate curve, this rate hike is all but expected.

However, it isn't the June rate decision that will guide the Swiss currency, rather it will be the expectations for the September and December meetings and beyond. When the policy group releases its supplementary policy report, analysts will look for rhetoric that does not diverge much from the boiler plate language seen from previous reports.

Bank of Canada – From Neutral to Hawkish in Three Months Flat; Rate Hike in July

Canadian Interest Rate Curve						
Country	Benchmark	1 Wk	1 Month	3 Month	6 Month	1 Yr
CAD	4.25	4.262	4.278	4.447	4.600	4.855



Canadian Dollar: One 25bp Rate Hike Priced In

The Bank of Canada sprung no surprises on May 29th when they left rates at 4.25 percent, but the hawkish policy statement released after the announcement caught the market completely off guard.

The bank said “there is an increased risk that future inflation will persist above the 2 percent inflation target and that some increase in the target for the overnight rate may be required in the near term.” This was all traders needed to hear to adjust their expectations in favor of a July 10th hike to 4.50 percent. Just three months ago, the Bank of Canada said that risks to the economy were balanced, but the central bank has grown increasingly hawkish since then, especially after core CPI for April hit 2.5 percent – well above the 2 percent target. Furthermore, inflation isn’t likely to cool anytime soon as the Raw Materials Price Index surged 3.3 percent for the month of April and will likely feed into consumer prices later in the year. As a result, the Bank of Canada is almost guaranteed to tighten policy in July.

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