Forex Focus: The U.S. Isn't Good For Risk Appetite

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LONDON (Dow Jones)--Risk takers beware!

There may be a lot to celebrate at the moment. But there is also still a lot to worry about.

Yes, there is greater market optimism about both the strength of the global recovery as well as the health of the European banking system. News from China, the European Commission and banking regulators over the last few days have all helped to do that.

But there is still one big problem--the U.S.

Data later this week may well show some improvements in manufacturing activity as well as in retail sales, and boost hopes that a double-dip recession can be avoided.

Nevertheless, that doesn't mean the worst is over.

As Daragh Maher, deputy head of global foreign exchange at Credit Agricole in London warned: "In isolation, the U.S. data looks likely to paint a less onerous picture, and should help remove some of the exaggerated terror in the market. But it is hard to see it dismantling the gloom entirely, with the growth in real output still rather lackluster even in these figures. The sense remains that the broader risks to growth are to the downside."

For the moment, though, the market has been focusing on the east and the stream of positive news from China. Not only have recent trade, industrial production and retail sales numbers indicated strong domestic demand, suggesting that China will avoid a hard landing, but new consumer and producer-price data suggest that the recent rise in inflation will be short-lived and that fears of an early Chinese rate increase are probably unfounded.

The fact that China has allowed its currency to be fixed at higher levels in recent days should also be good news for other Asian economies competing with Chinese exporters.

The other good news came from Europe, as global bank regulators finally achieved agreement on increased capital bank ratios that should help to protect the banking system from a repeat of the recent financial crisis.

This has all gone down well in the investment community, especially as the ratios aren't as high as some countries wanted.

A sharp rise in the European Commission's forecast for German growth this year, to 3.4% from 1.2%, has also boosted confidence in the euro zone recovery. Additionally, the fact that Greece will be setting out on a road show this week to drum up support for its new borrowing plans will boost market confidence that the worst is over.

However, it might be wise to remember that there are still considerable risks concerning the health of European banks. German banks may yet require more capital and the threat of sovereign default remains. It isn't that long ago that the cost of insuring the debt of some peripheral borrowers reached record highs.

In the U.S., meanwhile, fears of a double dip haven't gone away.

Only last weekend St. Louis Fed President James Bullard, who isn't known for being particularly dovish, called for the central bank to keep on buying Treasury bonds. In other words, he for one still sees the need for more quantitative easing as the U.S. recovery continues to sputter.

In a separate development in Japan, Prime Minister Naoto Kan has just seen off an attempt by Ichiro Ozawa to topple him. This has left the yen rising to a new 15-year high of Y83.09 against the dollar on the assumption that Kan will continue to hesitate over how to stop its advance. Ozawa had threatened more aggressive policy moves, including direct market intervention.

See how the dollar fell against the yen as Kan's victory became was discounted:

http://www.dowjoneswebservices.com/chart/view/4592

By 0645 GMT, the dollar had fallen back to Y83.14 from Y83.65 late on Monday in New York, according to EBS. The euro was also down at Y107.33 from Y107.66.

The euro was also down at $1.2862 from $1.2873 as the market now waits to see how well Greece fares with its latest auction of 26-week bills later in the day.

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