

UK markets likely overreacting to Brexit deal optimism

Remarks by Jean-Claude Juncker have sparked a rally in the pound. We think it's overdone



📌 GBP: Deal expectations likely overdone

Renewed optimism about a possible Brexit deal prompted another round of short-squeezing in sterling crosses, pushing cable above two-month highs. Outgoing EU Commission President Jean-Claude Juncker expressed optimism about the possibility of dropping the Irish “backstop” from a Brexit deal, adding that a new deal could be agreed before 31 October. We suspect markets have partly overreacted to the comments, especially considering that the main EU countries involved in the negotiations (France, above all), have not shown a similarly optimistic tone of late. We continue to see the chances of a new Brexit deal as limited, which leads us to believe that the rally in sterling may be short. Elsewhere, the Bank of England announced monetary policy yesterday and – [as highlighted by our UK economist](#) – is sounding increasingly cautious on the back of Brexit concerns, signalling a decreasing probability of monetary tightening ahead. Meanwhile, investors will await a Supreme Court ruling (most likely on Monday) on the legality of Boris Johnson's parliamentary suspension. The short-term impact should be limited (hence, GBP may show little reaction to the news), given that the initial intent of suspending parliament was to prevent it from passing legislation to stop no-deal (which was eventually approved).

➔ USD: Rate expectations unchanged after Fed

The dollar retracted yesterday, erasing all the gains from Wednesday's announcement by the Federal Reserve, with the DXY now hovering below pre-meeting levels. A look at the OIS curve partly explains this dynamic: rate expectations are mostly unchanged compared to the start of this week, with markets now pricing 32 basis points of cuts by year-end and 100bps by 4Q20. The week is likely to end on a quiet note on global markets, given the absence of major events and releases. The focus already seems to be shifting back to US-China trade talks and lingering hopes of a de-escalation in trade tensions may keep the emerging markets FX space supported today, while the dollar is likely to stay capped across the board.

➔ EUR: Moving in a tight range

The EU Commission's September consumer confidence index is expected to show a further stabilisation, although the market impact of this data is usually very limited. EUR/USD may even out around the middle of the 10.10-10.11 range.

⬇ CAD: Beware any correction in oil prices

Inflation data this week was in line with expectations, leaving price action in the Canadian dollar almost entirely driven by risk sentiment and oil prices. Today, July retail sales should mark a slight rebound, but shouldn't have a major market impact. Meanwhile, Saudi Aramco is shrugging off concerns about its ability to restore full production, which may suggest some further downside correction in crude prices. In turn, CAD upside may remain limited in coming days.

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