BARCLAYS COMMERCIAL

Interest & Exchange Rate Outlook

January 2010

Welcome to our latest bulletin, which provides information only commentary on the issues affecting interest and exchange rates.

Economic Background

Bank Rate remained unchanged at its historic low of 0.5% following the January meeting of the Monetary Policy Committee (MPC). The limit on the £200 billion Asset Purchase Facility (APF), through which the Bank conducts its quantitative easing (QE) policy, was also left unchanged this month. Both decisions were widely expected, with most observers taking the view that, in the absence of any significant shocks, a decisive policy shift appeared unlikely until February, when the current APF limit is due to be reached and the Bank's latest inflation forecasts will be available to the MPC.

A raft of broadly positive data releases since the previous MPC meeting also mitigated against any substantive change in monetary policy this month. Revised data show that, although still in recession, the UK economy contracted by 0.2% in the third quarter, rather than 0.4% as originally estimated. Based on the previous estimate of GDP growth, the MPC also noted in the minutes of its previous meeting that the mix of demand evident in the third quarter "was consistent with greater momentum looking ahead," with consumption and investment showing signs of stabilising "earlier than anticipated" and growth still to benefit from re-stocking. This view is consistent with the latest GDP data and with the more timely Purchasing Managers' Indices (PMIs), which indicated that both the services and manufacturing sectors experienced healthy growth at the end of 2009, suggesting a resumption of growth in the wider economy in the final quarter of last year.

The available evidence also suggests that retail sales remain resilient, with a number of major retailers reporting buoyant Christmas sales. Wider consumer spending, has also been bolstered by the government car scrappage scheme, which saw car sales increase by 40% in December 2009 from December 2008.

Rising prices and mortgage approvals also suggest that, although it remains relatively weak, the UK housing market is continuing to recover, while the rate of growth in UK unemployment has also begun to ease.

Period Averages	Base Rates	12-Month Interbank	3-Year Swap	5-Year Swap	Euro/£	Dollar/£
2006	4.64	5.0	5.1	5.0	1.47	1.84
2007	5.51	6.0	5.8	5.7	1.46	2.00
2008	4.68	5.6	5.0	5.0	1.26	1.85
2009	0.64	1.7	2.6	3.3	1.12	1.57
Q1 2009	1.07	2.4	2.5	3.0	1.10	1.43
Q2 2009	0.50	1.9	2.7	3.3	1.14	1.55
Q3 2009	0.50	1.4	2.7	3.5	1.15	1.64
Q4 2009	0.50	1.2	2.5	3.2	1.11	1.63
October 2009	0.50	1.2	2.5	3.2	1.09	1.62
November 2009	0.50	1.2	2.5	3.2	1.11	1.66
December 2009	0.50	1.3	2.5	3.2	1.11	1.62
Forecasts[1]:						
April 2010	0.50	1.6	2.9	3.4	1.11	1.62
July 2010	0.50	2.0	3.2	3.6	1.11	1.61
January 2011	1.50	2.8	3.7	4.0	1.11	1.61

[1]Based on market implied forward rates (source: Bank of England, Bloomberg & Barclays Bank).

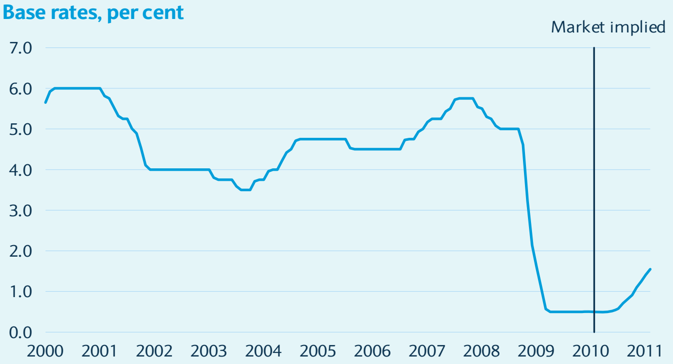
Nevertheless, the recovery is still at a very early stage and remains fragile. Looking ahead, the UK economy faces significant challenges - notably the reversal of the substantial policy stimulus on which recovery to date has largely been based. Money growth in the real economy, a key measure of the effectiveness of QE, remains "disappointing," according to the MPC, with further balance sheet repair in the household, financial and corporate sector likely to constrain medium-term growth.

At the same time, rising unit labour costs and declining productivity suggest that firms could be less willing and/or able to continue to 'hoard' labour if recovery proves weaker than anticipated. As well as dampening economic growth, this risks undermining the nascent recovery in the housing market which, thus far, has largely been driven by restricted supply, rather than resurgent demand. Although factors, such as this month's reversion to the full rate of VAT are likely to cause a near-term spike in inflation, the MPC believes that persistent spare capacity is likely to constrain medium term inflationary pressures.

Interest Rates

November's £25 billion increase in the APF limit was widely viewed as an attempt by the MPC to wind down QE gradually. As a result, no further increase to the APF limit is currently expected. However the MPC is likely to retain the option of resuming asset purchases, given the high degree of uncertainty over the outlook for the economy and the need to avoid the sort of short-term bond market volatility that a more formal end to QE might prompt.

UK interest rates
Base rates, per cent



Source: Bank of England & Barclays Bank

Nevertheless, with recovery expected to be protracted and inflation subdued, market participants do not expect Bank Rate to increase until August 2010. Monetary policy is expected to remain accommodative for some time thereafter, with base rates not currently expected to move back to a more 'normal' range (of 4%-6%) until 2012.

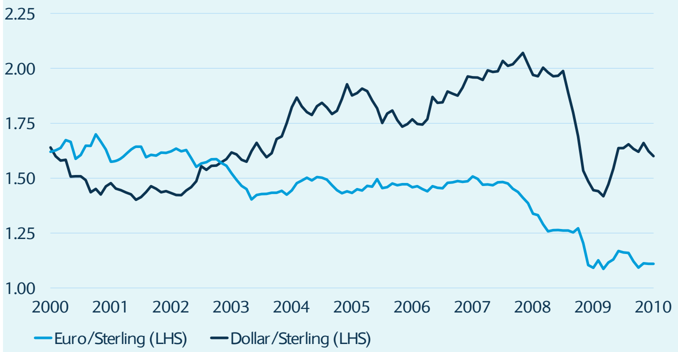
In the US, the Federal Reserve once more expressed its willingness to maintain the federal funds target rate at "exceptionally low levels" for an "extended" period to support recovery, following its December policy meeting. However, the Fed will continue to slow the pace of its asset purchase programme, which it expects to have fully executed by the end of the first quarter of 2010 (although it will continue to review the programme). Officials also confirmed that most of the Fed's special liquidity facilities will expire, as scheduled, on 1st February, in light of improved financial market conditions.

The European Central Bank (ECB) is expected to keep its main policy rate on hold at 1% this month (and for the remainder of 2010). However, the ECB has also begun unwinding its programme of 'enhanced credit support.'

Exchange Rates

The euro fell by 2.2% against the US dollar during December (based on monthly averages). While concerns persist over the outlook for US public finances, events in Greece have thrown the significant challenges facing several of the eurozone's peripheral member states into the spotlight in recent weeks, eroding support for the euro.

Sterling exchange rates
Monthly averages*



*Latest observation 8th January 2010 Source: Bank of England

Although this helped offset renewed concerns over the UK's public finances, in terms of the euro:sterling exchange rate (which remained little changed in December), the pound also depreciated by 2.2% against the dollar last month.

Prepared: 11th January 2010

Please note: This bulletin, and the commentary within it, is provided by Barclays Bank PLC and is intended to be used as information only. Whilst Barclays and its employees take every care to ensure that the content is accurate, Barclays will accept no responsibility or liability in respect of any errors, inaccuracies and losses which may arise from its use.

Source of ONS data: National Statistics website: www.statistics.gov.uk

Barclays Bank PLC Commercial Bank Marketing Services.
Authorised and regulated by the Financial Services Authority.
Registered in England. Registered No: 1026167. Registered Office: 1 Churchill Place, London E14 5HP.