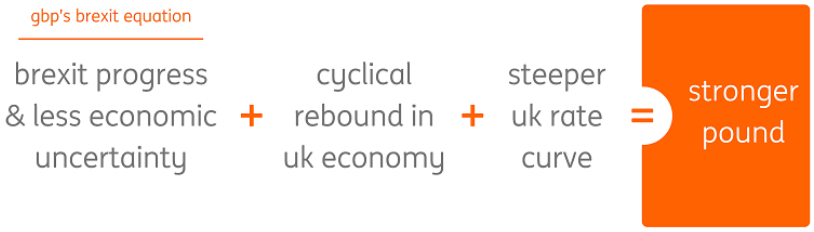
GBP: Brexit & The Bank of England

It will be interesting to see whether the Bank of England explicitly acknowledges the latest constructive developments in Brexit talks when they meet this week. If so, one could see this as a hawkish development – with risks that GBP/USD moves up to 1.35-1.36 on a steeper UK rate curve.



'Non-event' BoE meeting may have a subtle hawkish surprise...

- While Season 1 of the show 'Solving Brexit' ended last week with UK and EU officials striking a divorce deal at the 12th hour (see *GBP: Brexit Breakthrough*), there are still plenty of exciting spin-off shows for GBP markets to tune into this week. In terms of ratifying the Brexit divorce deal, the EU Leaders Summit (Thu) should pretty much be a formality - or a post-season wrap-up party as one might say. Although we do note that, like with most parties, things may not be as plain-sailing or virtuous as one may have initially planned for - and this could well see the pound retain its 'trashy' status for now.
- Despite this Brexit noise, the Bank of England meeting (Thu) is probably now the standout event for GBP markets this week - especially in light of recent developments. While one would expect the post-meeting statement to remain largely unchanged, it will be interesting to see whether the MPC explicitly acknowledge the recent Brexit progress up front in their comms. Coupled with greater clarity over the role of Brexit negotiations in the Bank's policy reaction function, a constructive tone over the recent divorce deal could be seen as a hawkish development.
- Two things may prevent Bank officials - and potentially markets - from making this hawkish leap of faith just yet:

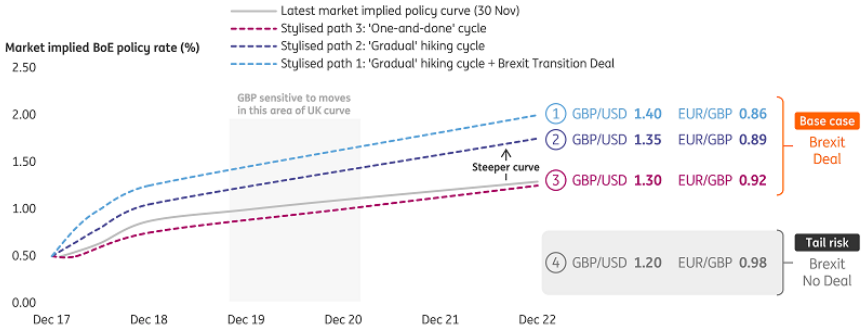
1. A transition deal still needs to be agreed in principle and this is what has greater economic significance for the BoE's near-term outlook
2. The evolution of key economic data over the next few months matters more for the timing of the next rate hike

- On the latter, this week's UK data splurge - which sees CPI (Tue), jobs and wage growth data (Wed) and retail sales (Thu) - will be worth keeping an eye. The combination of rising

underlying inflationary pressures (higher core CPI and wages) and solid UK consumer activity would be the perfect release for BoE hawks.

Bottom line: Risk-reward supports the case for GBP upside

- The focus is now on finding an economic catalyst for a positive re-pricing of BoE policy rate expectations. We identify two that are not necessarily mutually exclusive - Brexit progress and positive UK data surprises.
- With markets not pricing in a BoE rate hike until 4Q18 - and the UK curve looking pretty flat still - we think there is a good chance of any hawkish BoE commentary propelling GBP/USD up towards the 1.35-1.36 area this week. At the very least, we expect the pound to be supported now that the tail risk of a 'no deal' has been taken off the table. Risk-reward supports the case for GBP upside - and staying wary of a potential hawkish BoE surprise this week.



Source: Source: ING estimates, Bloomberg