

Monday 3rd March 08

Euro moves to new highs

With continuing weakness from the US economy Sterling moved higher against the US dollar last week to highs of 1.9972 however lost ground against the Euro to the lowest levels seen since the euro was launched in 1999. Further gains were kept in check by a lack of confidence in the financial sector given poor earnings figures from high street banks including a \$16 billion write-down on the part of HSBC and news that a prominent London based Hedge Fund managed by a former Goldman Sachs magician has decided to shut up shop after losing substantial amounts of money thanks to credit crunch falls.

Sterling data failed to provide any upward swell as most releases came out at consensus values. BBA mortgage approvals rose however mainly down to an increase in remortgages as supposed to new inflows into the housing market. This followed the news that house prices fell by 0.5% in January in a survey published by the Nationwide Building Society which launched a panic in the Daily Mail readership.

Looking ahead, economic sentiment and hard data points towards a gradual easing of UK monetary policy throughout 2008 however we and the market believe that this month will see Mervyn King and the MPC hold rates at 5.25%. Speeches given by MPC members gave an impression that they were concerned more about inflation than the lack of growth in the UK economy with Rachel Lomax, the deputy governor, going as far as to say that there is the distinct possibility that 'lenders are caught in the largest ever peacetime liquidity crisis'. She followed this with "But while sophisticated economic models are unable to identify the extent of the current credit crisis, consumers can stick to the tried-and-tested model of living below their means. And doing so sooner rather than later will help cushion the blow."

The rates decision is the only piece of tier 1 data this week with BRC shop prices and PMI services the only other releases; both scheduled for Wednesday.

The week ahead

As it always seems to be, the bulk of data this week will be coming from across the pond. The US Non-Farms Payroll change is the obvious key announcement and in my personal opinion could, if it differs far enough from the market consensus of 25k, be the catalyst for a GBPUSD push above 2.00. We will get a fair indication through Wednesday's ADP employment figure and Thursday's initial jobless claims as well.

Along with the BOE we will have the ECB's rate decision on Thursday. A hold at 4% is forecast but any adverse readings from Tuesday's EMU PPI or Wednesday's retail sales figures could see Jean-Claude Trichet dial back the hawkish rhetoric.

<u>Currency Rates</u>	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPEUR	1.3022	1.3305	1.3066

Euro was the talk of the town last week as it made all time highs against the USD and GBP. Although these gains were mainly down to their opponents' weaknesses some strong Euro data did help out. The German IFO index made an unexpected jump to 104.0 and German retail sales also made a 1.6% recovery. As with all economies recently inflation forecasts rose while their growth counterparts fell. We forecast a hold on € rates this week although as always Trichet's comments afterwards will give us a clue as to his policy weakening mindset.

GBPUSD "Cable"	1.9614	1.9972	1.9844
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The main story in FX circles last week was the surge in EURUSD. EURUSD is the most traded FX contract in the world and significantly weaker US economy prospects saw it move into record territory. Consumer confidence fell to a level not seen since 2003 with expectations the lowest since 1991 while house prices in December fell by 9.1%, putting our 0.5% fall in perspective. Ben Bernanke gave his semi-annual testimony to the US congress on Wednesday and Thursday and further weakened dollar by clarifying that the Fed is more preoccupied with the lack of growth in the US economy than an inflation problem. With Bernanke confirming that the US economy is in a worse condition than it was before the 2001 recession we are pricing in a 50bps cut on the 18th March.

Commodity currencies

	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPAUD	2.0944	2.1343	2.1225

Strong surges in the price of gold and oil lifted commodity currencies none more so than AUD. AUD rocketed to the highest level in 24 years against USD as the familiar story of American weakness continued to weigh. No major data announcements shaped the movement apart from continued belief that the RBA will hike once again to 7.25% in the early hours of Tuesday morning.

GBPNZD	2.4080	2.5022	2.4880
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Kiwi dollar continued its bullish run last week as it charged through record highs against the USD and moved within touching distance of a 2 year high against GBP before profit taking kicked in on Friday. In partnership with the Aussie dollar, high yielding currencies have benefited from increased participation in carry trades with news that US based bond insurers, which have been crucified after defaults in the subprime housing sector, may be subject to rescue plans which in turn saw sentiment increase in riskier assets.

	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPCAD	1.9308	1.9907	1.9508

Crude oil was the medicine the loonie needed last week as it moved to 3 month highs against USD. Given the US buys more oil from Canada than it does from Saudi Arabia, any significant movement in the price of crude will see CAD move ferociously. We could have seen it move higher were it not for the belief that further rate cuts may be sought at the BOC's March meeting.

GBPZAR	14.709	15.573	15.633
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South African rand is one of the most volatile currencies we trade here at World First and last week was no exception. Continuing problems in SA's electricity industry has caused one of the country's leading gold miners to warn that up to 25% of production could have been lost in Q1 alone. Friday was the day where ZAR was battered as fears of a global slowdown in the US hurt currencies with large current account deficits. This is down to the fact that South Africa is borrowing large amounts of money to finance its expenditures and will not be exempt from the global recession forecasters are predicting.

Produced by Jeremy Cook (j.cook@worldfirst.com) Please feel free to contact me at anytime regarding these briefings, if you have any questions or thoughts on them, or if you are interested in a particular event in the calendar.

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Notes:

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Any rates given are interbank and therefore for amounts of £5million and so are not indicative of rates offered by World First for smaller amounts.

Definitions

Bull/Bullish: one who thinks a market, currency or asset will appreciate

Bear/Bearish: one who thinks a market, currency or asset will depreciate

Pip: the fifth significant figure of a currency price: 1.234**5**

Big figure: the third significant figure of a currency price: 1.2**3**45

Basis point: a 0.01% unit

Tightening (Interest Rates): raising interest rates (loosening is opposite)

Hawkish: comments that suggest interest rate tightening i.e. moving higher

Dovish: comments that suggest interest rate loosening i.e. moving lower

MPC: Monetary Policy Committee, the body that sets UK interest rates

ECB: European Central Bank, the body that sets the Eurozone interest rate

RBA: Reserve Bank of Australia: the central bank of Australia.

Cross-Currency Pair Flow: Where a set of three interlinked rates, e.g. GBPEUR, EURUSD and GBPUSD, move as any combination of two of these rates must produce the third in order to satisfy a condition known as No Arbitrage. If there are movements in two markets, then the third must move deterministically. Also known as triangulation.

Carry Trade: Simply put, is the borrowing of money in a low interest economy (Japan) and investing it in a higher yield economy (Australia). This yields a certain profit unless the interest rate differential narrows or the exchange rate moves such that it costs more to buy the currency back.

Fair Value- Also called financial fair value: A measure of the theoretical exchange rate using certain Macroeconomic models (such as eCIP).

Underlying Inflation: A somewhat academic measure of long-term inflation- removing all the 'interesting' elements like energy and luxury consumption leaving the 'boring' elements like utility bills and food. [Quotes from BoE governor Mervyn King]

Interest Rate Traction: Although there is a group of people who announce an interest rate, it has to feed through the economy through some very complex and poorly understood channels. Once rate hikes are having an effect on inflation and long term yields it is said that they are finding traction with the economy.

Unemployment rate: The percentage of people who are able and 'willing' to work (i.e. in the labour force) who are not employed.

Participation rate: The percentage of the population of working age in the labour force.