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**Dollar Weakens Against Euro After U.S. Government Warns of Terror Threats**

July 8 (Bloomberg) -- The dollar traded near a three-month low against the euro after the U.S. Department of Homeland Security warned al-Qaeda may attempt terrorist attacks before the Nov. 2 presidential election.

Demand for the dollar also waned as analysts scaled back estimates for U.S. economic growth and the pace of interest-rate increases by the Federal Reserve.

"The allure of higher-yielding currencies elsewhere, combined with this new terrorist threat, makes it easy to sell the U.S. dollar," said **Chris Melendez, president of hedge fund Tempest Asset Management in Irvine, California.** "The jury is still out on the U.S. economy."

Against the euro, the dollar weakened to \$1.2386 at 5:01 p.m. in New York from \$1.2373 yesterday, according to EBS, an electronic trading system. It trimmed gains against the Japanese yen after the terror announcement, trading at 108.96 yen from 108.63 yesterday.

The risk of terror attacks is "increased" during the presidential campaigns, Homeland Security Secretary Tom Ridge said at a press conference. Ridge said the government is not changing the so-called threat level, which now is at yellow, or "elevated."

"Credible reporting now indicates that al-Qaeda is moving forward with its plans to carry out a large-scale attack in the United States in an effort to disrupt our democratic process," Ridge said.

**Higher Yields**

Melendez said higher interest rates and higher-yielding bonds in countries such as Canada favor their currencies. Ten-year benchmark notes in Canada yield 4.72 percent. The 10-year U.S. note yields 4.47 percent.

Melendez said the dollar will weaken to \$1.2620 per euro in coming weeks.

UBS AG cut its forecast for the dollar versus the euro and yen on concern the U.S. will struggle to attract foreign capital. UBS, the largest trader in the \$1.2 trillion currency market, now predicts the dollar will weaken to \$1.24 per euro in a month and \$1.26 in three months, compared with its prior forecast of \$1.22 for both periods.

Ridge's comments added to concern about prospects for the dollar, which have dimmed since Friday's report of a smaller-than-expected employment gain last month.

The figures prompted some analysts to cut their estimates for 2004 growth, bringing the median prediction in a Bloomberg survey down to 4.5 percent from 4.6 percent before the report. The dollar has shed 1.9 percent against the euro since Friday.

**Dollar 'Left Behind'**

Central bank policy makers last week raised their target rate by a quarter point to 1.25 percent, the first increase since 2000. The median forecast in a Bloomberg survey for the Fed's benchmark rate in the first three months of 2005 dropped to 2.25 percent this month from 2.50 percent in a June poll.

"The market has taken out 25 basis points of tightening from the Fed" and "now investors are going back to higher yielding currencies, such as the euro," said Meg Browne, a currency strategist at HSBC Bank USA in New York.

Browne said the dollar will trade between \$1.24 and \$1.25 per euro in coming weeks.

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Confidence in the economy among chief executives in the U.S. slipped from the highest in 20 years in the second quarter, a report yesterday showed.

``We're starting to see hard evidence that U.S. growth is slowing," said Richard Yetsenga, currency strategist in Sydney at Deutsche Bank AG. ``In that environment, the U.S. dollar gets left behind."

#### China and the Yen

The number of U.S. workers filing new claims for jobless benefits fell by 39,000 last week to 310,000, the lowest since October 2000, the Labor Department said. The numbers may be distorted because of difficulties adjusting for seasonal shutdowns at auto plants, according to the government.

In Europe, a German government report showed industrial production rose for a second month in May. Output increased 1.1 percent from April, when it gained 1.4 percent. Economists predicted a gain of 0.2 percent, according to the median of 38 forecasts in a Bloomberg poll.

The yen fell earlier today on concern slower growth in China will hurt Japanese exports and on speculation Japan's ruling Liberal Democratic Party will lose seats in a parliamentary election this weekend.

China's central bank governor, Zhou Xiaochuan, rejected complaints from local officials that steps to cool growth have been too harsh. He said regulators need to maintain curbs on lending that have raised concern imports from Japan will slow.

#### Japan's Election

``Our research shows that 60 percent of growth in Japan in the past period was due to China," said John Rothfield, a currency strategist in San Francisco at Bank of America Corp. ``The Japanese economy isn't strong enough to sustain an independent recovery."

Prime Minister Junichiro Koizumi's party may win fewer than half of the 121 upper house seats up for election, based on polls by Japan's four biggest newspapers this week.

An election defeat may hurt the party's ability to tackle record government debt and implement policies to sustain the longest stretch of economic growth in seven years.

``He could step down; it could lead to short-term vulnerability for the yen," said Marios Maratheftis, a currency strategist in London at Standard Chartered Plc. ``Koizumi has been in charge when the economic recovery has been in place, and the market believes he is the man."

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