

Monday 10th March

Sterling dependent on Darling

Depending on your contract of choice last week was either a welcome respite or a complete howler as Sterling made its 2008 highs against the USD but fell to new all-time lows against the EUR. With Mervyn King and the MPC deciding that a rate hold was the most suitable course of action for the UK economy and thus aiming at a controlled slowdown or 'soft landing', further volatility will be an issue.

The UK economy painted a mixed picture last week as a combination of positive and negative data was released. Both PMI indices, manufacturing and services, showed increases inline with growing optimism in both sectors and both price indices also showed expansion. On the downside the Halifax Bank, the largest mortgage lender in the UK, reported that house prices fell by 0.3% in February along with further falls in UK consumer confidence and retail spending figures.

Although we have few UK focused announcements this week, none has been more anticipated from a political or economic standpoint than Alistair Darling's first Budget as Chancellor which will be released at 12.30 on Wednesday. With most commentators focusing on the fight between the government and the CBI over the tax status of the so called 'non-doms' and Darling's own desire to emerge from behind the shadow of Gordon Brown little is being made of the FX ramifications. We see that should the Budget be beneficial for homeowners that the Bank of England may not need to cut rates as drastically as previously thought so as to keep the inflation problem in check. This will in turn support sterling against most crosses. Although we will be focusing on these economy boosting measures and fully expect growth to be downwardly revised, Darling does not have much room for manoeuvre.

Today's UK PPI data is expected to show pressures not seen since the early 1980s as the price of producers' baskets of capital and consumer goods continues on an inflationary path and we could see further pain for mortgage holders as both the Royal Institute of Chartered Surveyors and the Department of Communities and Local Government both report house price data.

All in all we expect GBP to stay in and around current levels against the main crosses with possible further upside against the USD as, at the time of writing, rumours abound over a possible second intermeeting cut in the Fed rate by a possible 50bps.

The week ahead

The US data announcement of note will be Friday's CPI figure and I think it may not show the jump anticipated as although US WTI Crude Oil once again broke through record levels the price of gasoline at American forecourts has stayed relatively stable. Any news will of course be monitored by the Fed however inflation at the moment is taking a back seat to concerns over a lack of growth.

Euro interest will be confined to the German ZEW economic sentiment release which is expected to hold at around -40.0 showing that at least 40% of analysts polled anticipate the European economy to deteriorate in the next 6 months.

<u>Currency Rates</u>	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPEUR	1.2997	1.3152	1.3133

With the USD sliding Euro was the currency to capitalise as it moved higher to records against sterling and the greenback. Jean-Claude Trichet and the ECB decided unanimously to hold rates at 4.0% and in a notable split from Fed Chairman Ben Bernanke will focus their efforts on controlling inflation in the Eurozone as supposed to stimulating growth. This forced many to rethink their euro strategy as most were hoping for at least some minor nod towards a weakening in the near future. Trichet also continued his policy of not commenting on the currency markets at his Thursday press conference angering some industry bigwigs who had voiced concerns over euro strength and its subsequent detrimental effect on their export markets.

Trichet's job is regarded as the hardest of the central banker's due to the multiple individual economies that must be factored into the decision making process. Certain countries are feeling the pain more than the Eurozone as a general; Spain and Italy's PMI indices both showing recession like conditions however neither of these readings could stop the single currency's strong march.

GBPUSD "Cable"	1.9720	2.0217	2.0157
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As predicted USD was not afforded a moment's respite against the Euro and GBP last week as further records were shattered. Euro moved higher than 1.54 briefly and Sterling consolidated above the 2.01 level after a slew of dollar negative data.

Wednesday's ADP employment release signalled that we would see a drop in the US jobs market but very few forecast the downward shift that was realised; Consensus views were in and around the +25k mark for Non-Farms with an actual figure of -63k published by the Bureau of Labor Statistics.

This was by no means the only negative announcement as every release be they regarding costs, prices, employment or growth all seem to point to a recession in the US. The US PMI survey moved below a reading of 50.0 signifying a contraction in the manufacturing and services sector and further denting confidence. With further confirmation that the Fed is more worried about the US slowdown than any ensuing inflation, rumours abound over a more drastic cut by the FOMC on the 18th March as some polls show 30% of analysts expect a full 1% cut taking the rate from 2.0% from 5.25% in the space of 7 months.

Commodity currencies

	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPAUD	2.1062	2.1830	2.1932

The RBA proved to be nothing if not predictable by rising rates by 0.25% to 7.25%, the highest in the developed world. The market from Tuesday morning gorged on the high yielding Aussie further pushing it towards parity with the USD reaching an all-time high of 0.95 before relaxing to consolidate in and around 0.93 due to profit taking. This strong yield will see it the main target for carry trade participants however in these days of global unease should participation in risky trades dwindle so could the AUD's value.

	<u>Low</u>	<u>High</u>	<u>Current</u>
GBPNZD	2.4515	2.5501	2.5489

Kiwi dollar had a fairly torrid time last week as global equity market falls hurt carry trade participation. NZD which was the currency of choice for said bets weakened consistently with the only fillip coming from the post RBNZ decision statement. Although they decided to hold rates, they gave an indication that the inflationary climate has not dissipated and that cuts will have to wait until H2.

GBPCAD	1.9488	1.9998	2.0015
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With further increases in the price of a barrel of oil it is little surprise that CAD had a strong week against its American counterpart. Although the BOC did cut by the estimated 50bps and signal that further cuts may be needed in the near future a sharp deterioration of the loonie did not follow. Although some domestic data, GDP down 0.7%, did disappoint the influx of funds for the purchase of booming commodities will hold CAD in good stead for the short term

GBPZAR	15.253	16.292	16.098
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Most emerging market currencies have had a terrible time over the past couple of weeks none more so than ZAR. Data told the now familiar story of rising inflation and falling growth as PPI accelerated to 10.4% with notable increases in the agricultural and manufactured food sectors. With the next SARB now not meeting until the 9th of April we will focus on Tuesday's retail sales and manufacturing output data with estimates that both values that will fall.

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.

Please call us on 0800 001 5055 if you have any questions or would like to discuss the markets.

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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.