

Pound Reaches 5 1/2-Year High as BOE Rates Prospects Trump Fed

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By Lucy Meakin

June 19 (Bloomberg) -- The pound rose to the highest in 5 1/2 years against the dollar after the Federal Reserve said it would keep interest rates near zero while the U.K. is moving closer to raising borrowing costs.

U.K. government bonds erased gains as Bank of England policy maker Ian McCafferty said an early start to interest-rate increases may be warranted. BOE Governor Mark Carney said on June 12 that the first interest-rate increase "could happen sooner than markets currently expect." Sterling has risen against all of its developed-country peers in the past month as investors pushed forward their expectations of when policy makers will raise the main interest rate.

"If it's a choice between central banks that are keeping rates low for a very long period of time or a central bank that is actually relatively hawkish, I think it's quite simple,"

said Simon Derrick, chief currency strategist at Bank of New York Mellon Corp. in London. "Sterling is the one out of all the Group-of-seven currencies that's got the opportunity to do something quite significant."

The pound advanced 0.3 percent to \$1.7041 at 4:48 p.m.

London time after reaching \$1.7063, the highest since Oct. 21, 2008. Sterling was little changed at 79.94 pence per euro after appreciating to 79.59 pence on June 16, the strongest since Oct.

1, 2012.

Gradual Pace

The Bank of England shouldn't "hold back too long,"

McCafferty said in a speech in London today. "It will be critically important that rises in bank rate are delivered, as far as we are able, at only a modest, gradual pace."

BOE Chief Economist Andrew Haldane said the choice of when to raise interest rates is "a difficult one" and there are "some signs of the economy's pulse quickening," in a speech in Scarborough, England, yesterday.

Forward contracts based on the sterling overnight interbank average, or Sonia, show investors are betting the benchmark rate will increase 25 basis points by February, versus May before Carney's speech last week. BOE officials last increased borrowing costs in July 2007.

"It seems that while the first BOE hike will be a 2015 story, we could see the first votes for a hike well before then," strategists at Morgan Stanley led by Hans Redeker in London, wrote in an e-mailed note today. "We would look for the break above the key \$1.70 resistance level to be sustained, with a move towards the \$1.71 target to come over the next few weeks."

'Considerable Time'

Fed officials expect interest rates to stay low for a "considerable time" after the conclusion of monthly debt purchases, which were trimmed to \$35 billion, the Federal Open Market Committee said in a statement yesterday.

The pound strengthened 1.8 percent in the past month, the best performer among 10 developed-nation currencies tracked by Bloomberg Correlation-Weighted Indexes. The euro slipped 0.4 percent, while the dollar gained 0.3 percent.

Ten-year yields were little changed at 2.74 percent. The price of the 2.25 percent gilt due September 2023 was at 96.055.

The rate on two-year gilts was also little changed, at 0.89 percent.

The 10-year yield will climb to 3.21 percent by the end of the year, according to a Bloomberg News survey of economists with the most recent forecasts given the heaviest weighting.

Gilts returned 3 percent this year through yesterday, according to Bloomberg World Bond Indexes. Treasuries earned 2.9 percent and German securities gained 4.1 percent.

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