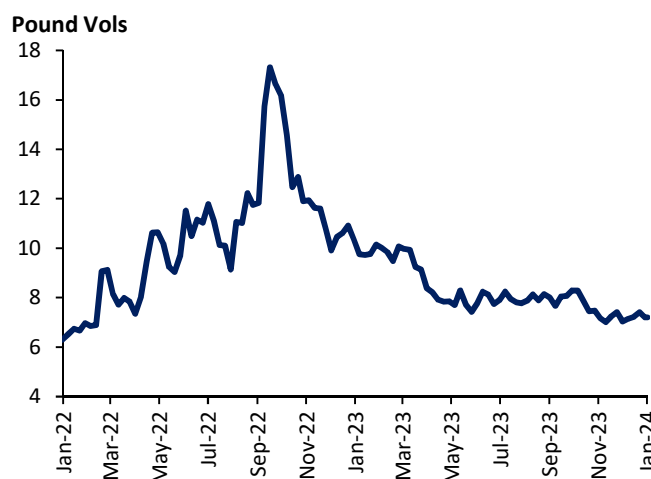


January 15<sup>th</sup>, 2024

## **UK still not out of the woods!!!**

Pound in 2023 has been one of the best performing currencies amongst major crosses, with performance being to the tune of ~5%. Weakness in the dollar has been one of the major contributors for this move, as fundamentals in the UK has not changed much. Overall, volatility for the currency has remained subdued but expect this to take a U-turn in coming months. Recently, the UK economy has faced quite a bit of challenges from higher inflation, the economy has seen a cost of living crisis to increased cost of borrowing. But the underlying question remains that how the economy is performing?

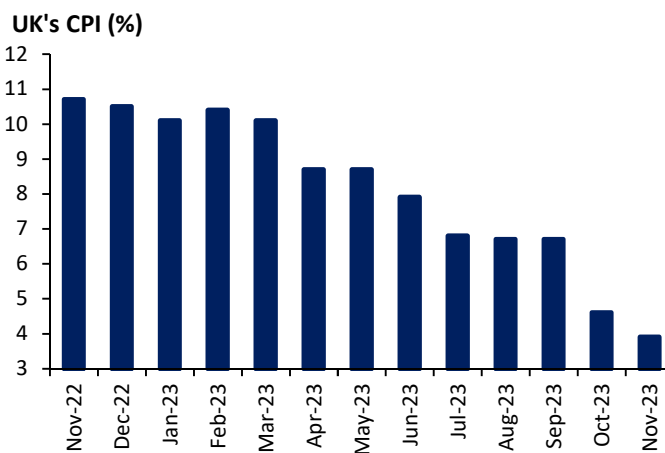


Source: Bloomberg

## **Concern over inflation still haunting?**

Inflation across major economies has receded with inflation in the UK touching to about 11% in October'22 and since then has slowly and steadily fallen. During the same time, the Bank of England (BoE) interest rates rose from 2.25% to 5.25% and since then has almost doubled. Impact of these steps start to show results and we have seen inflation falling to 4% mark, lowest level since Oct'21. While improvement in inflation is welcome and remarkable, legacy of inflation crisis will not end, once price rise at normal rates again.

Recently, the BoE governor mentioned that increase in interest rates has helped bring down inflation from 10% at the start of 2023 to 3% reported in January. The governor is likely to keep a watch on the incoming data and will take decisions necessary to get inflation all the way back to 2%. With households and businesses under pressure from higher borrowing costs, the Bank said it expected GDP growth to be broadly flat at the end of this year and over the coming quarters.



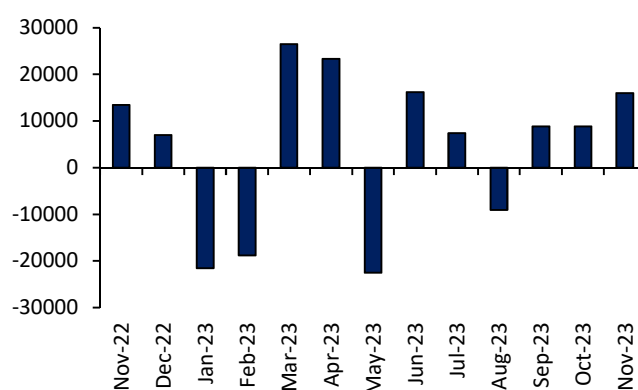
Source: Reuters



## Smaller rate cuts from BoE in 2024

Growth in the UK has been disappointing in the last few quarters and slowed to crawl as households come under pressure from higher living costs. The BoE has warned that there is a 50-50 chance of a recession and latest prediction suggest that growth of the UK economy could remain unchanged in '24. The ratio of debt-to-GDP has risen by comparable magnitudes. While deficits remain large, the government plans to improve budget balance in coming years. Weak activity and higher borrowing costs are expected to weigh heavily on employers' hiring intentions in 2024. The number of job openings has fallen in the recent months suggesting that employment in the UK continues to struggle. Weak hiring demand and cooling inflation, average annual pay growth is expected to fall about 3.7% in 2024 and 2.2% in 2025.

**UK Claimant Count**



Source: Reuters

The UK faces its own challenges; global economy appears to be losing momentum. There are also growing worries over the rising price of oil and a possible slowdown in China, which could act as a drag on global growth. However, longer-term headwinds remain, including an ageing population, and slowing growth in workforce participation, while the cost of tackling climate change is also expected to be hefty. Currently, market participants are expecting that the BoE in this year could cut rates by one percentage point i.e. four rate cuts starting May.

BoE Meetings	Interest Rate Probability
February	Unchanged
March	Unchanged
May	Rate Cut
June	Rate Cut

Source: Reuters

## Outlook

Similar to the Fed, the BoE will also remain data dependent and currently silver lining for pound could be broad weakness in the dollar and an uptick in the consumer confidence in the UK. Both these factors in the near term are likely to restrict further down side for the currency. Inflation has receded in the past few months, but any uptick in near term could spoil the party for the year. We expect that volatility for most of the currencies could remain elevated and will be witnessing a lot of swings at least in the first half of the year. In the short term, we expect that pound rally could be capped and on the higher side could face resistance around 1.2880 level and on the downside, support lies in the zone of at 1.2540 and 1.2480.

# CURRENCY INSIGHT

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