# Forex Focus: Sterling Is Due For A Pounding
6 Jul 2010, 09:15

By Nicholas Hastings
A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--A reality knock is on its way for the pound.

For the past week or so, sterling has been gliding higher, boosted by the new coalition government's fiscal discipline and by talk from one Bank of England monetary policy maker that rates should rise.

In a world where austerity is becoming the norm, Chancellor George Osborne's plans to slash public spending even more than expected removed the risk of a credit downgrade.

For investors who have spent the last few months dodging the debt crisis sweeping through the euro zone, this could only be seen as good news.

However, as data on Monday indicated, the economic price for reducing the country's deficit so fast will be high.

The economic recovery that showed signs of taking off in the first half of this year has already started to falter, even before the fiscal measures in the emergency budget late last month have been introduced.

Although manufacturing industry may not have contracted quite as much as many feared last month, the much larger and much more important services sector of the economy has proved a lot less resilient. The latest purchasing managers' index fell much more than expected with business expectations plunging to a 15-month low.

Coming against a background of increased fears about a double-dip recession not only in the euro zone but in the global economy as a whole, the prospects for the U.K. economy are looking decidedly dim.

So although the economy may have achieved growth of 0.6% in the second quarter, that is the best the country is likely to see for some time.

"The survey data have continued to cast doubt on the ability of the private sector to weather the fiscal tightening when it begins in earnest soon," warned Vicky Redwood, U.K. economist with Capital Economics, an independent research group, in London.

By taking its fiscal medicine on the chin, the U.K. economy may yet achieve more sustainable growth sooner than its competitors, paving the way for U.K. interest rates to start rising well before their peers do.

But, there is little sign that higher U.K. rates are needed in the near term.

On the contrary, pricing power in the service sector appears fairly limited while input prices are running at the lowest level in six months.

Given this, there should hardly be any fresh pressure for the Bank of England to start tightening policy when its policy members hold their next meeting on Thursday. Last week, three other members of the policy committee made it clear that they didn't support any early move.

This should ensure that sterling remains at a disadvantage to high yielders just now and even if general market sentiment improves that the pound loses some of its recent support.

Even though sterling is still trading firmly over $1.5100, technical analysts suggest that its recent rally is more or less over.

See how the pound has glided higher against the dollar:
http://www.dowjoneswebservices.com/chart/view/4220

At Den Danske Bank, analysts are putting out a sell recommendation for any rise over $1.5304, warning that there is scope for a return all the way back down to $1.3500.

Early Tuesday, financial markets were having a little bit of relief rally with the Nikkei rising 0.8% and the Shanghai Composite gaining 1.1% after the Reserve Bank of Australia left rates unchanged as predicted but proved much less dovish about global growth prospects than expected. A larger-than-expected increase in Australia's trade surplus also helped to offset some of the recent negative sentiment that has been dominating global markets.

By 0645 GMT, the pound was up at $1.5192 from $1.5135 late on Monday in North America, according to EBS.

The euro was up at $1.2585 from $1.2541 and rose to Y110.50 from Y110.02. The dollar was essentially flat at Y87.77 compared with Y87.75.

The improvement in sentiment may not last long given that a continued decline in the Baltic Dry Index points to a further reduction in global trade, suggesting lower demand from countries such as China. Also, the latest Institute for Supply Management survey for U.S. non-manufacturing is expected to show another decline, reminding investors that the U.S. recovery is stalling.

Bloomberg TNI FRX POV

Reuters   USD/DJ

Thomson   P/1066 or P/1074

July 06, 2010 03:15 ET (07:15 GMT)