

## BANKING ON KNOWLEDGE

## Currency market volatile on account of Fed's monetary policy dilemma

By Dr R Seetharaman

The Dollar Index had weakened by the end of last week to 95.194 as hopes of Fed rate hike had faded due to weak US inflation data which cooled expectations.

US producer prices were flat in August 2015, pointing to benign inflation pressures that could weigh on the Federal Reserve's decision whether to hike interest rates this week. Dollar was near 90 levels at beginning of the year and had surged by more than 5% YTD. It had touched an yearly high of near 100 in March 2015 on account of improvement in US economic data. The Dollar Index had witnessed volatile movements after China's yuan action and had also weakened a bit as hopes of Fed rate hike recede.

The euro had ended last week at \$1.1338 and had gained against the dol-



lar as caution reigned in markets ahead of next week's Federal Reserve meeting and data releases on the Chinese economy. The euro was at \$1.21 at the beginning of the year and had weakened by

more than 6% YTD as ECB began buying €60bn per month. The European Central Bank recently had cut its growth and inflation forecasts, warning of possible further trouble from China and paving the way for an expansion of its already massive €1tn-plus asset-buying programme. ECB President Mario Draghi also said explicitly the bond-buying programme may run beyond September 2016 and the bank may adjust its size and composition.

The pound had ended last week at \$1.5429. It had reached a two-week high last week after the Bank of England suggested that the turmoil triggered by the slowdown in China has not altered its plans to raise interest rates. Last week, the UK monetary policy committee kept rates on hold at the record low of 0.5% and the size of the Asset Purchase Programme at £375bn. The bank also trimmed its UK



growth forecasts for the third quarter from 0.7% to 0.6% and said Britain 'would not be immune' to a downturn in world trade.

The Japanese yen was at 120.59 against the dollar. The dollar had extended gains against the yen but was mostly in a range bound ahead of the Federal Reserve meeting this week. In the BoJ meeting this week it is expected to offer a bleaker view on overseas economies and may lower its assessment on the country's exports. Last October, the BoJ had expanded its annual target for expanding the monetary base to ¥80tn from the previous ¥60-70tn. The

programme has been primarily used to purchase government bonds in an effort to prime the economy and spur inflation.

The emerging economy currencies remained volatile with Indian rupee at 66.54 against the dollar by end of last week and had weakened by more than 5% YTD. The Russian rouble was at 67.99 against the dollar by end of last week and had weakened by more than 11% YTD. The Brazil real was at 3.87 against the dollar by end of last week and had weakened by more than 45% YTD. The Chinese yuan was at 6.3749 against the dollar and had weakened by 2.7% YTD.

Australian dollar was at \$0.7092 and it had touched \$0.72 last week as unemployment fell to 6.2% in August 2015. Australian dollar was at \$0.8165 at the beginning of the year and had weakened by more than 13% YTD on account of slowdown in China and recent Yuan action by China. The dollar gave up early gains against the Swiss franc and was at 0.9692 Swiss franc by end of last week. The dollar was at 0.9939 Swiss franc by beginning of this year and had weakened by more than 2% y-o-y against the Swiss franc.

The Global financial markets witnessed significant swings after the Chinese Yuan action on concerns of a currency war. The monetary policy dilemma of Fed still prevails and has contributed to significant volatility in currency market as well.

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