

Currency Profile for the British Pound



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A MarketLinkSM Service from Travelex Global Business Payments

GBP performance against the U.S. dollar:

Current bias for the GBP: Negative

GBP set an 8 ½ -month low in early February

Past week: +0.35%

Past month: -3.92%

Year-to-date: -2.94%

Sources of GBP strength:

While the BOE has left the door to further asset purchases open, it allowed its £200 billion quantitative easing program to expire in February.

Britain's longest recession to date ended in Q4, when the economy posted a 0.1%(q/q) rate of growth.

Upside surprises to recent CPI reports saw year-over-year inflation rise further above the BOE's 2.0% target, fanning fears that inflation could remain above target for a prolonged period and limiting the outlook for more asset purchases.

The number of Britons claiming unemployment benefits has fallen dramatically from the peak last winter.

Sources of GBP weakness:

While the BOE allowed its QE program to expire in February, additional asset purchases could not be ruled out.

Whist increased asset purchases have become unlikely, the BOE is not expected to lift borrowing costs anytime soon.

While the pace of job losses has slowed, the U.K. shed jobs in every month since February 2008 to October 2009. The unemployment rate is near its highest in over a decade.

Credit conditions in the U.K., remain tight, despite the BOE's best efforts to encourage increased lending.

Mounting worries about the dire state of British public sector finances and even a possible credit downgrade have kept investors wary of overexposure to GBP assets.

An upcoming general election, expected sometime around midyear, injects an air of political uncertainty into markets.

Monetary Policy: The Bank of England (BOE) last cut its key repo rate by 50 basis points to an all-time low of 0.50% in early March 2009, a move that marked 4.50% of lending rate cuts since the peak of the financial crisis in October 2008. Given that traditional monetary policy tools had essentially become exhausted, officials were forced to adapt unconventional policy measures like the outright purchase of longer-dated gilts (government bonds). The Bank of England increased its quantitative easing budget on three subsequent occasions bringing its total to £200 billion worth of assets purchased. The stabilization and in many cases, improvement in Britain's economy prompted the BOE to allow its quantitative easing program to expire as expected in early February. However, the fact that credit conditions remain tight and that the U.K. economy barely crawled out of recession in the final quarter of 2009 has kept the door to additional asset purchases open. Britain's housing market has stabilized, but at historically low levels of activity. Retail sales have improved as well, but much of that improvement appears to have been fueled by a short-term boost in demand ahead of the rise in Britain's value-added tax. Job losses too have slowed, but the unemployment rate remains near a decade high and is not expected to moderate significantly anytime soon. Consequently, additional asset purchases by the BOE can not be ruled out if the economy fails to improve meaningfully in the coming months, while a rise in rates above their current record lows is not likely until some time in 2011.

GBP Outlook: Balance of market opinion: Negative

Sterling recovered from an eight and a half-month low against the greenback and a four-month trough against the Canadian dollar in early February, temporarily boosted by an improvement in risk appetite and the Bank of England's decision to allow its £200 billion quantitative easing program to expire. The winding down of asset purchases is inherently positive for the pound and highlighted the gradual, if mixed recovery in Britain's economy. However, the pound's slightly improved tone is not likely to be sustained. While the BOE ended its asset purchases in February, it left the door open to additional QE measures if the economy fails to gain momentum or if prices dip back below target. Moreover, lending rates are not likely to rise until sometime in 2011, a generally more dovish scenario than expected in the U.S. and possibly the euro zone. Finally, a general election in mid-2010 could result in a hung Parliament, an outlook that threatens political gridlock at a time when drastic deficit reducing measures are needed to shore up confidence in Britain's dire state of public finances. Consequently, sterling is likely to remain vulnerable to selling pressure in the months ahead.

Upcoming critical events:

Feb 19: GB January Retail Sales

Feb 26: GB Q4 GDP (revised)

Mar 1: GB February PMI

Mar 3: GB February Consumer Confidence

Mar 4: BOE Monetary Policy Committee Meeting

Economic indicators	GBP	USD
3-month Deposit Rate	0.53%	0.41%
GDP (annual rate)	-3.2%	5.7%
Inflation (annual rate)	3.5%	2.7%
Unemployment	7.8%	9.7%
Trade Balance (US\$)	-126.0 bln	-517.0 bln

