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GLOBAL MARKETS-U.S. stocks rally, all eyes on Fed's FOMC

Wed Aug 12, 2009 1:10pm EDT

* Federal Reserve policy meeting in focus

* U.S. stocks rally on earnings

* U.S. dollar, Treasuries down ahead of Fed (Updates with U.S. market activity, changes byline, dateline; previous LONDON)

By Manuela Badawy

NEW YORK, Aug 12 (Reuters) - U.S. stocks were higher on Wednesday while the dollar and government debt eased ahead of the conclusion of a Federal Reserve meeting that could shed light on the state of the U.S. economy.

U.S. equities gained with the Dow Jones industrial average .DJI up 1.43 percent, The Standard & Poor's 500 Index .SPX up 1.37 percent, and The Nasdaq Composite Index .IXIC up 1.74 percent on positive earnings from homebuilder stocks and a rally in technology shares.

The Fed finishes a two-day policy meeting later on Wednesday, with expectations it will leave benchmark interest rates near zero and let a $300 billion quantitative easing program to buy Treasury securities expire in September as economic gloom lifts.

"When the Federal Open Market Committee releases its report this afternoon, Fed watchers will zero in on changes in the wording of the release, looking for any suggestion the committee has changed its view on recovery," Gerald O'Driscoll, senior fellow at the Cato Institute said in a note.

But after a report showing U.S. firms continue to cut inventories as they lack confidence in the economy, analysts expect the Fed will try to dampen speculation about higher interest rates while still supporting hopes that the makings of a recovery are at hand. Its statement is due at about 2:15 p.m. EDT (1815 GMT).

"Disinflationary forces are still at work in the economy, and Chairman Bernanke has indicated he is disinclined to raise rates so long as these forces are at work. Given this stance, the FOMC will not change its target range for overnight interest rates," O'Driscoll added.

The focus on the Fed overshadowed a U.S. Commerce Department report that indicated the U.S. trade deficit widened in June to $27.0 billion, as goods imports increased for the first time in 11 months on higher oil prices. [ID:nN11326860].

U.S. crude oil prices CLc1 were up $1.22 at $70.66 a barrel as traders followed the rise in the stock market for guidance despite government data showing domestic oil inventories rose more than expected last week.

U.S. Treasury debt prices fell as the rally in U.S. stocks curtailed demand for safe-have bonds, while traders made room for a record $23 billion in 10-year government note supply to be auctioned in the afternoon.

The benchmark 10-year U.S. Treasury note US10YT=RR was down 20/32, with the yield at 3.749 percent.

The dollar slipped from a 1-1/2 week high against the euro to trade at $1.4230 per euro EUR=. Against the Japanese yen, the dollar JPY= was up 0.06 percent at 96.02 from a previous session close of 95.940.

Sterling reversed early losses and rose 0.3 percent to $1.6537 GBP=D4 after The Bank of England said inflation will be well below a 2 percent target in two years if interest rates rise in the first quarter, suggesting markets have been pricing in rate increases too early. [ID:nLC556026]

World stocks as measured by MSCI .MIWD00000PUS were up 0.89 percent with emerging market equities .MSCIEF dropping 0.49 percent.

In China, Shanghai's bourse .SSEC dropped 4.7 percent. A similar tumble occurred at the end of July and while Chinese stocks are notoriously volatile, investors were nonetheless jittery about the market.

The pan-European FTSEurofirst 300 index of top shares rose 1.06 percent on good earnings reports from Germany's E.ON (EONGn.DE: Quote, Profile, Research, Stock Buzz), the world's largest power generator, France's EDF (EDF.PA: Quote, Profile, Research, Stock Buzz) and Spain's Iberdrola (IBE.MC: Quote, Profile, Research, Stock Buzz). [ID:nL0124017].

Earlier, Japan's Nikkei .N225 closed down 1.4 percent. (To read Reuters Global Investing Blog click here; for the MacroScope Blog click on blogs.reuters.com/macroscope; for Hedge Hub click on blogs.reuters.com/hedgehub)

(Additional reporting by Jeremy Gaunt in London, Nick Olivari and Richard Leong in New York, editing by Andrew Hay)