

**Monday 31st March**

## **Sterling Down But Not Out**

Confidence is a funny thing. Be it sport, business or whatever confidence plays a role. At the moment the UK economy is low on confidence and as such sterling is feeling the pinch as records continue to be broken against the euro and momentum against the dollar is hard to come by. After a fairly stable week Friday saw us erase gains and dip to 1.26 against the single currency and a move below 2.00 versus the greenback. Data supporting the lack of good feeling towards the UK economy was released showing that UK consumer confidence has fallen to the lowest levels since 1993. So what's holding us back?

The obvious drag would be that of the housing market. The latest news from the UK's second largest mortgage provider, the Nationwide Building Society, is that prices dropped once again in March and that the yearly growth rate has fallen to 1.1%, a level not seen since 1996. There was also a small increase in mortgage approvals however these were no different from seasonal norms given people's propensity to buy around the Easter period. It's not unobvious to say that if the value of your house is falling, you may start feeling gloomy.

Let's say however that most of your investments are not in property but in the stock market; unfortunately there's no ray of sunshine to be found here. The FTSE 100 index of shares at the time of writing is around 16% off of the highs seen in July and October with theory dictating that a market trading 20% below is in a bear market. Earnings are down across all sectors with billions wiped off the value of companies such as Vodafone, HSBC and Marks and Spencer. So your pension plan is being hammered as well.

This rather toxic recipe combined with higher prices at the petrol pump and at the supermarket checkout has left Joe Public feeling pretty sorry for himself and the cycle continues. The question is now what can or will break us out of this?

Simply put sterling is in a very precarious position and we may have to wait for the Bank of England's next cycle of raising rates, not forecast until Q3 2009, for these choppy sees to subside. As Groucho Marx said "I have nothing but confidence in you, and very little of that"; he very well could have been talking about sterling.

## **The week ahead**

The US data schedule is very busy this week but will be focused on Friday's Non-Farm Payrolls which is forecast to dip for the third consecutive month, an indication being found in Wednesday's ADP release. Other key statements include Tuesday's ISM figure and Thursday's Initial Jobless Claims announcement.

Euro watchers will focus on details from the Eurozone's manufacturing sectors as PMI is released Tuesday and Producer Prices on Wednesday. Three members of the ECB Central Committee are due to speak publicly this week and all ears will be listening for hawkish tones and belligerent hints.

<u>Currency Rates</u>	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPEUR</b>	<b>1.2609</b>	<b>1.2909</b>	<b>1.2560</b>

Euro is becoming unstoppable. Although some speculators took the opportunity to lock in some profits over the past week the single currency maintained its bullish stance against its competing crosses. In contrast to the US and UK both data and sentiment is on the euro's side.

Germany is Europe's largest economy and as such its data and readings have more of an impact than that of say Spain. The main boost last week was the German IFO Business Climate report, nudging higher against a global backdrop of falling belief. Analysts and commentators see this as an indication that the economy is stable, a rare commodity in today's financial climate. This was backed up by reports that the chances of a Eurozone rate cut this year has fallen to 50% from an almost certainty in January/February.

The only real opponent of the continued euro strength to voice his concerns was Nicolas Sarkozy, the new President of France, but markets viewed this as nothing more than a political kowtow given his desire to bring France and its economy closer to the US than was tried under Chirac.

<b>GBPUSD "Cable"</b>	<b>1.9758</b>	<b>2.0191</b>	<b>1.9859</b>
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The disparity between dollar and most of its crosses continues and the greenback persists in flailing around like a punch drunk boxer. Although dollar moved higher on Monday with European markets enjoying a long weekend it soon found itself sliding back into record territory.

Data was not a friend of dollar last week as most sectors and their relevant indices moved lower. The announcement that garnered the most headlines was the increase in US Existing Home sales however this was offset by the catastrophic fall in the Case-Shiller Index. This measures the value of residential real estate in 20 metropolitan areas in the US. With a fall of 10.7% it is certain that not only the low-end housing market is taking a beating this however could in turn lead to buying opportunities.

### Commodity currencies

	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPAUD</b>	<b>2.1575</b>	<b>2.1969</b>	<b>2.1747</b>

GBP/AUD was one of the most volatile crosses last week as the lack of domestic data left it at the mercy of commodity prices and global stock indices. We however have the RBA rate decision tomorrow with expectations of a hold at 7.25%. A survey was recently conducted by AAP and it found that not one of the 19 economists polled are expecting a hike.

	<u>Low</u>	<u>High</u>	<u>Current</u>
<b>GBPNZD</b>	<b>2.4542</b>	<b>2.5132</b>	<b>2.5130</b>

Strong GDP data allowed Kiwi strengthen last week. With a figure of 1% published against a forecast of 0.8% NZD combined with Reserve Bank Governor Alan Bollard's comments that he is entirely happy of the interest rate in New Zealand at the moment and a cut was not being forecast due to domestic inflationary pressures being seen as more of a problem than global market turmoil. Kiwi will however remain under pressure due to its current account deficit. New Zealand's currently runs at 7.9% of GDP; anything over 5% is viewed as risky.

<b>GBPCAD</b>	<b>2.0129</b>	<b>2.0607</b>	<b>2.0283</b>
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The loonie's saving grace at the moment is the price of oil. Falls below the \$100 a barrel level will hurt however retracements back to \$110 like we saw last week will continue to underpin. Without this we could have seen further losses given the problems the US, Canada's main trade partner, is having. We foresee CAD will continue to slide as the Bank of Canada looks to cut rates in the near term.

<b>GBPZAR</b>	<b>15.906</b>	<b>16.274</b>	<b>16.007</b>
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Inflation is still a concern in South Africa typified by last weeks PPI figures. As with most economies the largest rises were down to increases in the petroleum and coal products which were up 15.5% to 49.1% in March and food which were up 2.2% over the same period. All this points towards a CPI reading of 10% in the near term and the SARB will be torn between raising rates and hurting growth or leaving them on hold and watching inflation fly.

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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.