

GBP: Bar still high for pronounced sterling rally

If a Brexit deal is agreed, the pound could see further gains but they're unlikely to be material



Theresa May, UK Prime Minister

Source: Shutterstock

📈 GBP: Despite glimmers of hope, the bar for any material rally is still high

Sterling rallied yesterday in response to news that the UK and EU had agreed a Brexit deal. The focus turns to the UK cabinet meeting this afternoon and whether the deal is sealed by the government. If agreed, GBP may see further gains, though these are unlikely to be material as the key hurdle remains: the eventual vote and approval by Parliament (where a positive outcome is far from certain, with both pro-Brexit and anti-Brexit camps objecting to the deal). Moreover, should government approval be accompanied by the resignation of some pro-Brexit ministers, this would limit the scale of GBP upside. We also note that based on our short-term financial fair value model, EUR/GBP is no longer overvalued and far from the 4-5% richness seen in late August when concerns about a hard Brexit peaked. With the extreme short-term Brexit risk premium largely priced out and the uncertainty about the success / failure of the Parliament vote, GBP gains are unlikely to be excessive and more a function of potential positioning adjustment (with speculative positioning being still very short: 25% of open interest for GBP/USD) rather than sudden optimism about GBP prospects. With EUR/USD under pressure, we prefer to position for any short-term GBP

gains via EUR/GBP, rather than GBP/USD.

➔ **USD: The Fed on course, but short-term respite for Asian FX**

Headline US CPI should tick higher to 2.4% year-on-year and core inflation is set to stay at 2.2%. With the outlook for core prices skewed to the upside as wages are set to rise, today's number will reinforce the Fed's approach towards gradual and ongoing tightening, keeping the US dollar supported. The sharp fall in oil prices and hopes about the potential resumption of US-China trade talks remain short-term positives for Asian emerging markets FX and could lead to near-term outperformance of the region vs the rest of the EM (with commodity-exposed LatAm FX weighed down by lower oil prices and central and eastern European FX tamed by a struggling EUR/USD).

⬇ **EUR: Not many reasons to be cheerful**

September eurozone industrial production is likely to show a soft reading, reinforcing the message from the soft flash estimate of Q3 eurozone GDP (with the second estimate being released today) and today's lower than expected German 3Q GDP. This is unlikely to give much support to the struggling EUR/USD, particularly in light of rising US inflation and a tightening Federal Reserve.

➔ **SEK: Messy politics vs higher inflation**

In Sweden, parliament is set to vote on a new government. The probability of conservative leader Ulf Kristersson succeeding is low. But as this shouldn't come as a surprise, the negative implication for the Swedish krona should be fairly limited.