

Tuesday 25<sup>th</sup> March

## **Market Jitters Hurt Sterling**

The title of last week's report was 'There may be trouble ahead'; little did we know that sterling would feel the effects so quickly. Much like the commodity currencies' propensity to whipsaw violently due to sometimes small movements in the gold and oil markets, sterling has become the currency world's punch bag for financial sector concerns due to the UK economy's exposure to the financial services arena. Figures published at the beginning of the year show that this sector contributes 9.4% of UK GDP alone.

Bear Stearns' capitulation was the obvious drag however we nearly had another UK casualty or some would have us believe. Wednesday morning saw the city wires alight with rumour, suggestion and intrigue that a UK bank was due to go to the Bank of England and use it as a lender of last resort with further digging suggesting that it was HBOS, the parent company of Halifax and the UK's largest mortgage lender. This however eventually turned out to be a load of rubbish and the FSA is currently investigating suspicious activity in the trading of the bank's shares. In the ensuing panic most High St. banks' shares tumbled. Even though this turned out to be the act of a few unscrupulous individuals, it served as a warning for all sterling watchers.

Last week was an example of style over substance; a market influenced by rumour and fear more than the underlying fundamentals. If this had been the opposite we could have seen sterling higher. The data that garnered the most headlines was the rise in retail sales which posted a 1.0% increase against a forecasted -0.2% fall. This, combined with CPI rising to 2.5% on the back of increased food prices, falls in the unemployment rate and the CBI announcing export order levels at the highest level since 1996, paints a picture of an economy moving itself away from a recessionary problem.

The Bank of England also released the minutes from its March meeting showing a voting record of 7-2. Perennial dove David Blanchflower as expected voted for a 25bps loosening but was joined by the Deputy Governor John Gieve which surprised the markets and weakened GBP momentarily.

The pick of the data will be Friday's current account release which given the recent drop in the value of sterling should see a healthy strengthening from -£20bn.

## **The week ahead**

Much of this week's US data is focused on consumers and the labour market. Today we have a consumer confidence figure due to fall as this is the first reading since Bear Stearns' catastrophic fall from grace and the ensuing scramble for liquidity. Friday's Michigan Consumer confidence figure is due to follow the same path.

Most European data this week is from its largest economy, Germany. Tomorrow German IFO business climate data is due followed by consumer confidence figures on Thursday. These are expected to be on the upside and may solidify the single currency's strength given the lack of intervention from Jean-Claude Trichet.

<u>Currency Rates</u>	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPEUR</b>	<b>1.2664</b>	<b>1.2883</b>	<b>1.2811</b>

The euro continues to exert considerable pressure on sterling and dollar although weakness has been seen against 'safe haven' currencies and JPY and CHF. The only piece of definitive data last week were the 'flash' PMI figures which although were published above the 50.0 expansionary figure were lower than market forecasts, solidifying thoughts that the Eurozone economy is due a slowdown with exporters bearing the brunt especially.

Central Bank committee members once again expressed concern over the sharp rise and continued elevation of the euro in particular against the dollar however this may be all talk and no trousers as intervention seems ways off.

<b>GBPUSD "Cable"</b>	<b>1.9734</b>	<b>2.0270</b>	<b>1.9937</b>
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The dollar continues to ricochet between relapse and recovery as it again moved lower against the euro but strengthened against GBP last week.

As we expected the Fed thought a 75bps cut was the right option to reinvigorate the ailing US economy. This takes the rate to 2.25%, some analysts believed that a cut of 100 or even 125bps was needed however Ben Bernanke and other policy makers shied away from this due to inflationary concerns.

Ben Bernanke has been very active in loosening money markets stateside in order to increase liquidity and counteract the recent reticence lenders have been experiencing. One such measure saw the iconic Freddie Mac and Fannie Mae, both US government sponsored enterprises, to take on close to \$200bn worth of distressed mortgages and pump funds back into the system.

Wall Street has contributed a fair share to the dollar's woes but impressed last week as both Goldman Sachs and Lehman Brothers posted profits that were both above analysts estimates but still a lot lower than last year's figures. With news that JP Morgan has increased its offer fivefold for Bear Stearns the greenback has gained a portion of respectability.

### Commodity currencies

	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPAUD</b>	<b>2.1324</b>	<b>2.2130</b>	<b>2.1782</b>

As with all the commodity currencies AUD suffered last week as the recent commodity bubble did not burst but instead let out some air. The main data release last week was the publication of the minutes from the Reserve Bank of Australia's March meeting. As reported last week consumer demand has begun to fall and a slowdown in growth is forecast; as such further rate hikes seem unlikely.

	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPNZD</b>	<b>2.4406</b>	<b>2.5246</b>	<b>2.4783</b>

Kiwi has continued to be at the behest of carry trade participants as higher equity markets and lower commodity prices saw NZD move violently over the week. Lower gold and oil prices and a pick up in the fortunes of the USD towards the end of the week saw NZD's recent rally stall. Next week both fourth quarter balance of payments and gross domestic product data, on Thursday and Friday respectively.

<b>GBPCAD</b>	<b>1.9784</b>	<b>2.0406</b>	<b>2.0239</b>
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Everything seemed to go against the Canadian Dollar last week as it weakened to the lowest levels against sterling since mid December 07. Primarily the falls in the price of gold and oil hurt the loonie given their large proportion of Canadian exports with the financial turmoil radiating from across the border not helping either. CAD will also not be helped by expectations that although inflation rose in February by 0.1% the Bank of Canada is expected cut rates in the short term.

<b>GBPZAR</b>	<b>15.837</b>	<b>16.555</b>	<b>16.029</b>
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The SARB's Quarterly Report was published on Wednesday and held few surprises. The overall picture showed that the South African economy is continuing to grow at a healthy pace and is moving from sales-led growth to a more sustainable investment-led growth pattern. Looking forward tomorrow's consumer and producer price index figures are expected higher which will continue the inflationary pressures being felt by Africa's largest economy.

**Produced by Jeremy Cook ([j.cook@worldfirst.com](mailto: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.