# Forex Focus: Guessing game over Fed's next move

## Speculation that the tap of endless easy money may soon be turned off has put a brake on the world's stock markets, which were booming last month.


Currency markets may seem relatively calm but experts warn that 'the level of uncertainty is still very high' Photo: REUTERS

By Liz Phillips

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On the principle of first in, first out, the US economy seems to have turned the corner and is leading the pack out of the economic crisis. Now the worry is that the Federal Reserve is jumping the gun with its talk of tapering its boundless quantitative easing (QE) programme.

"The concern for the global economy is that central banks are starting to ease back on further stimulus, when in fact many of these markets are crying out for more easy money," says Charles Murray of FC Exchange **(www.fcexchange.co.uk).** "Investors have been spooked by signs that the

Federal Reserve is likely to scale back on its $85bn a month programme."

It seems likely the Fed will move slowly towards less QE with many believing it won't nail its colours to the mast until next month at the earliest. "Speculation that the Federal Reserve could be about to taper its expansive QE3 programme has kept investors on the edge of their seats this year," says Josh Ferry Woodard of TorFX (www.torfx.com)

When it does take its foot off the pedal pumping money into the economy, the dollar should get a boost, but that's not yet. In fact the dollar has weakened in recent weeks, losing ground against both the pound and the euro.

Meanwhile, Japan has only recently joined the QE party this year, causing the yen to veer all over the place.

"The inherent volatility is a by-product of the Japanese being late to the party," says Jeremy Cook of World First (www.worldfirst.com). "The other problem they will encounter is the accusation, especially by trade partners, that they are indulging in 'competitive devaluation' of their currency."

The name of the game is trying to second guess what central banks will do. In the UK this isn't helped by the fact that the Bank of England is about to have a new governor, Mark Carney. He's lucky that he's taking over the reins just as the economy appears to be slowly improving. "With UK data improving at an accelerated pace during the second quarter, the pound has begun to claw back some of its losses from earlier in the year against major currency rivals," says Ferry Woodard.

"However, another dose of QE from Mark Carney could poison demand for sterling and restrict the UK currency from making back any more ground against its peers."

Simon Smith of FXPro (www.FxPro.com) is more sanguine, saying: "I think he will take some time to adjust the way policy is set rather than come in guns blazing. This could limit any potential sterling downside over the summer, especially if we continue to see some better signs from the data."

But both Cook and Murray think he poses the biggest risk to sterling, and Vimal Popat of VPFX Consulting (www.VPFX Consulting.com) believes: "With Carney's arrival next month and his openness to interest rates taking second place to growth, GBP could lose its shine if fundamentals slip and the asset purchasing pot is refilled."

Unlike the UK and the US, the eurozone is not showing signs of improvement. Nevertheless, the euro is still remaining remarkably strong.

"The rise in the euro is bad news for weaker European economies and the ECB is running out of road with respect to monetary policy measures," says Michael Hewson from CMC Markets (www.CMCMarkets.com).

"European politicians would like the central bank to ease the pressure on them to reform. Unfortunately for them they are running into the limits of the central banks mandate and the politics of a German election in September."

Chris Towner of HiFX (www.HiFX.com) agrees: "Europe has a problem with low inflation and the potential to dip into deflation while the economy continues to contract. A stronger euro does not help either of these dilemmas and if we see further increases in the value of the euro, the authorities will soon voice their concerns."

Charles Purdy of Smart Currency Exchange (www.smartcurrencyexchange.com) sums up the global situation: "It seems clear that although the currency markets seem relatively calm, the level of uncertainty is still very high, which means that rapid and unexpected movements are not far from the surface – best then to plan accordingly."