Forex Focus: Time For The Fed To Spell It Out

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A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--If ever there was time for clarity, this is it.

For months now, the U.S. Federal Reserve has been dangling the prospect of further quantitative easing in front of financial markets as its solution to the faltering recovery.

But as this week's nasty fall in the dollar has shown, this is not enough to boost investor confidence any more.

With the European Central Bank still edging ever closer to the exit from its unconventional monetary policy and with the Monetary Authority of Singapore effectively tightening policy in an economy that is seen as a proxy for Asia as a whole, markets are demanding more from the Fed.

At the moment, the best the market can glean is that the Fed will more than likely announce more QE at its next meeting on Nov.3.

And, the assumption is that the extent of the new monetary exercise to stimulate the economy will depend entirely on just how good or bad U.S. economic data is between now and then.

But this is not enough.

As the dollar is sent to new lows against a variety of major currencies, the investment community is making it clear that it needs more from the Fed if the U.S. currency isn't to be whacked even lower in the weeks to come.

Fed Chairman Ben Bernanke will have a key opportunity to provide some clarity when he delivers a speech in Boston later Friday.

The market will be looking not only for details on timing--will it be slow or will it be fast--but also on size. Estimates of the new exercise have been as high as $1.2 trillion but realists suggest that $500 billion is more likely.

There is also the question of targets. Will the new QE be based on nominal GDP growth as some suggest? Will inflation no longer feature as large in the Fed's policy approach?

Of course, the dollar's decline is hardly going amiss in Washington. The extra losses posted this week, which took the dollar index down to a new 2010 low Thursday, will only help the faltering U.S. economy export itself out of trouble.

Also, as the U.S. prepares for the G20 leaders summit in Seoul next month, the administration is probably keen to keep its negotiating cards with China close to its chest, given Chinese Premier Wen Jiabao's refusal to hasten the appreciation of the yuan's dollar peg at the expense of Chinese economic growth.

There could yet be a compromise prepared for G20 with the U.S. introducing less aggressive QE and China allowing the yuan's rise to accelerate.

But while the market awaits this clarity, downward pressure on the dollar is more likely to intensify, possibly taking the U.S. currency even lower and even faster and triggering an even more vicious battle in the global currency war.

Overnight, the market took a breather from selling the dollar even lower and the greenback made a little ground in Asia Friday with regional equity markets mostly lower, which in turn dented market appetite for risk.

However, as early Europe entered the fray, the dollar is once again on the back foot.

Looking ahead, Fed chairman Bernanke's speech in Boston on monetary policy in a low inflation environment (1215GMT) will likely overshadow a crowded U.S. data schedule that include September's consumer price inflation report and retail sales.

Around 0700GMT, the euro trades at $1.4090, up from $1.4071 seen in late U.S. trade Thursday.

The dollar is weaker at Y81.22 from Y81.45 while the pound is higher at $1.6037 from $1.6005.

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