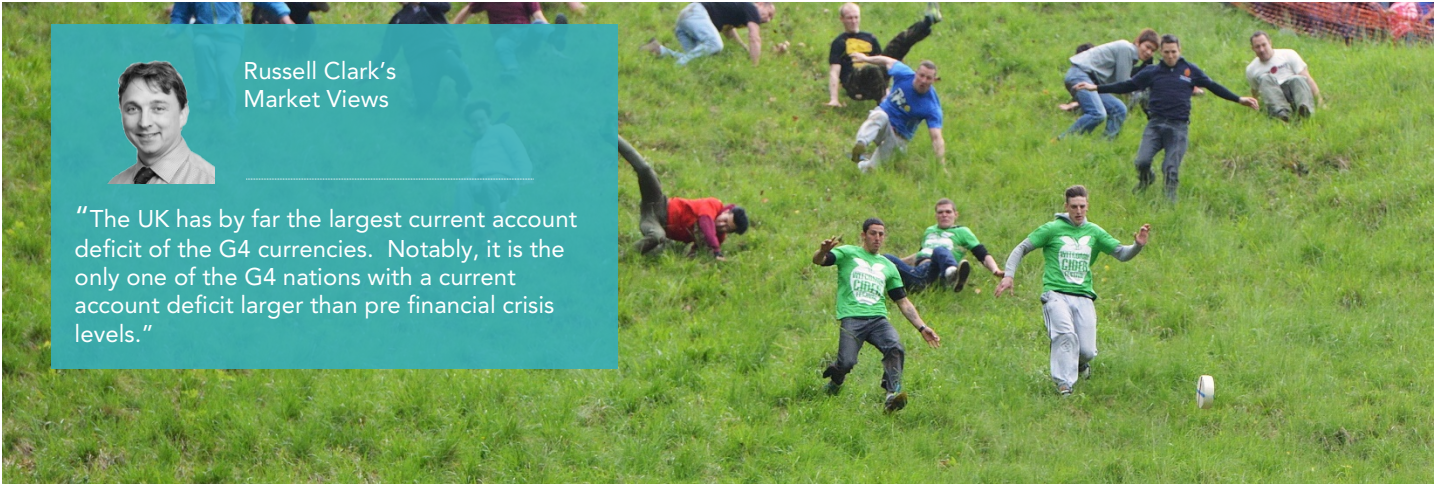
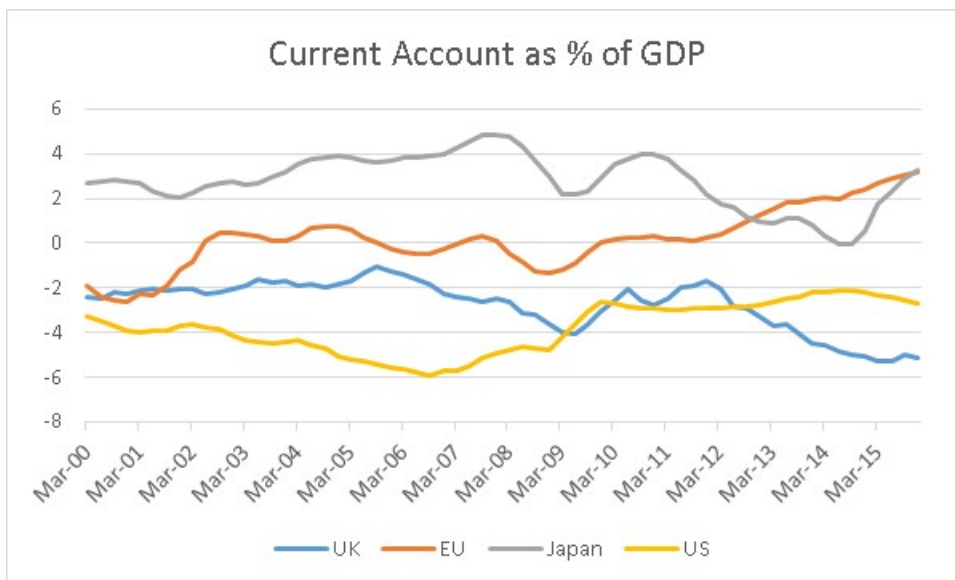


**THE WEAK FUNDAMENTALS OF STERLING – REGARDLESS OF THE REFERENDUM**

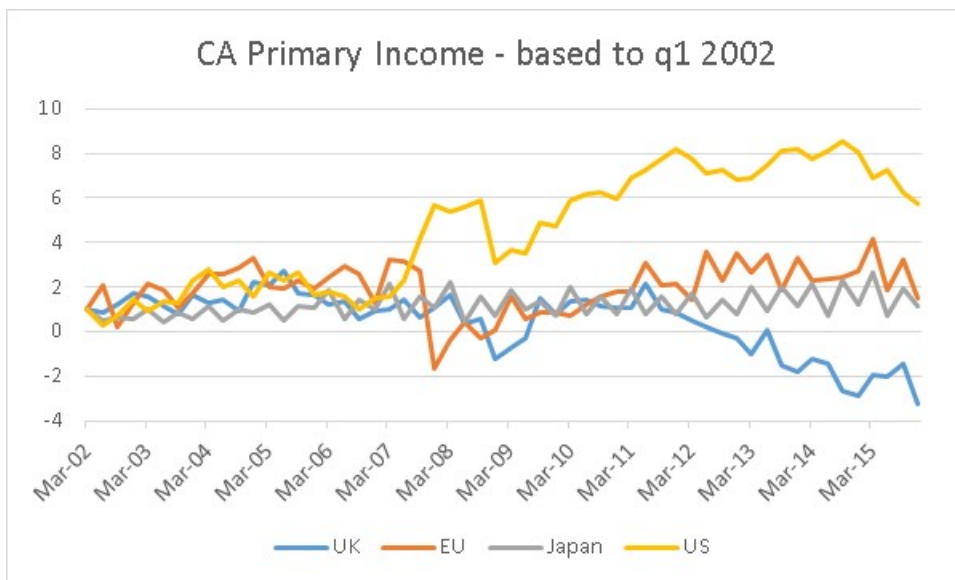


Typically currencies are valued on relative interest rates, and the expectation of the movement of those interest rates. While movement of interest rates determines the direction of currencies, fundamentals such as current accounts and fiscal deficits determine the magnitude of the movement. By these three measures, sterling looks set for a significant fall.

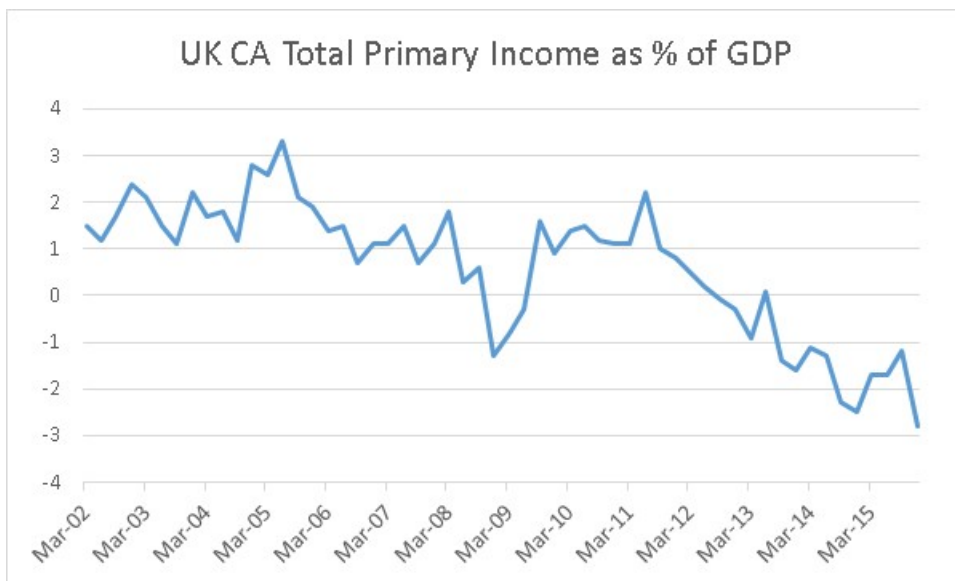
The UK has by far the largest current account (“CA”) deficit of the G4 currencies. Notably, it is the only one of the G4 nations with a current account deficit larger than pre financial crisis levels.



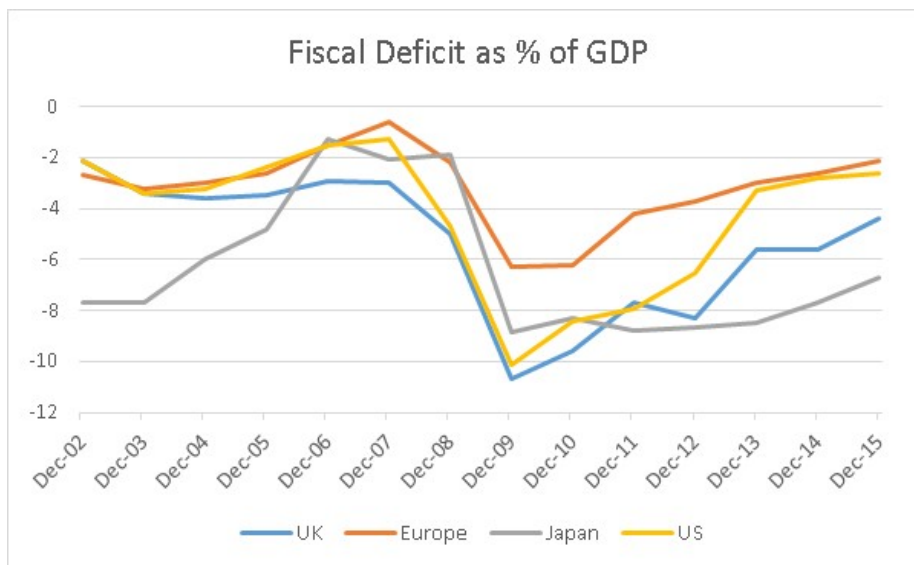
A large part of this deterioration comes from the primary income line of the current account. Primary income is the earnings on foreign investments less payments made to foreign investors.



Oddly, low interest rates should boost primary incomes as it reduces the bond interest flow payments to foreigners. Despite this benefit, the UK pays away a significant amount in primary income now. The Office of National Statistics has primary income moving from a 2% surplus in 2011, to near 3% deficit now.



Typically a widening current account is a sign of much stronger consumption domestically than with its trade partners, and certainly sluggish growth in Europe has contributed to a widening current account deficit. However, typically faster growth tends also to mean better government finances. The UK has oddly had a deteriorating relative fiscal position, despite faster growth, than Europe and US. Only Japan has a weaker fiscal position.



Given the deterioration in the UK’s current account and fiscal position, I would expect the current Sterling devaluation to be of at least a similar magnitude to 2008/9. In 2008/9 against the USD, sterling fell from 2.10 to 1.40 – a 30% fall. From a peak in 2014, sterling has fallen from 1.70 to 1.40 today. A target of 1.1 therefore seems possible.



Given the very large improvement in current accounts and fiscal positions in Eurozone versus the UK, an even larger devaluation than that seen in 2008/9 seems likely to me. GBPEUR peaked at 1.5 in 2007, and fell to 1.04 in 2009, a 30% devaluation. So far since Sterling peaked in 2015 it has fallen 11% from a peak of 1.41 to 1.26 today. Parity versus the Euro seems likely to me, and even a bigger fall is certainly possible.



## INFORMATION

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