WINLOCK

2018 REVIEW OF CURRENCIES

2018 currency fluctuations were all about Brexit – or were they? Here is your review of 2018 courtesy of Winlock

US Dollar

In the first 4 months of 2018 sterling continued to recover steadily against the US dollar, continuing the trend of the last quarter of 2017, and for a short time stood at just over $1.40 which was the best rate seen since the June 16 referendum. However since April we have seen a steady decline back to sub-$1.30 levels similar to rates seen for much of 2017. As the exact nature and timing of our EU departure remains uncertain the market view seems to be that a “soft “ Brexit with minimal trading disruption will see sterling go higher, whilst a “hard” or no -deal Brexit would mean sterling is vulnerable. With little over 2 months to go either outcome remains a possibility and with this in mind the £:$ rate could be anything between $1.15 and $1.50 between April and December of this year. It is likely that importers will refrain from setting 2019 price lists until the Brexit outcome is clearer. At one end of this scale prices will go up by 10% or more, whilst at the other end prices are likely to fall by a similar amount. With improving budget deficit numbers and strong employment growth one would expect to see sterling rise if the Brexit outcome is even remotely favourable, but it would be a brave man who would bet on such an outcome.

Euro

Despite the continuing ups and downs of the Brexit negotiations sterling has traded in a fairly narrow band against the euro in 2018, rarely straying from the €1.10-1.14 range all year. This is partly because a bad Brexit outcome for the UK is equally bad news for the EU, and in particular Germany, Holland and Ireland, and partly because the EU still has significant structural issues that it is making little progress in resolving. These issues include Germany having a huge trade surplus with the rest of the EU which would ordinarily mean Germany’s currency rising and the partner countries falling – impossible with the Euro. As a result Germany gets richer and the southern European states are forced into more budget cuts and high unemployment. In the long run either Germany will agree to “subsidise” these debtor countries or the Eurozone will have to split. This remains the case irrespective of what happens to the UK. Hence whilst the euro is likely to be weakened by a no deal Brexit it is unlikely to strengthened much by a more positive outcome as it’s fundamental weaknesses remain. This being the case the likely upside for sterling against the euro is much higher than the downside, so maybe a range of €1.05 - €1.20 is probable. Again – don’t put your mortgage on it! Not least because it will be some years before a UK – EU trade deal is agreed even if the UK departs on time on March 29th.

Chinese Yuan

As with the euro sterling has traded in a fairly narrow band against the yuan in 2018, approximately in the range CNY 8.6 to CNY 9.1. Again this is more to do with China's domestic economic problems rather than sterling being stable. China still has huge underlying problems with bad property loans some of which are almost impossible to track because they are so called "peer to peer" loans. These loans are not from banks but from private sources and are often used to raise a deposit for a property loan from a bank - meaning that the effective equity at the outset could be zero! Remind anyone of Northern Rock or the US sub-prime market 12 years ago ? The Chinese government will simply not allow these bad loans to disrupt the economy in the way free markets might, but even so there is a noticeable tightening of personal credit which is one of the reasons Chinese new car sales fell significantly in 2018. Add in a brewing trade war with the US, with tariffs already in place on many items, and it is clear that the growth outlook for the Chinese economy is not great. The Chinese government will undoubtedly cut exchange rates if it thinks this is needed to keep the economy growing, but this will place yet further strain on its relations with the US. With Vietnam growing rapidly on its doorstep China is unlikely to allow the yuan to rise in 2019 which should keep price increases on China sourced items relatively small.

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