

FX Daily: Technical reality check for sterling

The chances of a Brexit deal may have risen but we think the market has got ahead of itself and the pound is vulnerable



➔ USD: The trade deal offers no durable solution

While the tentative US-China mini deal is non-negative for markets (and has partly exceeded previously low market expectations) it does not, in our view, offer a durable solution to the trade conflict. As per [US-China trade deal; don't get over excited](#), there has been no resolution on issues such as intellectual property rights or forced technology transfers. China agreed to increase purchases of US agricultural goods while the US has agreed to hold off on additional tariffs this month. This is not enough to reverse soft business sentiment and depressed production and investment in manufacturing around the world. Hence, we look for a rather short-lived boost to emerging market FX and cyclical G10 currencies. The latter (i.e. the Australian and New Zealand dollars) have already seen a partial reversal of last week's gains overnight as the case for a risk-on strategy is not strong enough. The FX segment which should benefit the most from the trade truce is emerging Asia FX as (a) this is the currency basket with the largest downside risk potential

and (b) an improved near-term CNY outlook is supportive for regional FX.

➔ EUR: Still little upside potential

With the initial optimism about the US-China trade deal fading, EUR/USD upside has stalled. As the boost from the deal won't be large enough to weigh on the US dollar or cause a large rebound in cyclical FX, EUR/USD upside should remain limited. The euro still remains an attractive funding currency for tactical EM FX longs.

⬇️ GBP: The reality check

The pound has reversed some of its gains from last week as reality sets in. While UK-EU negotiations have moved on to "tunnel discussions" (i.e. detailed technical talks), the latest reports suggest that the UK has not so far offered an acceptable solution on the Irish border issue, with the current UK proposal on customs seen as very complicated. With the EU summit starting this Thursday, we still see a high bar for the talks to progress successfully (although the probability of a deal has risen). Large GBP gains have, in part, been caused by meaningful short speculative positioning, exaggerating the effect of the news flow. With the market possibly getting ahead of itself, the pound is now vulnerable to a sell-off should the talks break down again. EUR/GBP to converge toward 0.8800.

➔ PLN: Election result neutral for the zloty

As widely expected, the ruling PiS won parliamentary elections over the weekend, with around 44% in exit polls. Still, this is not a large enough majority for the ruling party to make constitutional changes or overturn a Presidential veto. This also suggests that some PiS pledges (such as the minimum wage rise) may be watered down. As per [Poland: Elections preview](#), this is in line with our base case and should be neutral for the zloty.