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Special Report

Dollar Falls; U.S. Factory, Jobs Data May Show Slowing Economy

By Ron Harui and Chris Young

Jan. 2 (Bloomberg) -- The dollar fell to its lowest in two weeks against the euro on speculation reports will signal the U.S. economy is slowing and European growth is accelerating.

The U.S. dollar slid against 15 out of 16 most actively traded currencies on expectations data this week will show manufacturing growth stalled and job creation slowed, bolstering the case for the Federal Reserve to cut interest rates.

Reports due today and tomorrow may show Europe's factories expanded and German unemployment dropped, adding to signs the European Central Bank will raise borrowing costs.

"The Fed will cut interest rates and the U.S. rate advantage will erode, weighing on the dollar," said Harvinder Kalirai, head of research in Sydney at State Street Corp.

The dollar fell to 118.68 yen as of 3:36 p.m. in Tokyo compared with 119.01 in

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2	USCI-WORLD PRFCI	33.71	11.13	96.30	101.00
3	INDONESIA FUND	7.90	15.49	10.00	101.00
4	ABERDEEN N DAWN	2.53	10.75	10.00	101.00

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New York late yesterday. It dropped to \$1.3244 per euro, the weakest since Dec. 20, before trading at \$1.3242 from \$1.3174. The U.S. currency has declined 1.1 percent versus the euro over the past week amid Christmas and year-end holidays in many countries. It will slide to \$1.35 in the next three to six months, Kalirai forecast.

Movements may be exaggerated and trading volumes will be "about 50 percent" below average today because of a public holiday in Japan and as U.S. financial markets observe a national day of mourning for former President Gerald R. Ford, said Robert Rennie, chief currency strategist at Westpac Banking Corp. in Sydney.

U.S. Reports

A report from the Institute for Supply Management tomorrow will probably show U.S. manufacturing didn't expand last month, after contracting for the first time since April 2003. The survey may show a reading of 50, the dividing line between expansion and contraction, for December, compared with 49.5 in November, according to a Bloomberg News survey of economists.

Employers in the U.S. added 115,000 workers to their payrolls in December, ending a quarter in which job creation was the slowest in three years, according to the median estimate of economists surveyed by Bloomberg before the Jan. 5 report. The economy created 132,000 jobs the previous month.

Economic expansion in the U.S. slowed in the second and third quarters last year, government reports show. Growth in gross domestic product was 2 percent in the third quarter and 2.6 percent in the second quarter.

By contrast, growth in the euro region was 2.7 percent in the third quarter and 2.8 percent in the second quarter. The Eurostat in Luxembourg releases the final

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estimate of third- quarter GDP next week.

The Fed has kept its overnight lending rate unchanged at 5.25 percent at its past four meetings, ending a two-year cycle of borrowing-cost increases. Interest-rate futures indicate the odds of a quarter-percentage-point rate cut by March were 17 percent on Dec. 29, up from 11 percent on Dec. 15.

Japanese Investors

Gains in the yen may be limited by speculation Japanese investors will keep seeking higher yields overseas. The yield gap between benchmark two-year U.S. and Japanese bonds has widened to the largest in almost two months.

There is still a `` tremendous weight of the Japanese selling the yen to buy foreign assets," Westpac's Rennie said. `` The yen will remain weak."

The yen may fall to 120 against the dollar and 160 per euro this month, he said.

The yield premium investors earn on benchmark two-year U.S. bonds over similar-maturity Japanese debt was unchanged today from 4.01 percentage points, the highest since Nov. 16, 2006.

The euro earlier rose to a record against the yen before reports that may add to signs the European Central Bank will raise rates faster than the Bank of Japan.

All-Time Euro High

The jobless rate in Germany fell to its lowest in more than four years in December, a government report tomorrow may show, according to a Bloomberg survey of economists. Royal Bank of Scotland Group Plc may today say its European manufacturing index rose to 56.8 from 56.6 in November, according to the median of 25 estimates in a Bloomberg News survey. A reading above 50 indicates growth,

a separate survey shows.

The euro last year gained the most against the yen since its debut in 1999 as the ECB raised interest rates five times, compared with a single increase by the Bank of Japan.

``The ECB look like they'll keep pushing up rates," said Matthew Jones, a senior currency dealer at Custom House Global Foreign Exchange in Sydney. ``On the other hand, Japan's recovery is very slow and expectations of interest rate rises are minimal."

Europe's single currency rose as high as 157.24 yen, before trading at 157.13 yen.

The euro will rise to 160 yen in the second quarter, he said.

The euro, shared by 13 countries in the region since Slovenia adopted it yesterday, advanced last year against 13 of the 16 most-actively traded currencies tracked by Bloomberg. It rose 12.6 percent against the yen and 11.4 percent versus the dollar.

The ECB may have to increase its 3.50 percent key interest rate in 2007 or risk inflation if growth continues at the current pace, ECB Executive Board member Lorenzo Bini Smaghi told Il Messaggero in an interview published Dec. 31.

The Bank of Japan will probably wait until it assesses market conditions before it decides whether to raise its 0.25 percent benchmark rate in January, Nikkei English News reported on Dec. 29, without saying where it obtained the information. Governor Toshihiko Fukui said Dec. 25 that recent inflation and consumer spending information has been ``somewhat weak."

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