

GBP: Feeling the pressure point

GBP is under immense pressure and GBP/USD reached the lowest level since 1985. The mix of external funding needs, still not stretched valuation and economic uncertainty is weighing on GBP in the strong USD environment. Unless markets calm down, GBP/USD 1.10 level can no longer be ruled out

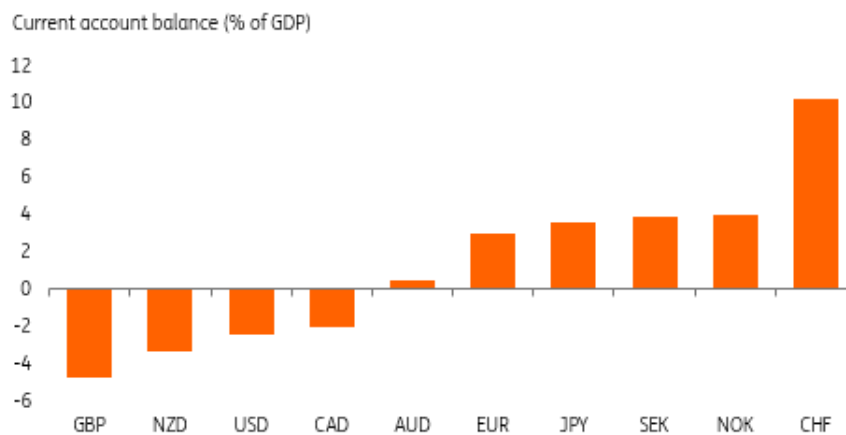


GBP is under immense pressure and GBP/USD reached the lowest level since 1985. In our view, three factors are currently weighing on GBP:

1 The worst current account position among G10 FX bites

In the current dollar funding crunch, a currency of a country with an ongoing funding needs and the exposure to the banking sector is unlikely to do well. The UK current account deficit has been a long standing negative for GBP. Even the post-Brexit fundamental hit to the UK economy did not change the UK current account dynamics and the deficit has remained elevated. Within the entire G10 FX space, GBP ranks the worse when it comes to the current account situation. This is particularly the case when compared to its European peers, where all G10 currencies show a better current account positions than GBP (Figure 1).

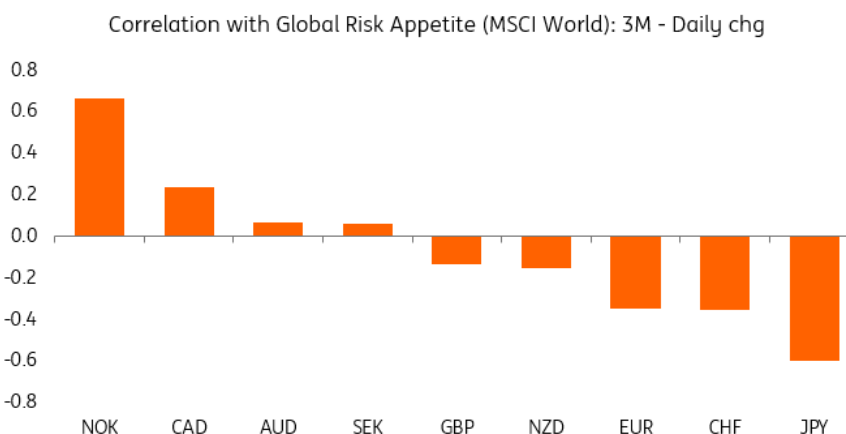
Figure 1: GBP suffers from worst current account position in the G10 FX space



Source: ING estimates

While the dollar suffers from the current account deficit too, unlike GBP, the dollar is a reserve currency of choice and during the periods of not-well-functioning markets, demand for the dollar is clear (as seen on the price action over the past days). With GBP not standing out as a currency with either high or low correlation with risk over the past months (as Figure 2 shows, it is close to zero and in the middle of the G10 FX spectrum), today's sell-off thus seems to have a lot to do with sterling idiosyncratic factors.

Figure 2: The usual GBP correlation with risk does not stand out



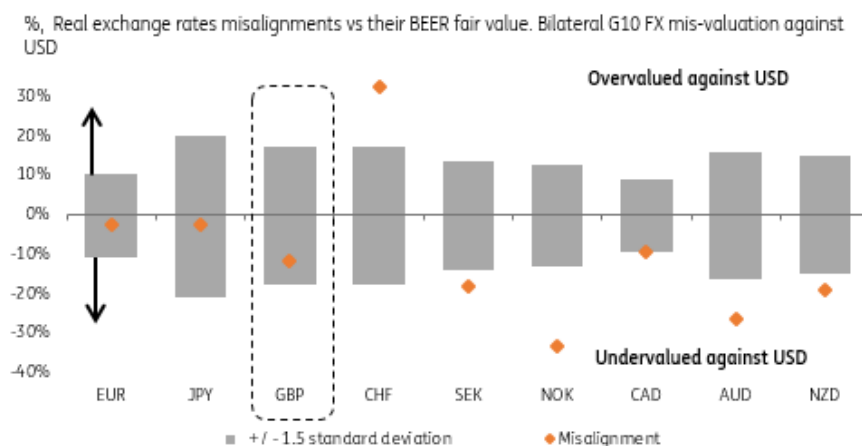
Source: ING estimates

2 Despite the multi-year sell-off, GBP is not cheap

On the valuation side, we have been arguing for a long time that GBP fair value has experienced a structural decline since the Brexit referendum. For example, GBP fair value vs EUR declined by a significant 8-9% since 2017 (see [G10 FX valuation: Why the dollar is not screamingly expensive](#)). This translated into GBP not being very cheap before the Covid-19 related market sell-off (based on our estimates, sterling was by and large fairly valued both vs EUR and USD at the start of the year).

This means that the recent GBP slide did not bring sterling into a meaningfully undervalued and stretched territory. GBP is currently undervalued vs USD, but as Figure 3 shows, the undervaluation is not extreme. It is still not outside of the one and half standard deviation band (vs the undervaluation for other G10 cyclical currencies). The lack of extreme mis-valuation means that at this point, the GBP valuation may still not act as a smoothing factor for GBP and the currency can fall more before hitting some valuation limits.

Figure 3: GBP cheapened up, but not to extreme levels



Source: ING estimates

3 Market concerns about economic outlook

The shaky sterling fundamentals is likely to keep the currency exposed, despite the already announced [strong fiscal response from the UK authorities](#). With the spread of Covid-19 affecting the economy and the UK still moving towards the measures already implemented in Europe (that are to affect the economy even more negatively) the outlook for sterling does not look optimistic. Indeed, the (denied) news that London may be 1-2 days away from a lockdown and its negative effect on GBP today provide a case in point. On the monetary policy side, [one more BoE rate cut and the reintroduction of QE](#) appear a question of when rather than if. Of course, UK-EU trade negotiations remain in the background, but the Covid-19 global crisis means that any conclusion this year seems unlikely at this point.

Tricky position

The GBP position remains shaky in the current market environment and the risks to GBP remain skewed to the downside, particularly if the USD funding squeeze remains in place and the deleveraging among the investors' community continues. Unless markets calm down, GBP/USD 1.10 level can no longer be ruled out.