

HIGHLIGHTS

- Dollar was firmer across the board, as the euro was hurt by a combination of 1) failure to follow-through break of 1.60, 2) the likely end to Fed easing, 3) weak German IFO survey, and 4) the shift in ECB tone (see below). The trend should continue in Q2, and so a significant break of 1.60 now looks unlikely. Actual intervention risk appears low, and we note that if policy-makers wanted more bank for their buck, this dollar rally would have been a great opportunity to punish euro longs. Verbal intervention proved effective, though, and we think fundamentals are shifting away from EUR and towards the dollar. Sterling outperformed, but we still think EUR/GBP will move back above .8000. Dollar/yen spiked up, helped by lower risk aversion. With optimism fragile but holding up for now, we see a move to 105.22 (50% retrace of the Dec-Mar drop) in the coming days. Break targets 107.45 (62% retrace) and then the Feb high of 108.60. The biggest losers against the buck on the day were CHF, NOK, DKK, EUR, and NZD. Weak US new home sales, strong US durable goods, and lower than expected weekly jobless claims had little impact on the markets. BRL lost ground to the dollar on somewhat dovish COPOM minutes, while MXN helped by higher than expected mid-Apr CPI. BOC Monetary Policy Review was in line with BOC's post-meeting statement.
- US equity markets ended up on the day on optimism that the worst is over for the credit crisis. Financials outperformed after big US house declared its regular quarterly dividend, while oil-related stocks underperformed on lower oil prices. Asian ADRs fell during North American trading, however, pointing to a weak start for regional stocks today, while Nikkei futures point to slightly higher open for Japan equities. Weaker yen should help Japan exporter stocks.
- US bonds are down on the day, with the 2-year yield up 16 bp and the 10-year yield up 10 bp. European bonds were also down, with 10-year yields up 10 bp in UK and up 4 bp in both France and Germany. Market continues to have lower Fed easing expectations, pricing in 80% chance (vs. 82% Wednesday) of a 25 bp Fed cut in April and no chance of a 50 bp move.

CURRENCY MARKETS

ECB Pres Trichet has finally intervened verbally with a statement that suits the fundamentals. The ECB President warned the firm euro could impact the economy and adopted a slightly less hawkish tone than have his ECB colleagues over the past few days. Trichet said current monetary policy will contribute to the ECB's objective rather than warning rates could move higher. There was no step up the actual intervention ladder however. Trichet voiced concern about the sharp fluctuations of the dollar in the FX market and that it was very important that the US supports a stronger dollar. Over the past month, the ECB chose to remain focused on its inflation mandate by warning of possible hikes, which helped boost the euro to record highs. Trichet's comments take a small step away from that stance.

With all the ECB comments hitting the wires this week, it's worthwhile to note what we view as a change in overall tone. While Trichet is making the headlines, others have also been part of the chorus we've heard this week that is dollar-positive. Stark added that past ECB rate increases are still working through the economy and will have an impact in the coming quarters, another strong implication that rates will be kept steady for now. Also, Michael Bonello said that while there are upside inflation risks, he was quite explicit in noting that with regards to the ECB board, "No one thinks interest rates should be higher than 4%. It's very difficult to make the argument for higher interest rates." Earlier in the week, Noyer had to clarify a statement that was interpreted by the markets as signaling higher rates, saying later that "I would never engage in a discussion about the future path of interest rates, simply because nobody knows" and adding that the 4% rate was appropriate. Is it a coincidence that the change in tone came after the euro breached 1.60, and that so many ECB members are taking a less hawkish tone? We think not, as the subtle change comes just as market participants are pricing in a halt to the Fed's rate cuts, which was a major factor behind dollar weakness/euro strength. We are also seeing some weaker data from the eurozone, so the fundamental picture is slowly but surely starting to move away from favoring the euro. We still downplay the risk of actual intervention in the FX market, however. Indeed, the authorities may not have to, as the simple shift in verbal tactics by the ECB was enough to get a 2 ½ cent move in the EUR/USD exchange rate today. We have already broken the post-G7 low, and the next target is the April low of 1.551 followed by 1.5400 (congestion from March and 38% retrace of the big Feb-Apr move up in EUR/USD).

Minutes from the April Brazil central bank meeting painted a picture of strong domestic demand and above-target inflation, and yet it said that a "significant" part of the rate move has been done. This is similar in tone to the comments that accompanied the decision to hike rates 50 bp this month, when the bank said that "The Committee judges that the decision to immediately materialize relevant part of the basic interest rate move will contribute to a prompt retraction in the risk to inflation and, as a consequence, to reduce the magnitude of the total adjustment to be implemented." The bank clearly feels that frontloading the hikes will prevent having to hike more later, but we disagree. We think rate hikes will be greater than what the market and the central bank are anticipating, and should help USD/BRL continue to make new lows this year. Bottom of a channel in place for USD/BRL since 2005 comes in currently at 1.6290 and serves as a good near-term target. From a long-term viewpoint, we note that the latest World Bank PPP estimate for BRL is 1.4160 for 2008, and convergence between spot and PPP is likely in the coming years. Minutes show that the bank sees strong domestic demand as a significant risk to inflation, which is now seen surpassing its 4.5% target in both 2008 and 2009. While the bank has a 2.5-6.5% tolerance band to work with, allowing inflation to remain above the target for an extended amount of time would hurt its credibility. Actual inflation has been above 4.5% so far in 2008, and was 4.73% y/y in March and still rising. Growth remains strong, while the labor market is tightening and wages are rising. The strong real will help limit some price pressures, but the bank will clearly have to keep hiking. Latest central bank survey shows that the market is still looking for an end-2008 policy rate of 12.75%, which implies another 100 bps of tightening left in the year and a total of 150 bps in hikes during this cycle. With momentum in the economy still strong and price pressures still rising, we think the market outlook is too dovish and we may see another 200-250 bps of tightening for a year-end rate of 13.75-14.25%.

UPCOMING ECONOMIC RELEASES

Korea Q1 GDP out, followed by Japan Apr Tokyo and Mar nationwide CPI. Philippines Feb trade, Singapore Mar IP, eurozone Mar M3, UK Q1 GDP, and Brazil mid-Apr CPI out. Colombia central bank holds policy meeting. For US, only final Apr Michigan confidence out. No major US speakers scheduled for today.

RATES AND RANGES -- at 16:00 ET/21:00 GMT

FROM NY OPEN			INTRADAY RANGES	
MAJORS	16:00/20:00	% Change	LOW	HIGH
EUR/USD	1.5677	-1.3%	1.5638	1.5897
USD/JPY	104.34	0.9%	103.32	104.54
USD/CHF	1.0363	2.1%	1.0143	1.0386
GBP/USD	1.9727	-0.4%	1.9688	1.9885
EUR/JPY	163.57	-0.4%	162.90	164.49
EUR/GBP	0.7947	-0.9%	0.7938	0.8030
EUR/CHF	1.6246	0.7%	1.6111	1.6248

COMMODITY CURRENCIES	% Change	LOW	HIGH	
AUD/USD	0.9399	-1.0%	0.9374	0.9496
NZD/USD	0.7894	-1.2%	0.7864	0.7988
USD/ZAR	7.6975	0.3%	7.6520	7.7973
USD/CAD	1.0143	-0.3%	1.0122	1.0211

FROM NY OPEN			INTRADAY RANGES	
OTHER ASIA	16:00/20:00	% Change	LOW	HIGH
USD/TWD	30.34	0.2%	30.26	30.36
USD/PHP	41.85	0.0%	41.63	42.15
USD/THB	31.57	0.3%	31.41	31.64
USD/IDR	9220	0.1%	9205	9234
USD/MYR	3.1423	0.2%	3.1321	3.1510
USD/SGD	1.3584	0.6%	1.3494	1.3607

FROM NY OPEN		% Change	INTRADAY RANGES	
LATIN AMERICA & NON EU EUROPE			LOW	HIGH
USD/MEX	10.4395	-0.3%	10.4324	10.4950
USD/BRL	1.6733	1.2%	1.6529	1.6750
EUR/CZK	25.19	0.5%	25.05	25.19
EUR/PLN	3.4336	0.6%	3.4082	3.4366
EUR/HUF	252.20	0.3%	250.90	252.58

MONEY MARKETS (3 MTHS)	LEVEL	SPREAD
U.S.	3.03%	---
Euro	4.82%	180bp
Japan	0.85%	-218bp
U.K.	5.85%	283bp
Canada	3.66%	63bp
Australia	7.83%	480bp
New Zealand	9.12%	610bp
Switzerland	2.78%	-25bp

BENCHMARK EQUITY INDICES				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
MSCI - World*	381	-0.3%	-2.6%	-2.6%
MSCI - Europe*	553	-1.2%	-4.2%	-4.2%
MSCI - EAFE	2112	-1.0%	-5.4%	-5.4%
MSCI - Asia Pacific	148	-0.5%	0.0%	0.0%
MSCI - Emerging Mkts	1187	-0.4%	21.1%	21.1%

AMERICAS EQUITY MARKETS				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
Dow Jones Industrials	12843	0.6%	-0.9%	-0.9%
S&P 500 Index	1388	0.6%	-6.2%	-6.2%
Nasdaq Composite	2429	1.0%	-3.8%	-3.8%
Canada Toronto TSE	13966	-0.7%	2.8%	13.7%
Mexico Bolsa Index	31846	0.0%	7.8%	13.4%
Brazil Bovespa Index	64746	-0.3%	31.9%	60.3%

EUROPEAN EQUITY MARKETS				
INDEX	LEVEL	1 - DAY	Y/Y	Y/Y (US\$)
Eurotop (FTSE)	2757	0.2%	-14.9%	-2.1%
FTSE Index	6051	-0.5%	-5.9%	-7.3%
German DAX Index	6821	0.4%	-6.2%	7.8%
French CAC 40 Index	4930	-0.3%	-16.3%	-3.7%
Italy MIB30	34142	0.4%	-20.8%	-9.0%
Swiss MP Index	7461	1.9%	-20.6%	-7.9%

COMMODITY MARKETS	Level	Previous	Change
NYMEX crude (near future)	\$115.87	\$118.30	-\$2.43
Gold (near future)	\$886.80	\$906.20	-\$19.40

BOND MARKETS	Level	Previous	Change
US 2-yr Note	2.38%	2.19%	0.19%
US 10-yr Note	3.82%	3.73%	0.09%
US 30-yr Bond	4.55%	4.49%	0.06%
German 10-yr Bund	4.18%	4.15%	0.04%
UK 10-yr Gilt	4.77%	4.67%	0.10%
Canada 10-yr Bond	3.72%	3.67%	0.06%

MARKET INDICATORS	Level	Previous	Change
VIX Index	19.85	20.26	-0.41
EMBI+ Sov. Spread (prior close)	271bp		

Source: Bloomberg. *These are the 'All Country' World & 'All Country' Europe indices, which cover developed and emerging markets for the respective regions.

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