FOREX FOCUS: Sterling Should Start Rising Now

By Nicholas Hastings
A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--There are still lots of reasons not to buy sterling.

But there is also one overwhelming reason for doing just that--the Bank of England will probably prove more hawkish than its counterparts in the U.S. and the euro zone.

In other words, on a yield basis alone, the pound should get more support against the dollar and the euro.

For several weeks now, the pound has found itself almost side lined.

See the pound's recent performance against the dollar:

http://www.dowjoneswebservices.com/chart/view/5100

Although third quarter growth in the U.K. has proved fairly robust, investors have remained wary of the sharp public sector budget cuts that start in the new year.

Fears over the large exposure of U.K. banks to Ireland, last estimated in March at $222 billion, and even the split appearing in the Liberal Democratic Party over an increase in university tuition fees have provided excuses for investors to steer clear of the pound for now.

However, as 2010 draws to a close, the prospects for sterling, relative to the dollar and the euro, should be improving.

Ireland appears set to get the debt bailout plan that will help take pressure off U.K. banks and the wobble within the ranks of the Liberal Democrats is unlikely to create any serious damage for the country's ruling coalition.

On the economic front, U.K. growth could still be damaged early next year once the budget cuts bite and the value-added-tax hike kicks in.

Manufacturing data Tuesday may well have proved twice as strong as expected in October but this is unlikely to be sustained once restocking is complete and global demand subsides.

As the latest British Retail Consortium figures showed, U.K. consumer are also having a rough ride, with the latest snow storms battering the country making it unlikely that Christmas sales will meet expectations.

Although the bad weather may have boosted on-line shopping, uncertain pre-Christmas deliveries won't encourage demand.

Against this backdrop, U.K. growth at the start of 2011 will hardly prove positive. That said, U.K. growth will likely prove stronger than in the U.S. and the euro zone, and the chances of the U.K. increasing quantitative easing is becoming less and less likely.

Despite the downside risks to growth, signs are that public sector cuts may prove less swingeing than initially forecast and private sector resilience may ensure that job losses prove less daunting.

Add to this, rising inflation expectations and any support within the Bank of England for further monetary policy easing can be expected to recede.

Not only has the latest YouGov poll shown that more U.K. consumers expect prices to rise in the next year, but the increase in VAT to 20% from 17.5% at the start of 2011 will put paid to any hopes that the authorities will take a risk with more QE.

This is a far cry from the Fed, which not only introduced a second round of QE early November but warned only last weekend, that more liquidity could be introduced if needed.

Similarly, despite its original hawkishness, the European Central Bank last week confirmed an ongoing program of bond purchases, its own version of keeping euro-zone markets liquid.

Bloomberg TNI FRX POV
Reuters USD/DJ
Thomson P/1066 or P/1074

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