

Market Commentary

GBPUSD

Following a 0.25% hike to 5.25% in June, the FED opted to leave interest rates on hold when they met earlier this month as the economy is showing signs of slowing which in turn should also help dampen inflationary pressures.

As highlighted by Bernanke, the FED are aware of the effects of a policy lag where higher interest rates are likely to have a dramatic slowing impact upon the economy. This appears evident when looking at the US housing market where both existing home sales (6.662m) and new home sales (1.15m) slowed in June. This suspicion was further confirmed when GDP figures for Q2 showed growth had slowed to 2.5%q/q from 5.6% previously.

The Dollar continued to lose ground against its major counterparts into the latter stages of July and wasn't helped by the employment report where the headline Non Farm Payroll number came out a disappointing 113k against expectations of 142k. Unemployment also rose to 4.8% from 4.6% highlighting that the labour market is starting to suffer from a slowing economy.

GBPEUR

The principle highlight of late has been the Bank of England interest rate hike (+25bps to 4.75%) which shocked the market and resulted in Sterling rallying aggressively against all the major currencies. The committee explained that strong, above trend economic growth and inflation at 2.5% prompted the move and highlighted that inflation would stay above the 2% target for some while yet. The market will have to wait for the minutes from the meeting (due out on Wednesday) for an indication of the voting pattern although Mervyn King suggested that further rate hikes are on the horizon when he delivered the Bank's quarterly inflation report last week.

The ECB also raised interest rates by 25bps to 3.00% when they met on 3rd August citing a continued economic recovery and concerns over inflationary pressures. In the accompanying press statement, Trichet stated that monetary policy remains accommodative, thus leaving the door open for further rate hikes in the months ahead. This move was widely expected by the market and consequently was already priced in, resulting in little impact upon the market.