

FX: Sterling risk premium tracker

We have observed a general reduction in various GBP risk premia measures over the past week, with UK legislation against a no deal Brexit on 31 October helping the battered pound. Still, early elections in late November / early December remain our base case and we retain a negative view on GBP for 4Q19

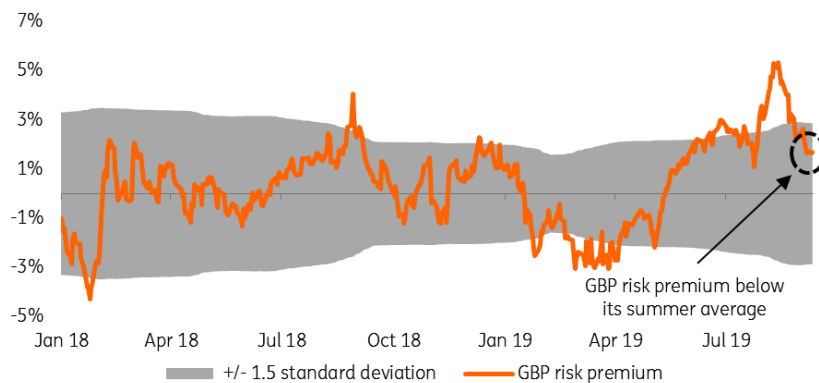


Where we are now?

The pound has strengthened over the past few days amid UK legislation against a no deal Brexit and stretched short GBP positioning. As a result, EUR/GBP risk premium has dropped and is now close to 1.5%. This is well below the summer average of 3% and the risk premium peak of 5.3% last month (Figure 1).

Figure 1: GBP risk premium declined further

The estimate of EUR/GBP risk premium. A residual between EUR/GBP short-term financial fair value and the spot.

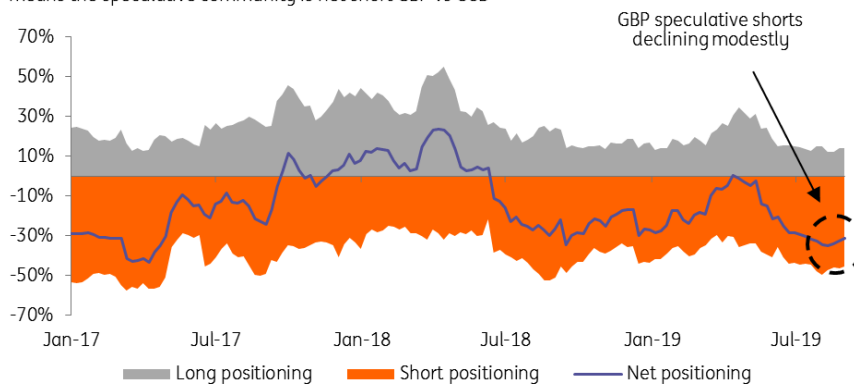


Source: ING

The GBP/USD speculative shorts remain elevated but have been modestly declining over recent weeks (Figure 2). As the data is reported with a lag, we suspect the speculative shorts are currently lower than the latest available data suggests (i.e. below 30% of open interest vs the last figure of 31%).

Figure 2: Speculative positioning lower but still elevated

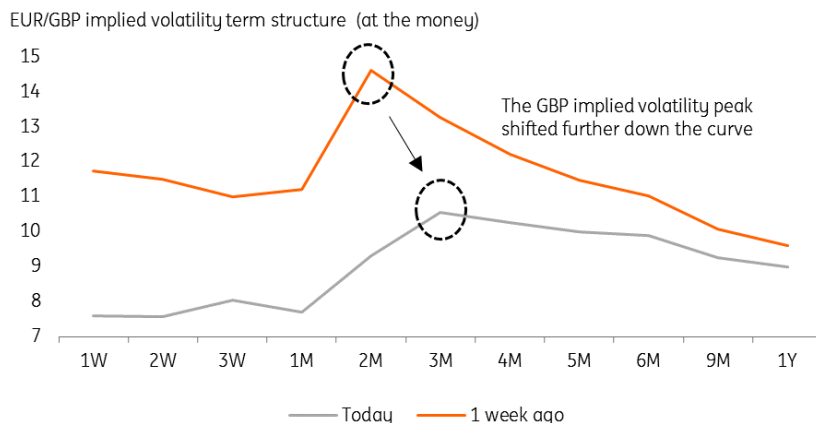
GBP/USD speculative positioning, as % of open interest (as of 3rd September 2019). Negative number means the speculative community is net short GBP vs USD



Source: ING, CFTC

The reduction in immediate risk of a no deal Brexit is very apparent in the options market. Not only has sterling implied volatility declined across all tenors, but as Figure 3 shows, the peak in volatility has shifted further down the curve from the two-month tenor (expiring shortly after the 31 October "do or die" deadline) to three months (the period when the possible election campaign should escalate / elections could take place). The options pricing, albeit currently less extreme, directly ties in with our view that more pressure on GBP is still to come ahead of a general election, which we expect in late November / early December this year.

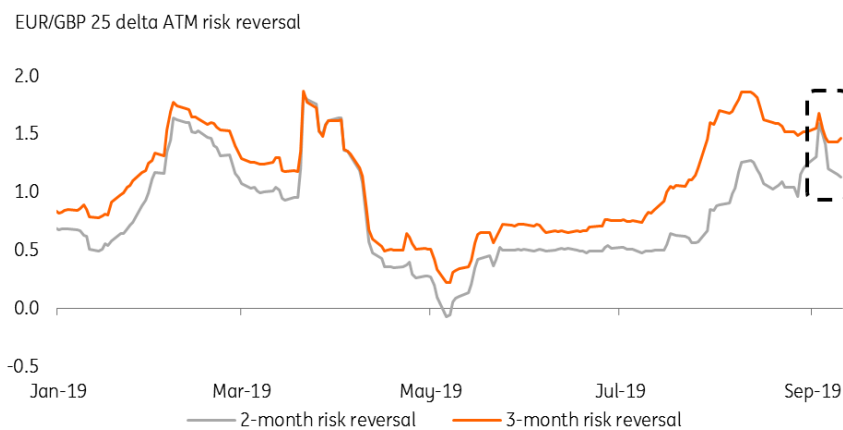
Figure 3: The GBP implied volatility peak shifted further down the curve



Source: ING, Bloomberg

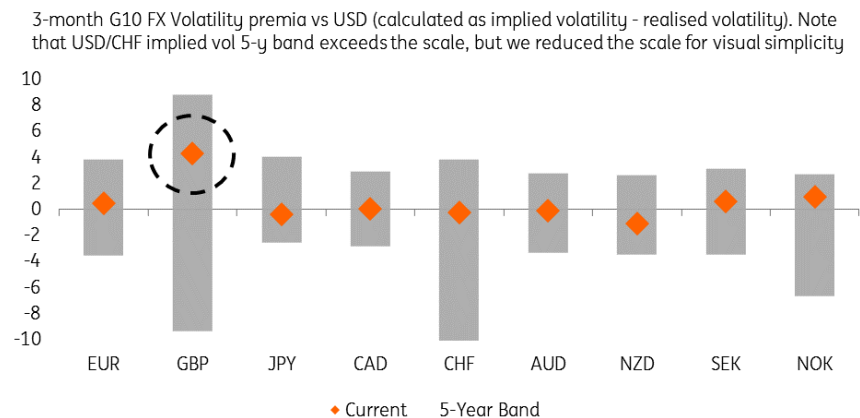
Indeed, the overhang of the early election within the three-month period (but after the 31 October deadline) is the key reason why three-month EUR/GBP risk reversals did not correct as much as the two-month tenor (Figure 4). We expect the sterling volatility risk premium to remain elevated vs its G10 peers (Figure 5), particularly the three-month tenor.

Figure 4: More limited correction in three-month EUR/GBP risk reversals



Source: ING, Bloomberg

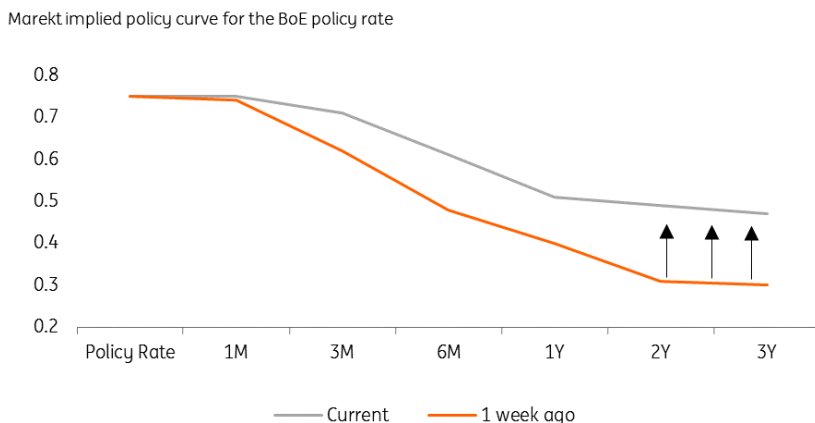
Figure 5: Sterling volatility risk premium to remain the highest in the G10 FX space



Source: ING, Bloomberg

With the risk of an imminent no deal Brexit declining, the market is now pricing (Figure 6) less aggressive easing from the Bank of England (though some of the hawkish re-pricing has also been caused by the rise in core yields) and sterling has been outperforming its G10 FX peers (Figure 7). As per below, we don't expect GBP gains to be long lasting.

Figure 6: Market pricing less aggressive BoE easing



Source: ING, Bloomberg

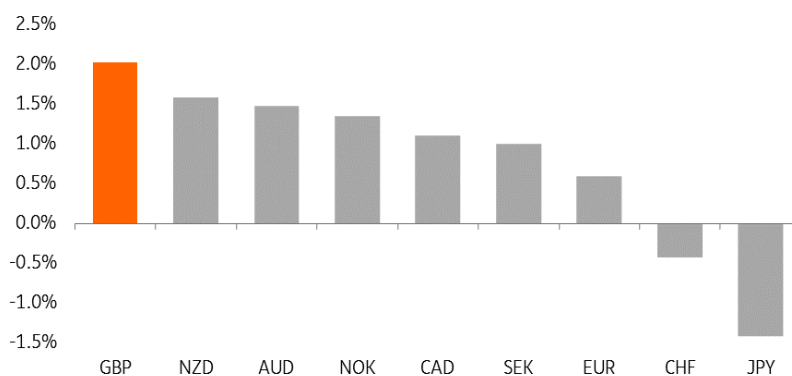
What to look for?

The UK Parliament has now been suspended for the next five weeks, with legislation against a no deal Brexit in place. For now, GBP may enjoy a calmer period with occasional upside caused by the still-stretched positioning. Yet, given our base case for early elections in late November / early December (likely to be triggered by a vote of no confidence) we expect GBP to come back under pressure. Among other things, the possible victory of the Conservative party under the leadership of Boris Johnson would mean an increased likelihood of no deal Brexit should Conservatives achieve a Parliamentary majority.

This suggests that the current subdued risk premium in the pound will increase, in turn weighing on the currency. We expect EUR/GBP to converge towards the 0.95 level and GBP/USD to fall below 1.20 over the next three months.

Figure 7: GBP outperforming as risk premium priced out of sterling

G10 FX returns vs USD over the past 5 days



Source: ING, Bloomberg

Author

Alissa Lefebre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic
420 770 321 486
david.havrlant@ing.com

Sander Burgers
Senior Economist, Dutch Housing
sander.burgers@ing.com

Lynn Song
Chief Economist, Greater China
lynn.song@asia.ing.com

Michiel Tukker
Senior European Rates Strategist
michiel.tukker@ing.com

Michal Rubaszek
Senior Economist, Poland
michal.rubaszek@ing.pl

This is a test author

Stefan Posea
Economist, Romania
tiberiu-stefan.posea@ing.com

Marine Leleux
Sector Strategist, Financials
marine.leleux2@ing.com

Jesse Norcross
Senior Sector Strategist, Real Estate
jesse.norcross@ing.com

Teise Stellema
Research Assistant, Energy Transition
teise.stellema@ing.com

Diederik Stadig
Sector Economist, TMT & Healthcare
diederik.stadig@ing.com

Diogo Gouveia
Sector Economist
diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials
marine.leleux2@ing.com

Ewa Manthey
Commodities Strategist
ewa.manthey@ing.com

ING Analysts

James Wilson
EM Sovereign Strategist
James.wilson@ing.com

Sophie Smith
Digital Editor
sophie.smith@ing.com

Frantisek Taborsky
EMEA FX & FI Strategist
frantisek.taborsky@ing.com

Adam Antoniak
Senior Economist, Poland
adam.antoniak@ing.pl

Min Joo Kang
Senior Economist, South Korea and Japan
min.joo.kang@asia.ing.com

Coco Zhang
ESG Research
coco.zhang@ing.com

Jan Frederik Slijkerman
Senior Sector Strategist, TMT
jan.frederik.slijkerman@ing.com

Katinka Jongkind
Senior Economist, Services and Leisure
Katinka.Jongkind@ing.com

Marina Le Blanc
Sector Strategist, Financials
Marina.Le.Blanc@ing.com

Samuel Abettan
Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany
Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst
rebecca.byrne@ing.com

Mirjam Bani

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)
mirjam.bani@ing.com

Timothy Rahill

Credit Strategist
timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland
leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist
oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy
antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research
jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare
edse.dantuma@ing.com

Francesco Pesole

FX Strategist
francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics
Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst

egor.fedorov@ing.com

Sebastian Franke

Consumer Economist

sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy

gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy

nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland

charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist

+31(0)611172684

laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania

valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK

james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials

suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante
Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klok
Senior Economist, Netherlands
marcel.klok@ing.com

Piotr Poplawski
Senior Economist, Poland
piotr.poplawski@ing.pl

Paolo Pizzoli
Senior Economist, Italy, Greece
paolo.pizzoli@ing.com

Marieke Blom
Chief Economist and Global Head of Research
marieke.blom@ing.com

Raoul Leering
Senior Macro Economist
raoul.leering@ing.com

Maarten Leen
Head of Global IFRS9 ME Scenarios
maarten.leen@ing.com

Maureen Schuller
Head of Financials Sector Strategy
Maureen.Schuller@ing.com

Warren Patterson
Head of Commodities Strategy
Warren.Patterson@asia.ing.com

Rafal Benecki
Chief Economist, Poland
rafal.benecki@ing.pl

Philippe Ledent
Senior Economist, Belgium, Luxembourg
philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary
peter.virovacz@ing.com

Inga Fechner
Senior Economist, Germany, Global Trade
inga.fechner@ing.de

Dimitry Fleming
Senior Data Analyst, Netherlands
Dimitry.Fleming@ing.com

Ciprian Dascalu
Chief Economist, Romania
+40 31 406 8990
ciprian.dascalu@ing.com

Muhammet Mercan
Chief Economist, Turkey
muhammet.mercan@ingbank.com.tr

Iris Pang
Chief Economist, Greater China
iris.pang@asia.ing.com

Sophie Freeman
Writer, Group Research
+44 20 7767 6209
Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA
Regional Head of Research, Americas
padhraic.garvey@ing.com

James Knightley
Chief International Economist, US
james.knightley@ing.com

Tim Condon
Asia Chief Economist
+65 6232-6020

Martin van Vliet
Senior Interest Rate Strategist
+31 20 563 8801
martin.van.vliet@ing.com

Karol Pogorzelski
Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

Global Head of Markets and Regional Head of Research for UK & CEE

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com