World First

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Be wary of markets bearing gifts

Is the worst over? Is the most extreme financial crisis since the great depression petering out? Global markets are certainly signalling so. Stock markets are regaining levels not seen since early January with government debt prices falling for the second consecutive week. Commodities are also coming back from record highs with gold and oil in particular seeing significant declines from price peaks. In essence, we are seeing a reversal. How this has been typified in currency markets is the resurgence of the dollar; EUR/USD slid to a 6 week low with cable testing technical and long term lows.

The British economy is still slowing however and a continued lack of credit supply is still deadweight around the neck of consumer demand; inflation figures remain high given current interest rate levels and are in touching of distance of 'letter-writing' territory. Inflation expectations are on the rise with some analysts predicting that CPI will hold above 3% for as long as 5 months and a recent survey showing that less than 25% of people polled by the Bank of England believed that the MPC was satisfied with the MPC's performance in dealing with the credit crunch.

CPI was actually down in March, falling to 2.5% against a consensus of 2.6%, but looking behind the figures the trend upwards is readily available to see. Wholesale gas prices have jumped from a low in 2007 of $5.23 per mmBtu to a high last week of $11.36 per mmBtu. The increase in gas prices are inextricably linked to the increases we have seen in crude oil and utility bills here in the UK will be set for a rise to accommodate the 117% price jump seen since August 07.

The MPC is due to meet this week, with a hold priced in on futures markets to more than an 85% possibility as belief uniformly would judge a cut as unnecessarily risky given the current inflation climate. The SLS, or Special Liquidity Scheme to give it its full name, has had a positive effect on credit markets with spreads narrowing however products available to so-called 'prime' borrowers fell by more than 1,000 in April.

To return to the original question, we believe the answer to be no. The housing market is still proving to be a media chew toy and with a 1% fall in house prices in the year up to April the memories of the early 1990's problems are beginning to resurface. 64,000 houses were purchased in April which is a low since records began in 1999 and consumer confidence once again dipped, this time to levels not seen since 1992.

We are at the end of the beginning of the crisis and no longer forecasting the beginning of the end. A lot will need to happen for the ship to be righted but measures such as the SLS have plugged some holes.

The week ahead

This week is fairly quiet on the dollar data front with Wednesday's pending home sales release the only real 'tier 1' release. Dollar watchers will be hoping to see the reversal in fortunes continue and a strong figure come to the fore.

It is a much busier week for the single currency. The ECB will announce the latest rate decision on Thursday; a hold being the obvious choice with a less than 10% probability of another decision expected. Wednesday's retail sales figures will also prove interesting given Germany's decline announced last week

Currency Rates	Low	High	Current
GBPEUR	**1.2580**	**1.2874**	**1.2694**

Euro extended its losses against sterling and dollar away from record lows reached over previous weeks as confidence drops and investors move away. Confidence figures were mainly off due to what seems to be increased problems in the French economy and a slowdown in Germany; so long the only economy performing in the EU.

HICP figures, the European CPI, fell last week and hopes are that should the trend continue we may see a more relaxed stance and sentiment emanate from Frankfurt with in the next few months; markets are pricing in cuts in August / September.

GBPUSD "Cable"	**1.9621**	**1.9964**	**1.9688**

Dollar was the main beneficiary of positive economic data last week prompting strengthening against the major crosses. The most documented and startling move was against the single currency; dollar pushed to a 5 week high and its trade-weighted index pushed to levels not reached since early March.

The volatile non-farms payrolls figure once again surprised the market posting a 20k decline against expectations as far ranging as -100k. A bullish figure saw traders buy dollars and move into riskier assets; The Dow Jones and S&P 500 enjoyed 0.5% and 0.7% jumps immediately after the release but fell back amid poor earnings figures. US Government debt yields also rose, itself a sign that sentiment is improving.

Other data also underpinned the greenback with GDP figures hitting target at 0.6% and the PMI report for the manufacturing sector although posting a contractionary figure of 48.6, halted the slide, symptomatic of dollar data in 2008.

We mustn't forget that the FOMC did meet this week and cut rates by 25bps to 2%. Language published immediately afterwards was unclear but the market interpreted it as a mandate for further cuts but not for a while; futures markets point to a less than 25% chance of a cut in June. Inflation now seems to be the main focus of the Fed as its chosen preference to measure the increases in prices, the PCE deflator, registered a 0.2% rise.

Commodity currencies

	Low	High	Current
GBPAUD	**2.0948**	**2.1362**	**2.0841**

AUD was broadly unchanged over the course of the week against sterling due to a mixed data environment in Australia. Although retail sales rose once again these were offset by falls in building approvals which summoned fears over further problems in the housing market.

Upward moves were down to increased commodity prices although such moves higher can and would be reciprocated lower should the commodity bubble burst. Global risk acceptance has also increased in light of news from the US; carry trade inflows from Japan have risen sharply over the past week.

GBPNZD	**2.5073**	**2.5570**	**2.5035**

Kiwi dollar may be in for tough time over the next month or so. Most analysts are tipping it to fall against its trans-Tasman counterpart and with a move below A83c for the first time in 6 months; the kiwi boom is starting to lose some of its lustre.

The week ahead provides a good indicator of the state of the economy with the release of the Household Labour Force Survey, the main NZ unemployment measure. This may give us a clearer picture of labour supply but without a drastic move in the unemployment rate currently sat at 3.4%

GBPCAD	**1.9860**	**2.0239**	**2.0048**

CAD continues to battle towards parity against its US counterpart but found little joy slipping over the course of the week as poor data took its toll. GDP weakened by 0.2% as the manufacturing sector continued its decline. Further interest rate cuts are probable given these growth figures however the Bank of Canada will be wary especially after a sharp wholesale price rise. Its saving grace however remains to be oil prices and recent records will continue to underpin the loonie.

GBPZAR	**14.8058**	**15.1189**	**14.9522**

The Rand had a relatively quiet week in comparison to its normal volatility. GBPZAR traded in a range of about 1.5% around a mid rate of 15.00 and saw a high of 15.10. The main excitement came as a result of comments from the Reserve Bank governor, Tito Mboweni. In an SABC interview he claimed, "The situation is deteriorating and we can't say we must wait for that (the MPC meeting) date because it is in the calendar. Economic policy can't wait for that date." This was interpreted to mean the MPC would soon be calling an emergency meeting to hike rates in an attempt to curb rising inflation. However, later that day, the emergency meeting was denied and a statement released that Mboweni's comments were misconstrued. Nevertheless, the Rand rallied and then fell back on the news. The market now widely expects the MPC to hike rates by 50bp at the next meeting.

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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 knows 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.