Our Guides - the **Technical Trader's Guide** and the **Macro Trader's Guide** both deal with these and many other markets in much more detail over multiple time- frames. **Key Trades Bulletins** subscribers receive a detailed report on every trade we enter for our Key Trades Portfolio. More details about all these products: CLICK HERE

Market Update 22st April 2010

Short Sterling and the election

The Macro Trader's view:

How will the election affect the Short Sterling market?

Until recently it was widely assumed in the market that UK interest rates were on hold for the rest of 2010. The Bank of England suggested that a spike in inflation would soon resolve to below-target CPI for much of the two-year forecast period.

They advised that:

- **with plenty of spare capacity in the economy resulting from the recession,**
- **a weak Pound,**
- **forecasts of a tepid recovery**

inflation would remain tame and, indeed, the door was left open for future QE operations if needed.

Well, the recovery has begun to look a little more robust. And although some forecasters predict a second period of housing market weakness, that hasn't occurred so far. Additionally, the Pound has weakened further during the last few months and inflation has proved more stubborn and more volatile than expected, making previous assumptions a little less certain.

But there is one more variable, the General election. Why does this have any bearing on UK interest rates? Simply put the UK is running a very large budget deficit and debt to GDP is running at 62%, much higher than before the financial crisis/recession hit.

The explosion of debt has added a huge stimulus to the UK economy, but now the economy is starting to recover that stimulus needs to be withdrawn, the budget deficit reduced and the National debt cut back down to size, (about 40% of GDP).

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By and large the three party leaders agree the deficit needs reducing. They differ by how fast and by what means; tax hikes, tax hikes/spending cuts or spending cuts.

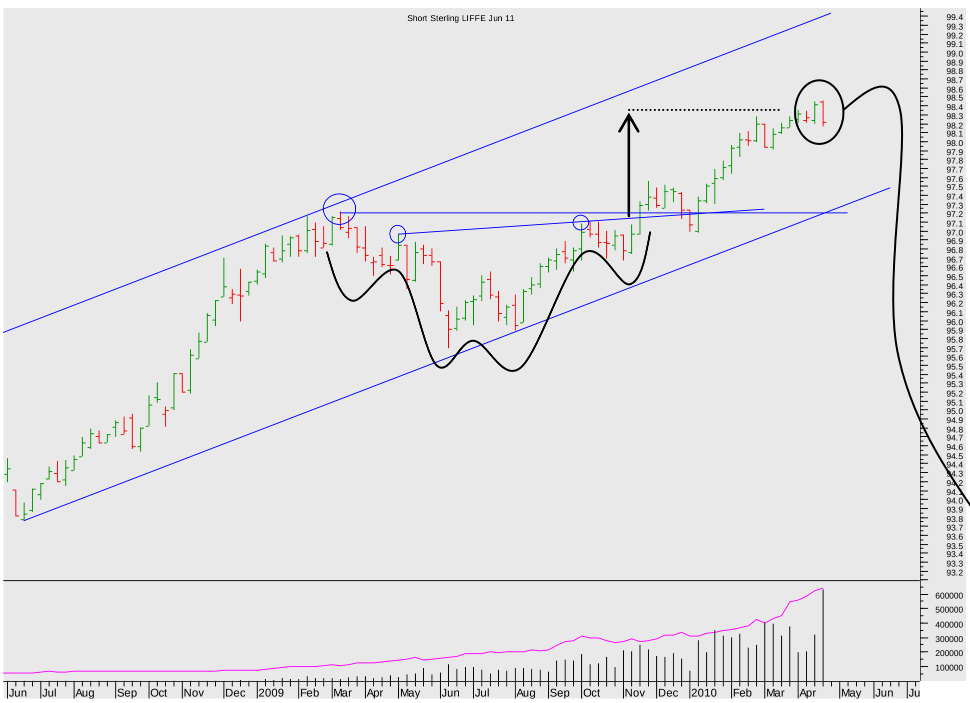
The opposition Conservative party had until a week or so ago looked on course to form the next government. They want to cut the deficit the most aggressively and by relying more on spending cuts with some tax hikes.

This would have removed the fiscal stimulus quite quickly meaning monetary policy would have needed to remain slack to continue aiding the recovery. Now though a hung Parliament really does look like the most likely outcome, meaning the deficit could be cut more slowly with tax hikes the preferred method. That’s if an agenda can be agreed and a government formed.

This option would see the Central Bank judging monetary policy would need to be adjusted upwards sooner than under the previous scenario and the Short Sterling market has sold off over recent days to reflect this new reality.

So the Short Sterling market cares very much about the outcome of the May 6 General election because the **fiscal stance the new government takes, will dictate the path the Bank of England follows with regard to interest rates**.

The Technical Trader’s view:

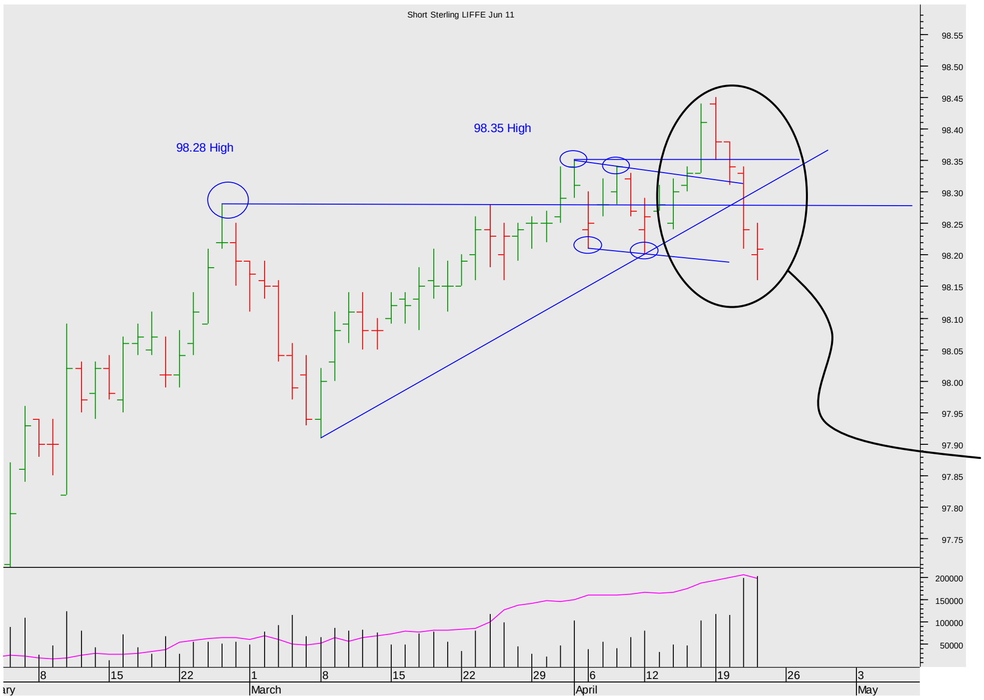


WEEKLY CHART

The market has been in a solid and consistent uptrend.

Note the substantial continuation Head and Shoulders pattern in the middle of the trend – but the minimum measured move has been achieved.

Note too, the possible weekly key reversal (only possible since we need to see the close tomorrow).



DAILY CHART

The detail is intriguing.

The bulls were excited about the way the market finally overcame the Prior High at 98.28, after having dithered there, but completing a flag formation.

But see how the last four days high volume price action has entirely smashed that bull break.

(1) The re-entry into the Flag as well as (2) the pull-back through the 98.28 Prior High support and (3) the break of the weak rising diagonal support ….. these are emphatically bearish, but there is no compelling top formation in place, yet.

In short, traders should wait for the close tomorrow (after the second Leaders' debate) to see if the weekly Key Reversal is substantiated before taking a view.

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Seven Days Ahead

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