WEEKLY FX OUTLOOK

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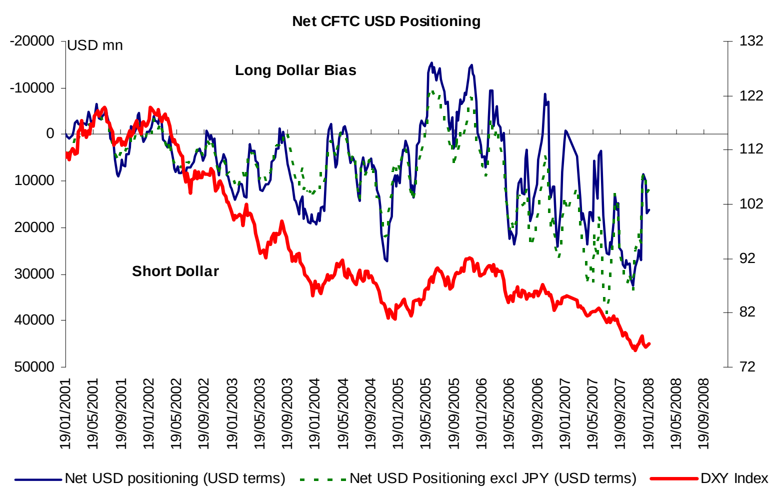
Underlying Themes

28 weeks later…actually 27…

- Twenty-seven weeks after the EUR-JPY topped out near 169 in Jul 07 (in FX space, we think this marks the top before global risk appetite was dragged lower by the sub-prime crisis), risk aversion and de-leveraging heightened to extreme proportions in the past week as rate futures rose, bond yields dropped, short term vols pushed higher (1M EUR-USD above 10%), spreads widened and most visibly, global equities tanked. Markets are apparently unimpressed with US President Bush's call for a fiscal stimulus package – note that short term interest rate futures not only have risen further, but have begun to price in a more extended profile for US rate cuts while the US curve continues to steepen. Note that since our last weekly, the chances of an inter-meeting rate cut may have heightened if the Fed deems such a cut to be a stabilizing force in the markets.

Futures positioning show a retraction of excessive USD shorts



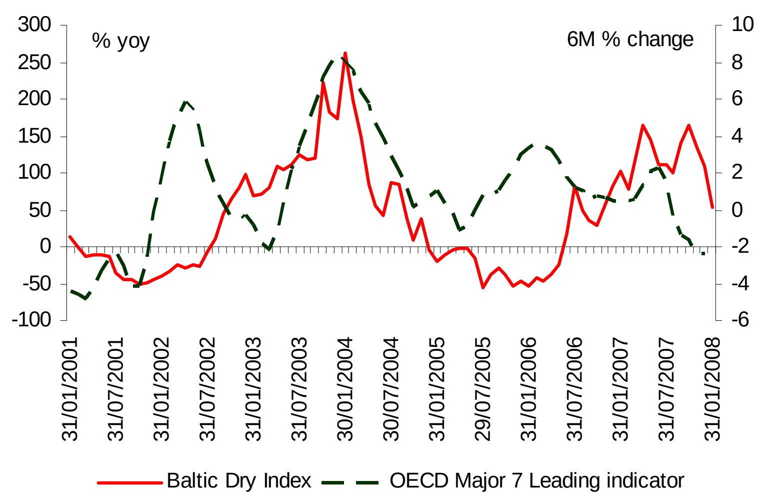
- In the current week, we think these two themes will continue to dominate with a sparse US data calendar – portending further selling in the G10 against the USD (which had already stopped out our prior long NZD-CAD call with a -0.92% drop last). Apart from the ongoing US reporting season, US numbers include: Jan Richmond Fed (mkt:-3) on Tue, weekly initial claims and Dec existing home sales (mkt:-1.0%) on Thu.

Fear of a growth slowdown beginning to hit markets…

- In the interim, the approaching sound of a global slowdown is growing unmistakably louder. In our Dec 07 Monthly FX Outlook, we had warned of pressures from the global economy in capping and perhaps softening commodity prices. In recent weeks, the easing in the Baltic Dry Index presents further evidence of a medium term slowing in the global economy. Going ahead however, we think it may be premature to embark on a major USD revival trade in the near term, given that the magnitude of the US and global slowdown, plus the extent of probable US rate cuts, have still not been not quantified as yet.

- Elsewhere, the BOC is expected to cut 25bp tonight while the RBNZ is expected to stand pat on Wed. Minutes from the latest BOE MPOC are due on Wed while the BOJ today kept rates unchanged today at 0.5%. In the near term, we think that all this counts for naught if the global de-leveraging continues to permeate the market – **we still look for USD-JPY to seek out the 105 neighborhood**.

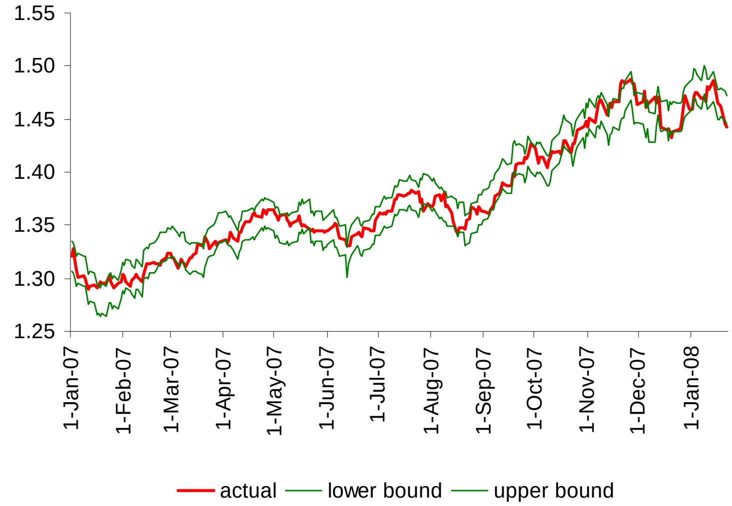
Global growth slowdown on the cards



The ECB and the EUR…

- In the EZ, confidence in the ECB's hawkishness has been pared (note the lower Euribor curve and easier EZ bond yields) as markets begin to work in a lower economic growth profile for 2008. However, we think that the hawks in the ECB may prevail in the current round. Markets will however continue to scrutinize ECB rhetoric in the coming sessions. On the EZ data front, the German Ifo due Thu Taking a closer look at our short term EUR-USD model, we find that oil prices falling below USD90/bbl have paved the way lower for the pair, as have the skew in riskies re-favoring EUR puts as well as futures positioning. We think these factors currently outweigh the degenerating US-EZ rate differentials, although the recent selling in the pair does seem to suggest an overshoot in the making in the near term. **Nonetheless, a sustained break below the 1.4360 area (double top) may open the way lower to a targeted 1.3800.**

Short term proprietary model: EUR-USD overshooting… for now

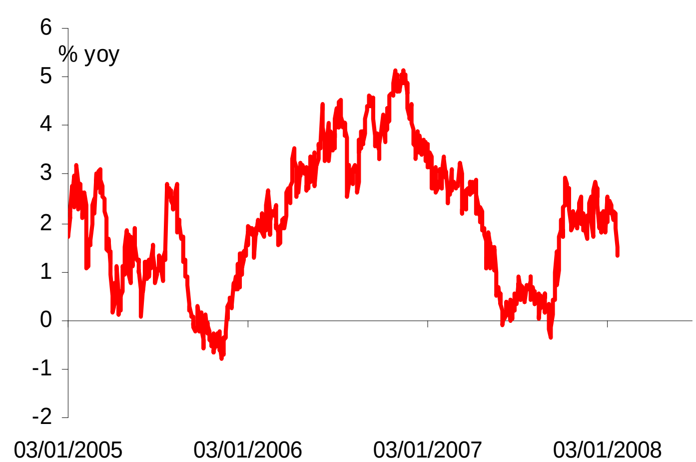


Asia caught up in the current turmoil…

- Our cautious tone towards Asia in last week's Weekly FX Outlook proved particularly timely given the spike higher in regional pairs and slumping Asian bourses in the past week. We think that this trend may remain the path of least resistance in the coming sessions until the market manage to find a degree of stabilization (either from an inter-meeting Fed cut, the ECB talking tough on inflation, or signs of a recovery in the Dow). In the interim, we retain our recommendation for a short 6M **USD-MYR** NDF from 3 Jan 08 (-0.83%).

- We also find it slightly disconcerting that even the **USD-SGD** has reacted to the weakness in regional sentiment, with the pair bouncing past 1.4500 and taking the SGD NEER lower to just 0.4% above its perceived parity. We deem current levels as 'slightly more comfortable' given the prevailing uncertainties towards the state of the global economy.

SGD NEER appreciation may remain more subdued



- On the domestic front, given that domestically-driven price shocks are also contributing to the overall headline inflation figure, we expect further administrative/legislative measures to cap domestic price pressures, with the SGD NEER already performing relatively well in containing imported price pressures. As such, the SGD NEER may not see excessive upside appreciation pressure if global commodity prices remain under wraps in the coming months. This view would be largely in line with our prior view that the SGD NEER would potentially end the year nearer towards parity than at the extreme strong end.

- Elsewhere, despite the recent hemorrhage in Asian currencies, we think our prior call on 10 Jan 08 for an Asian relative basket (**long MYR, INR, PHP vs short KRW and TWD via 3M NDFs**) is weathering relatively well with a -1.09% dip and we expect prospects for this basket to turnaround as sentiment stabilizes.

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