FOREX FOCUS: Keeping Safe In 2011

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A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--2010 is ending with one very clear message: international investors still don't have much appetite for risk.

Only weeks ago, the story was quite different.

Optimism over the global recovery was on the rise, bond prices were falling and sentiment in currency markets was once again being driven by yield differentials.

Investors appeared keen to buy into risky markets, with commodity currencies heading sharply higher.

Then, the focus was very much on China and whether Beijing would allow the country's economy to continue surging ahead.

With interest rates firmly in the driving seat, risky markets were the place to be.

But this has all been turned on its head again, with investors heading back into safe havens as the year draws to a close.

The trend has been highlighted by the flood of funds out of the high-risk euro into the safe-haven Swiss franc, driving the pair to a steady series of new record lows over the last week.

After its bounce to nearly CHF1.3800 near the middle of October, the euro has now traded as low as CHF1.2493.

The return of market pessimism that has made the franc so attractive has been aided by the ongoing uncertainty over the euro-zone sovereign-debt crisis and the continued risk of contagion.

The level of concern about financial markets in general was driven home by the news on Tuesday that the U.S. Federal Reserve has renewed its dollar swap arrangement with other major central banks until next August. The Fed was obviously not comfortable enough with global liquidity levels to allow them to expire as planned in January.

Rating agencies haven't helped either, issuing warnings over possible euro-zone downgrades next year that will push funding costs among peripheral debtors even higher and increase the risk of sovereign default.

Other reasons for global concern at the end of 2010 include a rise in inflation pressures, not only in China and in some emerging markets that can afford to raise interest rates, but also in major developed economies such as the U.K., where recoveries remain far too fragile to withstand rate hikes.

Should this higher inflation trend continue next year, investors will become even more concerned that global economic growth will have to be stifled at a later stage.

Geopolitical tensions have also become a market driver as the year has drawn to a close with South and North Korea entering an even more dangerous military standoff. The South is expected to ratchet tensions even higher by conducting its largest ever maritime drill on Thursday.

So far, most global equity markets are ending the year on a strong note and the underlying confidence in the global upturn has pushed the price of Nymex crude oil up to two-year highs over $91 a barrel.

But the edginess of the global investor can still be seen in the lackluster performance of the commodity-driven Australian and Canadian dollars, which under different circumstances would have powered ahead as investors showed their preference for risky rather than safe-haven asset options.

Now, both have lost momentum, with the Aussie and its Canadian counterpart failing to establish sustained parity against the U.S. dollar.

Bloomberg	TNI FRX POV
Reuters	USD/DJ
Thomson	P/1066 or P/1074

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