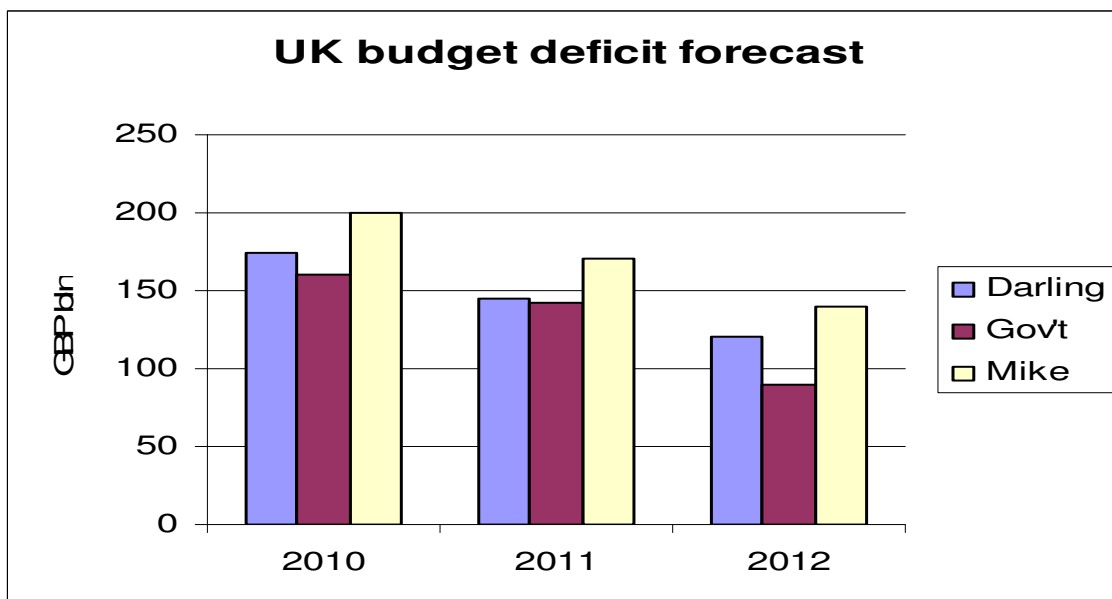


Selling England by the pound

GBP traded at a 10 month low versus the USD and weakened to 91 pence versus the EUR for the first time since December. GBP was pressured by UK political, economic and monetary policy uncertainty with the decline versus the EUR partly attributed to speculation that EU is nearing agreement on an aid package for Greece. GBP was also pressured by report that British life insurer Prudential will buy AIG's Asia life insurance business for \$35.5bln. If this deal goes through Prudential will have to sell a lot of GBP for USD. The impact of the AIG news should be limited for GBP.

GBP traded sharply lower Monday in reaction to UK election polls and concern about UK debt. GBP traded below 1.50 versus the USD for the first time since last May pressured by a Sunday Times UK election poll which showed that the opposition Conservative party's lead over the ruling Labor Party had narrowed to two percentage points. The UK is expected to hold a national election on May 6th. (The election must be held by June 3rd.) Today's UK election poll increases the risk that the UK will have its first minority government since 1974 and that the UK election will result in a hung parliament. A minority government would need the help of other parties to pass legislation and budget reform. A hung parliament could lead to gridlock and lack of credible effort to reduce the UK deficit. Rating agencies have warned that the UK AAA sovereign debt rating is at risk for downgrade if the UK government does not take credible action to reduce its rising deficit. A hung parliament will make it much more difficult for the UK government take action to reduce the UK deficit and investors are aggressively selling the GBP. UK government spending rose by 1.2% in Q4.



There is additional concern that the new UK government will be under intense pressure to take immediate action to reduce the UK deficit. A premature withdrawal of UK stimulus while the UK economy is still struggling could lead to more significant deterioration not only in the economy but the long-range deficit outlook. Analysts at Tokyo Mitsubishi forecast that GBP losses could accelerate towards 1.40 because the formation of a minority government in the UK could reduce

the chance of UK budget reform. Analysts at UBS said that GBP could fall below parity with the EUR and to 1.05 versus the USD if the UK government prematurely withdraws stimulus and tightens fiscal policy.

UK political uncertainty is not the only negative for the GBP. GBP is also pressured by uncertainty about the strength and sustainability of the UK recovery and uncertainty outlook for BOE monetary policy. Recent UK economic data has been mixed with improvement in the housing sector slowing, jobs claimant count rising and Monday the UK reported weaker than expected mortgage approvals and lending in January. These reports generate concern about the sustainability of UK recovery and have prompted statements from a number of BOE officials including the BOE Governor King that the BOE may have to consider expanding quantitative ease. The BOE will conclude a two day monetary policy meeting Thursday. Market consensus is the BOE will hold interest rate policy unchanged but there is a great deal of uncertainty about whether the BOE will elect to expand quantitative ease. If the BOE were to expand quantitative ease it would be an additional negative for the GBP.

GBP has declined 8% versus the USD and 2.4% versus the EUR since the start of the year pressured by concern about UK debt and election uncertainty. The UK will need to raise a record £178bln in 2010. UK GDP debt ratio is over 12% which makes the UK debt shortfall similar to Greece. Many analysts are asking the question whether the UK is the next Greece. The fundamental outlook for the GBP remains negative. UK election uncertainty will increase the risk of a hung parliament and diminishes the likelihood that the UK will take quick action to reduce its deficit. GBP remains vulnerable to rising UK budget deficit, concern about UK recovery and speculation the BOE may expand quantitative ease.

UK technical outlook is also negative with today's break below 1.5000. Expect GBP/USD support at 1.4685 the April 29th low with resistance at 1.5230 March 1st high.



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