Forex Focus: What Chance Of A Sustained Euro Bounce?

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LONDON [Dow Jones]--What are the chances of a sustained euro bounce? Probably fairly small.

What are the chances of concerted central bank intervention to trigger such a bounce? Probably about the same.

The euro's sharp recovery late Wednesday from a fresh four-year low of $1.2143 came about in a market spooked by talk of imminent central bank intervention.

On a day when the German regulator threw the market a curve ball by slapping a naked short-selling ban on government bonds, credit default swaps and the shares of the 10 largest German banks and insurers anything was probably possible.

But in the clear light of another day the size and speed of the euro's recovery against the dollar Wednesday could easily be explained.

The four-year low of $1.2143 came within a whisker of a 50% Fibonacci retracement of the single currency's entire 2000-2008 rally. That level sits around $1.2135.

And Commerzbank AG's technical analyst Karen Jones pointed out that the weekly Relative Strength Index sat at 10, the usual rule of thumb is that a reading below 30 means the instrument in question is oversold while above 70 means the instrument is overbought.

Jones said euro is undeniably oversold against the dollar and she would be surprised to see the rate plummet through such major support when it is already so oversold.

Now it is a well known fact that central banks watch the charts very carefully, and timely intervention can be much more effective than just a stab in the dark.

Add to this the latest data from the Commodity Futures Trading Commission that showed speculative euro shorts stood at record highs and it is no wonder that a strong bout of short-covering added 2% to the single currency's value in under an hour.

As for actual intervention, well Wednesday's trade was muddled by the ever present Swiss National Bank, which bid for the euro around CHF1.4005, and it isn't too much of a stretch of the imagination to think that the SNB used the afternoon's confusion to increase its buying a little as the euro sped to a one-week high of CHF1.4310 for a 3 cent gain on the day.

But as for concerted intervention in euro/dollar, that is unlikely.

As Brown Brothers Harriman's senior currency strategist Win Thin asked, why would the Group of Seven leading industrial nations intervene now?

They didn't bother when the euro was speeding toward $1.60 and getting way overvalued relative to its purchasing power parity, which the Organization for Economic Cooperation and Development estimates is around $1.17. So why would they when the rate is simply heading back down toward its purchasing power parity.

Thin thinks instead that the euro is in for an extended period of trading cheap to fair value, much like it did between 1999-2003, which would certainly not be a disaster and certainly not imply the end of the euro.

Either way says Thin, yesterday's intervention chatter was a good excuse to take profits, but selling into euro rallies will remain a profitable strategy.

Around 0700 GMT the euro is enjoying another bounce after shedding around one cent of its overnight gains in Asian trade Thursday.

The move, at the outset of European trading has no clear catalyst.

"It's surprising, as you would have thought the easiest thing to do today would be to sell the euro afresh," says Daragh Maher at Credit Agricole.

The euro currently trades at $1.2417, down slightly from $1.2428 seen in late U.S. trade Wednesday but well up on its overnight low of $1.2321. The pound fetches $1.4360, down from $1.4459, while the dollar is worth Y91.36, down from $91.78 in late U.S. trade Wednesday.

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