

Forex Focus: Sterling Has Uglier Sisters

13 Aug 2010, 09:15

By Nicholas Hastings  
A DOW JONES NEWSWIRE COLUMN

LONDON (Dow Jones)--Sterling may be one of the ugly sisters, but it isn't the ugliest.

So, while it may now have seen the best of its recent gains against safe haven currencies, such as the dollar and the yen, it will still do better than others, such as the euro.

See how the pound has started to come down against the dollar:

<http://www.dowjoneswebsecurities.com/chart/view/4417>

But how it has held up against the sliding euro:

<http://www.dowjoneswebsecurities.com/chart/view/4418>

At the moment, there are two reasons to sell the pound.

Global risk sentiment has taken a hammering in the wake of the Federal Reserve's decision to lower its U.S. growth outlook and preserve market liquidity for longer.

As concern over the global recovery has risen, investors have lost their appetite for risk and headed straight for traditional safe havens.

The other reason to bring sterling's rally to an end is this week's downgrade in the Bank of England growth outlook for the U.K., which helped to confirm market fears about the economy.

While the country's second quarter growth may have been better than expected, new data showing a downturn in house prices, tighter credit conditions and softer consumer confidence all suggest that the recovery is stalling just as the new coalition government prepares to introduce even more fiscal austerity.

With the central bank also lowering its outlook for inflation in the next year or two and with dis-inflationary forces showing signs of growing, there is still the risk that the Bank of England will need to resort to further quantitative easing.

The bank's governor, Mervyn King, may have sidestepped a direct question on the possibility of more QE but he did suggest that more could be introduced if that was appropriate.

As far as U.K. interest rates are concerned, there is little sign that hikes will be under discussion any time soon.

With the U.K. growth downgrade just adding to worries about the global recovery, risk is likely to remain off the table for even longer, providing more reason to look for sterling losses against the safe havens.

Nevertheless, there are other currencies against which sterling will remain on top--such as the euro.

This week has seen the return of financial market jitters in the euro zone as slower global growth and disappointing euro-zone data, including Thursday's disappointing fall in industrial production, suggest that conditions for debtor nations will remain difficult.

Without a quick recovery, the risks of debt default will start to grow again.

#### 2010-08-13\_Forex Focus

This has already been reflected in wider yield spreads and a higher cost for credit default swaps.

So while economic conditions in the U.K. may appear tough, those in the euro zone appear to still be even tougher, ensuring that the pound should continue to trade at a premium against its euro zone counterpart.

Although, the euro is still holding up over GBP0.8200, market analysts are still looking for an early test of support around GBP0.8180.

Early Friday in Europe, the euro was getting a lift from news that Germany's second quarter GDP growth was 2.2%, much more than the 1.4% that had been expected and much faster growth than the 0.2% that the country managed in the first quarter.

This had lifted hopes that euro zone GDP figures as a whole, due later in the day, will also come in better than forecast and lift some of the market's recent concerns about the higher funding costs being faced by peripheral members such as Greece and Ireland.

Otherwise, market sentiment is still dominated largely by a flight to safety as concerns over the global recovery remain high. Thursday's data showing the largest rise in U.S. jobless claims in six months and worries about retail sales and consumer confidence figures due later Friday are likely to continue driving the market.

By 0645 GMT, the euro had rebounded a little to GBP0.8249 from GBP0.8236 late on Thursday in New York, according to EBS. It was also up at \$1.2890 from \$1.2833.

The pound rose to \$1.5625 from \$1.5581 while the dollar rose to Y86.10 from Y85.90.

The euro also rose to Y110.95 from Y110.23.

Bloomberg TNI FRX POV

Reuters USD/DJ

Thomson P/1066 or P/1074

August 13, 2010 03:15 ET (07:15 GMT)