

Forex Focus: Weak Dollar Should Give Pound One Last Run

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A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--Sterling will have one last burst of buying that should send it sailing over \$1.60, especially if the dollar remains as weak as it has been.

After that, though, economic realities will hit home and support for the U.K. currency will wane.

For the moment, stronger than anticipated U.K. data, good bank earnings and favorable merger and acquisition flows are all helping the pound to extend the two-and-a-half month rally that has brought it up from under \$1.4300.

See the pound's rally against the dollar:

<http://www.dowjoneswebservices.com/chart/view/4357>

More support for the currency will emerge later this week as long as the Bank of England doesn't express any dovish sentiments after its policy meeting on Thursday and as long as U.S. employment data on Friday increase speculation of more monetary easing by the Federal Reserve.

This will likely weaken the U.S. currency even more and send the pound hurtling as high as \$1.63.

Thin trading conditions in August as well some signs of a short squeeze in the pound make this move even more probable.

After that, though, sterling's run should come to an end.

Not only will the currency start to look overpriced up at that level but, as recent data have shown, the U.K. economy won't be looking as good as it was.

Second quarter growth may have proved stronger-than-expected and contributed to the pound's rally.

But, the summer has brought proof that this strength is not sustainable.

U.K. house prices remain very subdued with little sign of serious recovery. Credit growth, in both the personal and business sectors, is still soft both because of a lack of demand and because of tight credit conditions.

And now, with euro-zone growth prospects being downgraded as fiscal austerity kicks in, the U.K.'s export outlook is also at risk. Hopes that higher export demand would help to compensate for lower domestic activity are looking badly misplaced.

So far, there has been little real talk of further Bank of England easing. The central bank is likely to confirm that its quantitative easing will be left unchanged at this week's policy meeting.

However, there is growing concern that if the Fed is considering pouring more liquidity into financial markets, then the Bank of England may be following suit--a consideration that could be reflected in the minutes of Thursday's meeting when they are released in two weeks time.

If that is the case, sterling will quickly lose any yield attraction and the rally that has lasted since the Conservative/Liberal Democrat coalition came to power will come to an end.

Early Wednesday, the pound was trading a little higher at \$1.5957 at 0645 GMT, compared with \$1.5948 late Tuesday in New York, according to EBS.

Further speculation of more U.S. monetary easing left the dollar under pressure against most other major currencies as well, with the U.S. currency falling to Y85.51 from Y85.85 despite talk that the Japanese government may put pressure on the Bank of Japan to ease its policy further to prevent the yen from getting any stronger.

The dollar did stage some recovery against the euro, which fell to \$1.3200, but it has since stabilized to trade hardly changed at \$1.3230 from \$1.3233. The single currency was also down at Y113.08 from Y113.60.

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