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Carney Inherits Pound's Potency as Bears Capitulate: Currencies
2012-12-04 10:06:11.743 GMT

By Emma Charlton and David Goodman

Dec. 4 (Bloomberg) -- Strategists are raising estimates for the pound faster than for any other developed-nation currency, signaling incoming Bank of England Governor Mark Carney won't be able to count on a weaker exchange rate to stimulate growth.

Analysts increased their forecasts for sterling against the euro by 5 percent this year, even as Britain's economy headed for its first annual contraction since 2009. In a bullish signal, traders have cut the premium paid on options to sell the pound versus the dollar to the least since 2009, after the U.K.
currency outperformed the euro, yen and the greenback this year.

Carney, who takes over from Mervyn King in July, will be faced with a currency that has appreciated even as the Bank of England created an extra 375 billion pounds ($605 billion) since 2009 to buy bonds. The London-based central bank said last month that sterling's strength was undermining corporate earnings, while the government has said its plan to cut the deficit is running behind schedule.

"The BOE has already been talking about the strength of the pound in terms of U.K. competitiveness," Melinda Burgess, a foreign-exchange strategist at Royal Bank of Scotland Group Plc in London, said Nov. 28. "This is likely to be an area that will be closely monitored, particularly against the euro and if it's not changing, we may hear some more vocal noises."

The pound will appreciate to 77 pence per euro by June next year, Burgess said. Sterling was little changed at 81.09 pence at 9:58 a.m. London time and climbed 0.2 percent to $1.6120.

Boosted Forecasts

Analysts have increased year-end forecasts for the pound against the euro to 80 pence, from a prediction of 84 pence at the end of 2011, according to estimates compiled by Bloomberg.
They increased their target for sterling versus the dollar to
$1.60 from $1.56.

Sterling has appreciated 1.4 percent this year, according to Bloomberg Correlation-Weighted Indexes, which track 10 developed-nation currencies. The euro weakened 1.7 percent, the dollar fell 2.6 percent and the yen dropped 9.4 percent.
Norway's krone was the best performer, rising 4.2 percent.

In his current role of Bank of Canada Governor, Carney has overseen an economy that outperformed Britain's in recovering from the 2009 global slump. Canadian gross domestic product expanded an average 2.9 percent in 2010 and 2011, while the U.K.
economy grew an average 1.4 percent. Canada's dollar has gained
6 percent versus the U.S. currency since the end of 2009.

Bank Bailouts

While Canada's banks didn't require bailouts after the global financial crisis in 2008, Britain's lenders were given an unprecedented government lifeline and emergency loans from the central bank.

"The pound has defied gravity in some people's eyes,"

said Stuart Frost, who helps oversee $4 billion as a fund manager at RWC Partners Ltd. in London. "Canada has had a strong currency, so Carney is used to our currency situation.
How he chooses to deal with it, I don't know."

The pound has appreciated 10 percent against the dollar since the end of 2008, even as the Bank of England undertook so- called quantitative easing to reignite growth.

Overseas investors helped support the pound as the asset purchases encouraged them to boost holdings of U.K. government bonds by 141 billion pounds since the program began in March 2009. Non-residents increased their holdings for a fourth straight month in October, the Bank of England said Nov. 29.

'Conditional Commitment'

Instead of printing money to buy bonds, Carney introduced a "conditional commitment" in Canada in 2009, when he said the benchmark rate would remain at its lowest possible level for 15 months. The Bank of Canada raised its overnight lending rate three times in 2010 and has held the policy rate at 1 percent since then. It's alone among Group of Seven central banks in still suggesting an inclination to tighten policy.

The U.K. central bank's balance sheet was 414 billion pounds on Nov. 21, while the Bank of Canada's was C$72.7 billion
($73.1 billion) as of Aug. 31.

"Carney is expected to be more hawkish with little tolerance of above-target inflation," Adrian Lee, president and chief investment officer at Adrian Lee & Partners, which manages more than $5 billion from London and Dublin, wrote in an e-mail response to questions on Nov. 30. "We may see less QE as he is not the firmest believer that QE has been an effective BOE stimulus tool." Lee declined to give a pound forecast.

Top Rating

Chancellor of the Exchequer George Osborne said Dec. 2 it's taking longer than planned to balance Britain's public finances, the first hint he may miss his targets and extend austerity for another year. Osborne will present the government's latest economic and fiscal forecasts to parliament on Dec. 5.

The delay may jeopardize Britain's top rating at Moody's Investors Service, Fitch Ratings and Standard & Poor's. The U.K.
was given a "negative" outlook this year by Moody's and Fitch.
Moody's said Nov. 14 it would assess the Aaa ranking at the beginning of next year.

A rating cut would be unlikely to curtail the pound's strength, according to Michael Sneyd, a currency strategist at BNP Paribas SA in London.

"The impact of a U.K. downgrade on sterling is less than might first be expected," he said. "In terms of currency in general, a rate cut doesn't seem to have too much of an impact.
If one rating agency were to downgrade, this wouldn't put off central-bank reserve investors from buying gilts."

After Moody's

The pound gained 0.2 percent against the dollar and dropped
0.2 percent versus the euro the day after the Moody's announcement. The dollar has appreciated 1.7 percent against the pound and 9.3 percent versus the euro since S&P removed the U.S.'s AAA rating on Aug. 5, 2011.

Britain's currency is still below its 10-year average of $1.73. It climbed to $2.11 in November 2007, the highest since 1981. Sterling has averaged 72.57 pence per euro over the lifetime of the 17-nation currency.

Derivatives traders are paring bets the pound will weaken.
The premium for three-month options granting the right to sell sterling against the dollar, relative to those allowing for purchases, fell to 0.45 percentage point on Nov. 29, the smallest since June 2009. As recently as June 2012 it was 2.35 percentage points.

Sterling will end the first half of next year at $1.59, according to strategists' forecasts compiled by Bloomberg. It will strengthen to 79 pence per euro, a separate survey shows.

Faster Recovery

While the U.K. economy is set to shrink 0.1 percent in 2012, analysts see Britain recovering at a faster pace in subsequent years than the euro region.

GDP will expand 1.1 percent next year and 1.65 percent in 2014, according to the median of analyst estimates compiled by Bloomberg. The euro area will grow 0.1 percent in 2013 and 1.1 percent the following year, according to the forecasts.

The Bank of England halted expansion of its bond-purchase plan at its Nov. 8 meeting.

BNP predicts the pound will end 2013 at $1.78 -- the most bullish forecast in the Bloomberg survey -- and 74 pence per euro. That compares with forecasts of $1.48 and 88 pence per euro at the end of last year.

"The aggressive call we have on sterling is based on the expectation the U.K. economy will be outperforming the euro zone," BNP's Sneyd said. "We expect the consensus expectations to shift and sterling to benefit."

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