Forex Focus: Sterling's Rally Has Run Its Course
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A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--Call time on sterling's post-election rally.

As feared by many, the U.K. recession last year has proved deeper than expected and the country's economic recovery this year is proving even more fragile than thought.

And, as new consumer price figures later Tuesday will probably confirm, price pressures will soon subside, ensuring that the Bank of England can afford to keep interest rates down at current low levels for at least another year.

For sterling, this should mean the end of the line.

Ever since the Conservative/Liberal Democrat coalition came to power in May, the pound has been rising.

First, it was bought on relief that the U.K. finally had a government that would pursue fiscal discipline and reduce the country's budget deficit. This was confirmed last month, when Chancellor George Osborne unveiled an emergency budget with public spending cuts that boosted confidence that the deficit will be reduced.

Since then, the pound has attracted additional support as inflation pressures appeared stickier than expected and speculation grew that the Bank of England might have to tighten monetary policy again sooner than forecast.

However, economic data over the last few days have blown this rosy sterling picture apart.

For a start, delayed revisions to first-quarter gross domestic product on Monday showed that the recession that ended in the third quarter of last year was even deeper than expected.

Also, the recovery since then has proved weaker than initially thought, putting growth even more at risk from the fiscal squeeze just introduced by Osborne.

As Standard & Poors warned on Monday, there is still a "material risk" that the country loses its triple-A credit rating if economic growth is not as strong as expected.

Trade data last week showed that even the fall in the pound earlier this year, when it declined from over $1.67 late last year to a low around $1.42 just before the election, failed to boost U.K. exports. The trade gap was revised out to GBP7.41 billion, near the record levels achieved in 2008.

Those counting on inflation pressures to bring an early hike in interest rates will also be disappointed.

Last week's producer prices for June fell even more than forecast and with the revised GDP suggesting that spare capacity is even larger than expected, there will be even more pressure on producers to keep prices down.

The latest CPI numbers later in the day should help to confirm this trend, with a fall in energy prices helping to push the headline CPI down to a four-month low of 3.1% from 3.4% previously.

At the same time, the GDP suggests that the country's savings ratio may well have to fall back close to zero to keep consumer spending growing and to prevent the country from falling back into recession.

"This should further help to ensure loose monetary policy continues for the foreseeable future," said James Knightley, senior U.K. economist with ING Financial Markets in London.

So, any speculation of an imminent rate hike has been killed dead--with analysts now suggesting that the earliest the Bank of England could start thinking of raising rates is next summer or even after that.

And the pound, which appeared to be establishing itself back above $1.50, now looks more likely to revisit its $1.4235 May low, according to currency strategist at BNP Paribas.

See the pound's performance in recent months:
http://www.dowjoneswebservices.com/chart/view/4252

Early on Tuesday, sterling slipped a little to $1.4980 by 0645 GMT from $1.5030 late on Monday in New York, according to EBS.

The decline came with a general slide in market sentiment after China made it clear that it will continue to rein in property speculation. Also, new GDP later this week is expected to show Chinese growth slowing.

This downturn in sentiment, reflected in a general decline in Asian stock with the Shanghai Composite losing as much as 1.8% so far Tuesday, eclipsed earlier optimism after Alcoa's earnings surprised a little to the upside and two Fed members insisted that the U.S. economy isn't at risk from a double-dip recession and that further monetary easing isn't needed.

The euro was knocked back to $1.2559 from $1.2593 and to Y111.39 from Y111.55, while the dollar was up a little Y88.68 from Y88.59.

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