

Forex Focus: Reassessing The Pound's Poor Outlook

By Nicholas Hastings

A DOW JONES NEWSWIRES COLUMN

LONDON (Dow Jones)--Sterling has got a reprieve--at least for now.

A combination of better-than-expected economic data, less talk about more quantitative easing and the sheer distraction of rising economic problems elsewhere all played into the pound's hands last week.

Instead of facing new selling pressure, the U.K. currency traded nearly flat as investors appeared keen to reassess their outlook.

See how the pound has just hung on in there against the dollar:

<http://www.dowjoneswebservices.com/chart/view/4588>

Hopes that third-quarter growth isn't going to be quite as slow as many feared were fed by a series of positive economic figures, including more robust retail sales and a rise in house prices, according to the latest survey from Halifax.

A larger-than-forecast deterioration in the country's trade gap may have been disappointing, in that export growth failed to live up to expectations. However, the figures also showed that U.K. domestic demand remains resilient.

In itself, this was all good news for the country's currency, as it reduces pressure on the Bank of England to rush into further monetary easing. New producer price figures on Friday showing that output prices fell more than expected and that input prices remained flat will have certainly made life easier for the central bank.

However, inflation itself is still expected to remain above the central bank's 2% target for some time to come, ensuring that the bank will avoid introducing more QE for as long as it can.

Politicians have also helped sterling as the coalition government prepares to announce its public spending cuts next month. Indications are they are shying away from the draconian measures initially expected.

Deputy Prime Minister Nick Clegg insisted that there is no "sword of Damocles" that's going to come down straight away.

This has come as the Organization for Economic Cooperation and Development issued new more upbeat forecasts that show that the U.K. will grow faster than any other G7 country during the third quarter.

The organization has suggested that the coalition consider delaying spending cuts now that growth isn't slowing so rapidly.

It's this comparison between the U.K. economy and other major countries that is also proving pound-positive.

Although the U.S. reported better-than-expected economic figures at the end of last week, fears over a double-dip recession remain and support for the dollar has often been limited.

Last week also brought a nasty deterioration in the euro zone's prospects. Apart from disappointing data out of previously strong growth areas such as Germany, the euro zone also faced renewed speculation over a sovereign debt default.

Peripheral debtors were able to raise new funds from financial markets, but the cost of insuring some borrowers through credit default swaps rose to record highs.

All this contributes to the feeling that while the U.K. may not be able to start raising rates until well into 2011 or even 2012, it is still likely to be the first major nation to take such a step.

So while the pound may have appeared the worst of a bad bunch not so long ago, it has probably risen up the popularity ladder and is less likely to find itself sustaining serious falls against the euro as well as the dollar.

Credit Agricole is suggesting that the pound is technically a good buy against the Swiss franc as well.

The pound kicked off the new week in strong fashion, capitalizing on the latest improvement in global risk sentiment after China reported stronger-than-expected industrial production and a rise in consumer prices over the weekend. This lifted fears about the global slowdown.

A weekend accord by global banking regulators on new capital ratios, known as Basel III, also lifted sentiment. The new ratios, which should reach 7% by the year 2019, are expected to be manageable for most banks and help to remove some of the immediate concerns over the global financial system.

By 0645 GMT, the pound had bounced to \$1.5471 from \$1.5358 late Friday in New York, according to EBS.

The euro rose to \$1.2821 from \$1.2712 as well as to Y107.64 from Y107.03.

The dollar fell to Y83.94 from Y84.21.

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