

02/19/10 - Dollar Skyrockets after Federal Reserve Increases Discount Rate

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The Dollar surged in value versus the euro after the Federal Reserve surprised the forex market late yesterday by raising a key interest rate. This may be the first stage in rolling back its stimulus packages enacted during the financial crisis.

Economic News

USD ? Dollar Soars after Fed Interest Rate Change

Just after the close of New York trading, the Federal Reserve released a statement saying it would increase the discount rate it charges banks to 0.75% from 0.50%. This is a key interest rate the Fed uses for overnight lending to banks. Also included in the statement was the Fed's position that this change should not affect interest rates and financial conditions for households and businesses and is not a change in the outlook for the economy or for monetary policy.

Immediately after the release of the Fed's statement the markets reacted strongly as traders bid up the Dollar. The EUR/USD fell to a low of 1.3444 from 1.3568 for a 1-day drop of 0.9%.

Market analysts were expecting the move to be made by the Fed, but the interest rate increase was not expected to come so soon. Despite pledges by the Fed to maintain the key Fed Funds Rate at a significantly low level for a considerable time period, the market showed its regard for the rate increase by buying the Dollar.

We may not see a rate increase in the Fed Funds rate for some time as was noted in the statement. However, this shows the Fed is paving the way for a hike in interest rates and the tightening of monetary policy. Just like the Dollar's sharp rise yesterday, we may expect the Dollar to continue to rise on the assumption of higher future interest rates.

EUR ? More Debt Problems for the Euro-Zone

Prior to the release of the Fed's interest rate increase, the EUR was trading lower versus the Dollar. Further bad news was released yesterday in the Euro-Zone economy. A warning from Italy's Audit Court signaled that derivative contracts used by Italian municipal governments could multiply their debts over time.

This report comes at a time when the European Union is already facing headwinds due to the fiscal crisis in Greece. The report has garnered more attention due to swap contracts used by Greece which may hide future monetary obligations from their reported financial statements.

It appears that one bad story after another is coming from the EU. If it is not Greece one day then it is Portugal. If today it is Spain, then it will be Ireland tomorrow. This group of nations has come to be known under the abbreviation as PIGS. The countries appear to be the hardest hit from the global recession and the most fiscally troubled. Now Italy may also be added to this prestigious group. What will we call them now; PGS II?

JPY ? USD/JPY Rises on Fed Interest Rate Increase

The Dollar continued to climb against the Yen, reaching a one-month high after the Federal Reserve raised the interest rate it charges banks on overnight loans to 0.75% from 0.50%. The Fed signaled the higher interest rate was not the beginning of tightening of the monetary policy, but the market reacted otherwise.

The USD/JPY rose to a high of 92.08 from an opening price of 90.94. The EUR/JPY also climbed in yesterday's trading to 124.44 from an earlier price of 123.41.

The rally in the Dollar shows traders what might happen when the Fed does decide to increase the Fed Funds interest rate. We could see another Dollar rally across the board, much as we experienced yesterday. If this is any indication of the future price movements in the major Dollar pairs, it looks as though being long on the Dollar could be the right move.

Crude Oil ? Spot Crude Oil Prices Rise despite Fed Rate Increase

Despite the Fed rate increase, spot Crude Oil prices rose to a five-week high during yesterday's trading. This price increase also came after a rise in Crude Oil inventory numbers. The weekly Crude Oil inventory data released by the Energy Information Agency showed a 3.1M barrel increase in the amount of crude the U.S. holds, significantly higher than the 1.8M barrel market expectation. However, the key data in the report showed distillate stocks fell by 2.9M barrels. The market expected only

a 1.5M barrel reduction. The data helped to increase the price of spot crude oil to a high of \$79.61 from an opening price of \$77.25.

Spot Crude Oil trading should be impacted by the release of two economic data releases due out today. The first report will be Britain's monthly retail sales numbers. The data release is a key economic indicator for the British economy and shows consumer spending along with overall sentiment of the British consumer. The second key economic data is due out from the U.S. Last month's core CPI numbers are expected to be a minute 0.2%. Should the actual number be greater than expected, this could hurt Crude Oil prices, sending them lower to their next support level of \$77.99.

Technical News

EUR/USD

Some correction to the pair's recent downward trend may be expected today. A fresh bullish cross is evident on the 2 hour and 8 hour charts' Slow Stochastic with the 4 hour and hourly RSI floating in the oversold territory signaling an impending upward movement. Going long with tight stops may be advised for today.

GBP/USD

The hourly, 2 hour and 4 hour RSI are floating in the oversold territory while a breach of the lower Bollinger Band is evident on the 4 hour and 8 hour charts. Furthermore, a bullish cross is evident on the 2 hour and 8 hour charts' Slow Stochastic. Going long for the day may be advised.

USD/JPY

The 4 hour, 8 hour and daily RSI are floating in the overbought territory with a bearish cross evident on the daily and 4 hour charts' Slow Stochastic signaling an impending downward movement. Furthermore, a breach of the upper Bollinger Band is evident on the 8 hour and daily charts. Going short for the day may be advised.

USD/CHF

The hourly and 4 hour RSI are floating in the overbought territory with a bearish cross evident on the 2 hour and 8 hour charts' Slow Stochastic. A breach of the

upper Bollinger Band is evident on the 8 hour chart. Going short for the day may be a good choice.

The Wild Card

GBP/AUD

The 2 hour, 4 hour, 8 hour and daily RSI are floating in the oversold territory with a bullish cross evident on the daily and 4 hour charts' Slow Stochastic indicating an imminent upward movement. Forex traders may be advised to go long for the day.

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