Forex Focus: Risk Is Back On The Menu

By Gary Stride

A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--It doesn't take a genius to note that the sharp risk-off trades that flooded the markets after China unexpectedly hiked rates have already been unwound.

In the immediate aftermath of the People's Bank of China's 25-basis-point hike in both its one-year lending and deposit rates Tuesday, investors sold anything that is oxygenated by global growth.

Commodities sank with gold racking up a $40 decline, the Australian dollar--which only last week hit parity--slid below $0.97 and global equity markets fell sharply.

However, less than 24 hours later all the above are once again in demand.

So why the quick turnaround?

Well, Credit Agricole Daragh Maher says the market's reaction to China's move was bizarre in the first place.

The market seemed to take the view that any move by the authorities to trim growth in China is bad for global growth and risk as a whole.

Not so, says Maher, the hike was likely driven by a greater certainty that China's economy continues to run at too fast a pace, which isn't a signal for the markets to batten down the hatches into some kind of risk-adverse mode.

And the bank's head of emerging market research and strategy Sebastien Barbe concurs, saying that in his view the PBOC has started hiking rates because it is confident growth is solid enough to withstand monetary tightening.

Once the dust settles the markets will reenter long positions in risky assets, added Barbel, a view that has already proved correct.

From a technical point of view, BNP Paribas says the limited falls seen in the Shanghai Composite and crude oil in the wake of China's rate hike suggest that the weakness seen in the commodity currencies will be limited, and that they will probably go on to set new cycle highs later in the fourth quarter.

So as the dust settles, has anything really changed to dim the markets appetite for the risky trades?

Well, interest rate hike expectations in both Australia and Canada have been trimmed back after less-than-hawkish minutes from both The Reserve Bank of Australia and the Bank of Canada this week.

However, over in the U.S. the bulk of Fed policy comments made Tuesday from a flurry of Fed speakers signaled support for more Fed easing, notes Lena Komileva at Tullett's.

And as it's the latter, more than anything else, which has powered investors to search for higher yields elsewhere, the stage looks set for Tuesday's risk-off mentality to be quickly forgotten.

As for targets, well Danske Bank says China's surprise hike will not change risk sentiment and it favors buying euro-dollar on dips with a target of $1.45.

In the commodity currencies, parity again for both the Australian and Canadian dollar may be a little harder to achieve for reasons already stated, however if commodities continue to climb a revisit is likely on the cards.

The dollar made brief gains in Asia Thursday on the back of comments from U.S. Treasury Secretary Timothy Geithner that major currencies are "roughly in alignment now," which the market took as a hint that the dollar had fallen enough.

The dollar spiked to Y81.84 from around Y81.00 while the euro lost almost half a cent to trade below $1.39, although both moves proved only fleeting.

China released a flood of data Thursday which reinforced the logic behind Tuesday's rate hike.

Consumer price inflation rose 3.6% on the year in September, up from 3.5% in August, while producer price inflation remained at 4.3%--it had been expected to slow to 4.1%.

Retail sales posted an 18.8% gain, slightly above forecasts, while headline growth slowed to 9.6% in the third quarter from 10.3% in the second quarter, but still came in above the market expectations of 9.5%.

Around 0645 GMT, the dollar is mixed from late U.S. levels Wednesday.

The euro is up at $1.3963 from $1.3949, the pound is down at $1.5807 from $1.5840 while the dollar is down at Y81.00 from Y81.16.

Bloomberg TNI FRX POV