FX Daily: Sterling's downside risk is underpriced

We think the GBP market is overly complacent about the possibility of the Brexit transition period coming to an end this year, with no trade deal in place

Source: iStockphoto

USD: Dismal April US data

The USD appreciation trend of recent days eased overnight, with the focus turning to US data points today. US April retail sales and industrial production should show a dismal picture as the lockdown only kicked in from mid March (meaning the previous month was not fully affected and in April there was no panic buying of groceries). But even backward looking indicators - which could prompt concerns about the pace of the recovery and keep risk sentiment fragile - should not be negative for the USD.

EUR: Looking for possible revision

We could see a weaker than expected German 1Q GDP number - delayed until 10am GMT - which may push down the 1Q eurozone GDP estimate. Uncertainty remains very high, given the Covid-19 effect. We also have a Eurogroup meeting today but any meaningful announcement seems unlikely. EUR/USD to stay around the 1.08 level today.

GBP: Markets look too complacent on transition risk

Little progress has been made in the UK-EU trade negations so far, with both sides reported as being far away on the conditions of the possible trade deal while the UK continues to refuse any extension to the transition period. We view the GBP market as overly complacent to such a risk. The GBP downside risk being under-priced by the market is evident in (i) the GBP implied volatility term structure, (ii) speculative positioning and (iii) the lack of risk premia in the GBP spot market. We expect pressure on GBP to grow going into the June deadline for the extension of the transition period. Non-extension would likely bring EUR/GBP above 0.90 by end June.

CE3: Markets looking through the 1Q GDP data

CE3 1Q GDP figures are published this morning. In Hungary, our economists think construction will surprise on the upside, meaning that Hungary will be able to avoid a significant quarter-on-quarter GDP contraction, for now. We expect a relatively mild slowdown in Poland, with Czech Republic growth being the most negative of the CE3 economies in 1Q. Still for all countries, the bottom will come in 2Q. As the second quarter will be the worst for growth and first quarter GDP data provides a backward-looking view, we expect a fairly limited impact on local FX. We continue to view the recent Czech koruna fall as exaggerated (we don't think the re-introduction of the FX floor is imminent, with the bar for this being set very high – ie, a risk of deflation) while the Polish zloty should underperform the Hungarian forint given Poland's large QE.

Authors

Chris Turner
Global Head of Markets and Regional Head of Research for UK & CEE
chris.turner@ing.com

Francesco Pesole
FX Strategist
francesco.pesole@ing.com