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“Best to keep Yuan eye on the currency markets”

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David Johnson looks at factors driving currency fluctuations in key markets, and implications for UK property investors buying overseas

The currency market is, as always, being pushed and pulled by several major factors and traders have to weigh the pros and cons of data releases to assess whether it is good or bad for their currency and whether it is more significant than every other piece of information they are factoring into their pricing.

As an example, during June, UK based investors in EU properties were getting some of the best levels on Euro purchases in eight months until the US Dollar surged and clouded the whole picture. However, the €1.51 exchange rate had far more to do with the sluggishness in the European economy than it has to do with any strength in the Pound.

Europe

The EuroZone is currently presenting a less than attractive destination for investment in bonds and financial instruments. Low and stagnant interest rates, an Italian recession, 12% unemployment in Germany, reduced economic growth forecasts for the Eurozone, the rejection of the EU constitution and continuing strife over the Stability and Growth Pact, have all conspired to weaken the case for holding Euros. Despite all that, as long as the GBPEUR exchange rate stayed above €1.4550, there was every reason for it to push up to test the highs of €1.4950 and even €1.5150.

That all changed, though, with the bombings in London on 7th July. Sterling lost its strength in the minutes that followed those awful and callous attacks and the world once again tasted the bitter pill of terrorism. Trans-Atlantic and Trans-Manche buyers were faced with the decline in confidence in the Pound allied to the sharpened blade of a resurgent US Dollar and, despite all the concerns over the Euro, traders selling their Sterling positions, had to buy Euros back to square their books. Consequently, the GBPEUR exchange rate dropped along with the GBPUSD rate. The US Dollar, having driven all in its path since 7th July, has finally declined, allowing the Pound to push it back up within the upward trend that has characterised the GBPUSD exchange rate for three years.

The moves of the last weeks of July were a real ‘shock horror’ moment for traders after three years of continual, and therefore reliable, US Dollar weakness. The sudden weakness of the Pound after the London attacks caused a rush through the \$1.7480 support but the markets failed to follow on with further Sterling selling. The general feeling that the move was overdone, as we approached the Bank of England’s meeting on 4th August, caused a bounce in the GBPUSD exchange rate and kept GBPEUR within a tight range for weeks. Having been utterly convinced that the BoE would lower UK interest rates at their 4th August meeting, traders started to question the certainty and the higher bond market yields caused a rally in the Pound.

United States

US employment is now rising within an economy that is growing at an annual 3.4%, which ranks the US economic growth near the top of the industrialised nations. Even the surge in oil prices hasn’t rocked Uncle Sam’s boat too violently as US oil inventories grew to protect traders from the worst that OPEC and various production problems had to offer. Despite this, the two month bout of US Dollar strength is itself being seen as overdone and the US Dollar is weaker as I write.

China

Away from the obvious effects of the US economy, the debate has raged over whether the Chinese authorities are ready to revalue the Chinese Yuan to a more realistic level. That speculation ended on 21st July when the Chinese Yuan was adjusted to track a basket of currencies - a move that effectively pegged the Yuan to the US Dollar at Y8.11. This 2% adjustment fell far short of the American demands, so no



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sooner had the Chinese announcement hit the newswires than traders were speculating that there would have to be another adjustment some time soon. This idea was resolutely denied by the Chinese and the minuscule 2% adjustment compared to the generally accepted view that the Yuan is still undervalued by more than 20%, allowed the US Dollar to weaken on the basis that a marginally weaker Yuan certainly won't make any noticeable impact on the monstrous US trade deficit. The continued undervaluation, allied to China's low labour costs, boosts exports and the relatively low purchasing power of the Yuan increases the cost of (and thereby restricts the attraction of) imports.

What was very unclear, though, was exactly what a revaluation would do to other currencies. Analysts talked of the weakening of the US Dollar on the news of a change and yet, what has happened is that the slightly stronger Yuan has enticed wealthy Chinese investors to buy US assets and the flow of US Dollar buying has helped the US Dollar to maintain some semblance of strength despite it's recent slide to \$1.78 against the Pound and \$1.23 against the Euro.

This and the dreadful events in London are examples of the way that the foreign exchange market is rarely driven by the blatantly obvious factors. Most property investors will keep a wary eye on the currencies that directly affect them and, in many cases, only watch the exchange rates when they are just about to exchange their funds, only to be taken by total surprise when the rate they were watching has suddenly dived by three cents and cost them thousands of Pounds more.

A UK investor in Florida based property is very likely to have a good idea where the GBPUSD exchange rate is but may not be aware of the effect that an imminent change in the Chinese Yuan or an unexpected geopolitical event might have on their funds or what it could make or lose them on their transaction. Having a specialist currency dealer keep a broad eye on the market for you could make all the difference.

Remember the Velociraptors in Jurassic Park? It's not the one you are watching that gets you. Currency news is like that.

Alastair Sweetman is an FX Consultant with Halo Financial Ltd, a specialist foreign exchange company providing expert currency exchange services to both companies and private individuals. If you are at the start of buying an overseas property or in the process of buying currency to migrate, it is never too soon or too late to save money on foreign exchange. Halo Financial can be contacted on +44 (0)20 7350 5474 and their website can be viewed at www.halofinancial.com