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• Why the US economy is ahead of the curve
• What the 2012 Budget means for UK businesses
• 12-month currency forecasts
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Dear Reader,

Welcome to the April edition of Smart Currency Exchange’s Outlook, a monthly update on currency markets and an invaluable resource for any company that does business in more than one currency.

The following pages collate information about how the world’s key currencies have performed against each other over the last month, in light of global political and economic factors which have affected the international currency market. This month, we consider what the Chancellor’s Budget for 2012 means for UK businesses and the UK economy as a whole. We also look at the effect of the second Greek bailout on the Euro zone and business confidence throughout the world, as well as discussing the signs of strength in the US economy.

Furthermore, you’ll find forecasts for the three key Western currencies by leading financial institutions for the upcoming 12 months. Whichever industry you work in, if you make international payments, you should find it useful.

We currently have clients from a wide range of industries, from manufacturers of plastics to wine importers and art dealers. When our customers transfer Sterling abroad or repatriate another currency to the UK for business purposes, we ensure they always receive the best exchange rate available. We can do this as we have access to “live” market rates and can negotiate on behalf of our customers.

But there’s a bit more to what we do than consistently offer better exchange rates than the banks and quickly and safely transfer money from one account to another. We value long-term business relationships and integral to our service is gaining an understanding of each of our customers’ individual currency requirements, so that we can formulate a strategy based their needs. If like them you make international payments, why not call my team today for a no-obligation chat about how we could help you.

Enjoy this month’s Outlook.

Carl Hasty
Head of Trading
Where to next for sterling, the US dollar and the euro?

Exchange rates continue to be volatile, moving quickly and in any direction during the course of a trading day. However, the actual trading range since the start of the year has been limited as the markets await some catalyst to drive the exchange rate one way or the other.

Here in the UK the Government is focused on two things, namely maintaining the best possible credit rating for its debt so that interest rates that have to be paid are minimal and encouraging businesses to invest in the UK, thereby increasing employment. So barring any disasters in these two areas sterling should be reasonably supported in the short term.

In the Euro zone the debt crisis is in a period of respite as Greece finally received its second bailout. However, business confidence has suffered and other Euro zone countries are suffering significant debt problems. The feeling is that these will come back to undermine the euro over the coming months.

As for the US, the economy there is moving forward and, more significantly, unemployment is falling, unlike in the UK where it is still increasing. This will be supportive of the US$. However, waiting in the wings are the possibilities of the Euro zone debt crisis re-emerging and the Chinese economy failing to keep on growing as it has been.

All of the above make it very difficult to predict where to next for different currencies, but if we were to look at a hierarchy of currencies, the following would be our order of strength at this moment in time: 1st the US$, 2nd sterling and 3rd the euro. Will this be our view next month though?

“As a manufacturer, we import a great deal of materials and making sure we get the best price for them at the right time is critical to our business. Since using Smart’s service we have saved thousands of pounds when making international payments. These savings have helped ensure we maintain the healthy profit margin needed to remain competitive and grow stronger as a business”

Jon Partridge, Operations Director, RS Sailing
Euro zone

Summary

Although a difficult month for the Euro zone, the euro has held its own, trading in a fairly narrow range against both sterling and the US dollar. The Greek bailout was finally agreed by all parties and the success of the European Central Bank’s three-year funding package for the Euro zone banks also helped. But the underlying Euro zone debt problem is far from sorted and as such the euro probably has limited upside.

One down, how many to go?
Everyone finally signed up to Greece bailout 2. I wonder if there will be a sequel, Greece bailout 3, or will we see Greece default. I think most market commentators believe the latter because the economic fallout may well force politicians, Greek and European, to rethink.

What of other Euro zone countries where the debt problems, government and bank, are significant? Spain seems to be at the top of the list where they are already admitting that they are not going to hit the fiscal targets set by Brussels. Unemployment is significant, especially amongst the young and the enforced austerity packages will only exacerbate this further. Yields on Spanish government debt are already beginning to increase, as are yields on Italian and Portuguese debt as investors begin to worry. So it may not be front page news at the moment but don’t expect the Greece debt crisis to be a one-off and the debt quantum’s involved for Spain and Italy dwarf the amount that had to be refinanced for Greece.

Business confidence – will it return?
Clearly the Greek debt bailout was a major problem which caused a great deal of angst for many people. However, its major impact was on business confidence throughout the world. The US felt its impact, as did the Far East with business confidence falling. The most significant impact was in Europe. The UK felt its chill but in Europe it caused a deep freeze resulting it seems in a number of countries falling into recession. Even the mighty Germany has seen its production machine stutter.

For countries such as Spain this compounds their problems further as they need to somehow grow their economy and one of the ways to do this is to export more which is impossible if a lack of business confidence results in worldwide contractions. Hopefully the resolution of the Greek bailout will restore some confidence but it is going to be a slow process and any further hiccups will be very unhelpful.

Is there a plan B?
I mentioned this last month but I do wonder if the Euro zone politicians will devise a framework by which a country could either leave the Euro zone and/or allow a second tier euro to come into being. It will be interesting to see if this thought process has any credence.
United States

Summary

The US$ is a bellwether for the world economy rather than what is happening to the US economy. This could change if the US economy begins to grow at a much higher rate than other Western world economies, which increases the likelihood of increasing US interest rates.

The US economy

The US economy is clearly in a better place than the economies of the UK and the Euro zone and this is expected to continue for 2012 and beyond. Unemployment is finally coming down in the US. This is obviously key when trying to restore the electorate’s confidence and willingness to spend money. However, there is still a major deleveraging process taking place in the US with banks improving their balance sheets and private individuals trying to lower or eliminate their debts.

Which way is up?

If the US economy strengthens will we see the US$ strengthen. One outcome is that there is unlikely to be further US quantitative easing which is positive for the US$. Market commentators are also beginning to think that interest rates may be raised late 2013 rather than 2014. This again would be positive for the US$.

However, one of the drivers of the US$ is the safe haven status of US treasury bonds, which means that when there is uncertainty then the US$ strengthens as the demand for treasury bonds increases. As confidence returns worldwide, the opposite happens and funds go elsewhere which is negative for the US$.

So it will be interesting to see which has the greater influence over the coming months as we hopefully see a period of growth worldwide.

“Smart ensures we consistently buy above budget levels. I cannot recommend their service and proactivity highly enough”

James Goodhart, Director, Wine and Spirits Industry
United Kingdom

Summary

The advantage that the UK economy has over other countries is that the UK Government understands the need to be focused on reducing debt and matching government expenditure to income, and they understood this at an early stage. This seems to be supporting sterling despite less than positive UK economic data. However, if the UK economy was to falter then this would be very negative for sterling.

The Budget

Every year our beloved Chancellor gets up and delivers his thoughts on the UK economy and where he thinks government money should be spent and where this money to be spent will come from. This year the focus was very much on helping businesses by reducing corporation tax and by incentivising companies to invest, to carry out research and development, and develop operations in disadvantaged areas. Not everyone was happy and the opposition party was up in arms about the reduction in the top rate of tax and the removal of the tax allowances for those over a certain age.

I think most people realise that the Chancellor’s hands are pretty much tied when it comes to giving too much away. Maintaining the UK’s AAA credit rating means that we borrow at much lower rates than the Spanish or the Italians, which means that the interest burden is much less and that the “surplus” funds resulting can be used elsewhere. Also government expenditure is a drain on growth and the need to have more people employed in the private sector rather than the public sector is critical.

The Economy

The Chancellor is confident that we will avoid a recession but two members of the Bank of England Monetary Policy Committee seem less confident as they voted for an additional £25 billion of quantitative easing. The belief is that the economy will grow this year but only by 0.5 to 1.0 per cent. This month we had worse than expected retail data, public sector borrowing and increasing unemployment. Inflation is on the way down, which is helpful, but the price of oil is on the way up due to demand and difficulties in supply – not good for inflation.
Other Currencies

China announced reduced growth forecasts for the current year of 7.5 per cent. They also announced a record trade deficit for February 2012. The knock-on effect has been significant.

In China
China is no longer the supplier of choice of cheap goods for the world. Salaries have risen and the Chinese Yuan has appreciated by 8 per cent against the US$. The Chinese Government has also become concerned by there being a property bubble and therefore has reduced the ability of banks to lend money. So what sort of China will emerge over the next few years? The hope is that Chinese consumers will take up the slack and start spending. This hasn’t as yet and will be a key factor in determining whether the Chinese economy has a soft or hard landing.

Elsewhere
The fallout has been focused on those countries and business who have been reliant on the insatiable appetite from China for raw materials. The first cracks in the Australian dollar have appeared as it weakened against sterling. This is far from a rout at this moment in time but could turn into one if we see a hard landing in China.

“The service we’ve received from Smart has been great since day one. Not only do our contacts there keep us up to date with changes in the world of currency through daily emails, they also call us when they feel particular changes in the markets could benefit our business”

“With their help we have saved thousands of pounds, compared to the rates offered by our bank. I would recommend Smart’s service to any company with currency exchange and international payment needs”

Gavin Baldwin, Accountant, Trinity House
Forecasts

On balance the expectations are for the euro to be the weakest of the three key Western currencies, losing ground against sterling and the US$. However, as can be seen from the divergence in the forecasts this is far from a certainty and the debt crisis in the Euro zone will have a significant influence. What would happen if the European Central Bank reduces interest rates and the US increases? It’s likely the upside for the euro is limited in the short to medium term.

Our expectations for 2012

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Barclays Capital forecasts for 2012

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### GBP/USD Bank Forecasts for 2012

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Source: FX Week

### EUR/USD Bank Forecasts for 2012

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Source: FX Week
Graphs

USD/EUR

USD/GBP

EUR/GBP

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