

Pound Slumps Most in 18 Months as BOE Holds Rates at Record Low
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By Emma Charlton

July 4 (Bloomberg) -- The pound plunged the most in 18 months against the dollar after the Bank of England signaled it will keep interest rates at a record low for longer than investors had expected.

U.K. government bonds rose and short-sterling futures jumped, signaling traders were reducing bets on higher borrowing costs. Led by new Governor Mark Carney, the central bank kept its bond-buying target at 375 billion pounds (\$566 billion) as predicted by all 44 economists in a Bloomberg survey. Sterling has strengthened in the past month and gilt yields climbed after data, including reports on services, manufacturing and construction growth, indicated the economy is gathering pace.

"The statement is probably a little bit more dovish than the market was expecting, pushing back on the rise in longer-term interest rates and suggesting that monetary policy will remain accommodative for some considerable time," said Paul Robson, a senior currency strategist at Royal Bank of Scotland Group Plc in London. "This leaves sterling vulnerable against the dollar and the euro."

The pound fell 1.3 percent to \$1.5088 at 2:33 p.m. London time, the steepest decline since Dec. 28, 2011. It reached \$1.5061, the lowest since May 29. Britain's currency depreciated 0.5 percent to 85.56 pence per euro. It earlier reached 86.33 pence, the weakest since April 17.

The pound pared its decline against the euro after European Central Bank President Mario Draghi said the institution's monetary policy will "remain accommodative" for as long as needed.

Implied Yield

"The implied rise in the expected future path of Bank Rate was not warranted by the recent developments in the domestic economy," the London-based central bank said in a statement.

The increase in market interest rates would weigh on the nation's economic outlook, it said.

The implied yield on the short-sterling futures contract expiring in September 2014 fell 11 basis points to 0.73 percent.

Today's announcement was the first by the central bank since Carney became governor on July 1. The nine-member Monetary Policy Committee also left the U.K.'s main interest rate at a record-low 0.5 percent.

Ten-year gilt yields fell four basis points, or 0.04

percentage point, to 2.35 percent after rising as much as three basis points. The price of the 1.75 percent security maturing in September 2022 rose 0.36, or 3.60 pounds per 1,000-pound face amount, to 95.08. The rate reached 2.59 percent on June 24, the highest level since October 2011.

Two-year note yields also slid four basis points, to 0.37 percent, after touching 0.32 percent, the least since May 24.

First Foreigner

Former Bank of Canada Governor Carney is the first foreigner to run the 319-year-old U.K. central bank. The Bank of England typically doesn't release statements after leaving policy unchanged. The decision to do so today reflects comments Carney made earlier this year to use communication, including forward guidance, as one of his policy tools.

"The August policy meeting could implement further changes, perhaps even formal threshold guidance," Rob Wood, an economist at Berenberg Bank in London who used to work at the Bank of England, wrote in a note to clients. "Carney appears to be doing a good job of convincing his colleagues of the need for clear guidance to the markets and the public in order to keep market-rate expectations in check and cement the recovery."

Carney has indicated a preference for further action, saying central banks aren't "maxed out" and that guidance on future policy can help them respond to shocks and financial imbalances.

House Prices

The pound has risen 3 percent in the past three months, according to Bloomberg Correlation-Weighted Indexes, which track 10 developed-market nations. The euro gained 3.8 percent and the dollar climbed 4.2 percent.

U.K. house prices rose last month to the highest in almost three years, a report showed today. Home values increased 0.6 percent from May to an average 167,984 pounds, the most since August 2010, the mortgage unit of Lloyds Banking Group Plc said in a statement in London today.

Citigroup Inc.'s Economic Surprise Index for the U.K. climbed to 48.90 percent yesterday, the highest level since December. The index shows whether U.K. data beat or fell short of forecasts.

"U.K. data has been unambiguously strong recently, but we remain bearish on the pound," George Saravelos, a London-based currency strategist at Deutsche Bank AG, wrote in a note to clients. "We don't think better growth numbers will translate into tighter monetary policy. We expect incoming Governor Carney

will introduce verbal guidance” after a review of policy tools concludes in August, he wrote.

The pound will fall toward \$1.40, Deutsche Bank predicted, without giving a time frame. Britain’s currency will end the year at \$1.50, according to a Bloomberg survey of forecasters.

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