

Friday, 11 September 2009

Flash Notes

United Kingdom

- **BoE Leaves Repo Rate Unchanged at 0.5%;**
- **Keeps Asset Purchase Plan at 175 Billion Pounds**

The Bank of England held its key lending rate unchanged at 0.5% and maintained its programme of asset purchases totalling 175 billion pounds. The Bank, in its statement, said that it expects the programme will complete in November though it highlighted that “the scale of the programme will be kept under review”. The minutes of its latest two-day meeting will be published on September 23.

Albeit signs that Britain may soon follow France, Germany and Japan out of the recession, Governor Mervyn King’s actions at the BoE’s meeting in last month suggested that he was less optimistic on the country’s recovery prospects. At the August meeting, King had wanted the Bank to increase its so-called quantitative easing (QE) programme by 75 billion pounds. However, his plan did not go through as the nine-member Monetary Policy Committee voted instead, to increase QE by 50 billion pounds to a total of 175 billion pounds. Still, the move took markets by surprise.

The QE programme of asset purchases was launched on 5 March this year, the same time where the Bank slashed rates to their current record-low of 0.5%. The BoE has since ramped up its QE policy to encourage commercial banks to lend to businesses and individuals.

Latest economic data in the UK showed real GDP contracted by 0.7% q/q in the second quarter, compared to a decline of 2.4% q/q in the first three months of this year. While there may be signs that the economy may be turning around, concerns that the UK recovery will lag behind that of the Eurozone have remained in the backdrop. So far, there has not been strong evidence of stabilization in Britain’s main export markets. Furthermore, the unemployment rate climbed to a high of 7.8% in June, with the number of unemployed rising towards the three-million-mark.

Nonetheless, the responses to the measures taken by the central bank have been moderately encouraging so far. Earlier this week, the National Institute of Economic and Social Research, whose clients include the central bank and the Treasury, said that the recession probably ended in May. According to reports, house prices in the UK rose by 0.8% in August, while a survey of services companies showed the fastest pace of expansion in almost two years. Consumer confidence seems to have stabilized as well.

Furthermore, signs that the economy may be returning to growth helped push the UK’s benchmark FTSE-100 index above the 5,000-mark for the first time in almost a year on Wednesday. However, we are particularly cautious as we move away from the US summer season when thinner trading may heighten downside risks.

	End 4Q09	End 1Q10	End 2Q10	End 3Q10
Repo Rate	0.50	0.50	0.50	0.75
GBP/USD	1.640	1.650	1.655	1.675
Source: UOB				

On the inflation front, CPI printed a 1.8% in June, slightly below the BoE's 2.0% target. The Bank recently forecast that the rate of 12-month inflation was set to fall under 1.0% this year as the economy makes a slow recovery. As such, we think that there is no urgency for the central bank to hike rates anytime soon. However, as the downside risks to the economy diminish, we see the BoE moving away from the current record-low of 0.5% in the second half of 2010.

GBP/USD had fallen before the monetary policy decision (on fears that the BoE would expand its QE program). However, post-BoE saw the pair rebounding from 1.6481-lows to highs of 1.6688 overnight, ending the NY-session higher against most the other major currencies. And the pair has been climbing steadily in Asian trades today to intraday-highs of 1.6708 so far. While the support in the GBP/USD has been exacerbated by the broad-based dollar weakness permeating most of this week; recent price action suggests that risk appetite is returning amid signs of improvement in the global economic outlook. This should in our view support the GBP/USD as the pair makes a modest climb ahead.

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