

## GBP: Market too complacent on transition risk

After being driven by global factors over recent months, GBP is now facing the idiosyncratic risk of the EU transition period failing to be extended. With the end-June deadline looming and the possibility of non-extension rising sharply, GBP looks unprepared for this risk event. No extension is likely to drive EUR/GBP above 0.90 by end-June.



Following its solid recovery after the Covid-19 outbreak hit global FX markets, GBP has started underperforming its G10 peers yet again - being the weakest G10 currency so far this month. With the end-June deadline for the extension of the transition period approaching (this is a deadline written into the withdrawal agreement) and the UK government so far being adamant not to extend, the downside risk to GBP is growing. Our economists now see the non-extension as an above 50% probability event.

### Non-extension impact: Economic and monetary channels

Not extending would in our view have a negative impact on GBP as it would increase the odds of:

- (1) a shallower economic recovery, with the UK potentially experiencing a double dip recession and
- (2) more easing from the Bank of England.

The risk of not extending would have meaningful economic implications. With the Covid-19 crisis causing a demand-driven slowdown, a failure to extend the transition period and the imposition of tariffs from 2021 in the case of no deal would likely cause supply disruptions and deliver a second blow to the UK economy. Even if there is some form of a free trade deal on goods reached later in 2H20 (which sets tariffs to zero), it would involve plenty of costs and bureaucracy (and one particular headache for firms might be the so-called rules of origin). And the free-trade agreement covering goods is likely to do very little for services (which account for 80% of UK output). See [Brexit in 2020](#) for details. All this would in turn suggest an economic slowdown / possible contraction in 1Q21 and a possible double-dip recession for the UK economy in the worst-case scenario (vs the U-shaped recovery expected for the UK and the global economy at this point).

A possible second dip in UK growth in a relatively short period of time would likely warrant further BoE easing, likely in the form of more QE (we still think negative rates are a lower probability event). This would be likely more detrimental for the GBP's prospects than the current BoE easing cycle as, at this point, the BoE is just following the global trend of aggressive monetary policy loosening (ie, the Federal Reserve and the European Central Bank are doing the same) and does not stand out. The trend has been a friend for the BoE and GBP so far. However, should the BoE have to respond to idiosyncratic negatives such as no extension of the transition period in an environment where other central banks are no longer in easing mode, the pound would not be judged kindly.

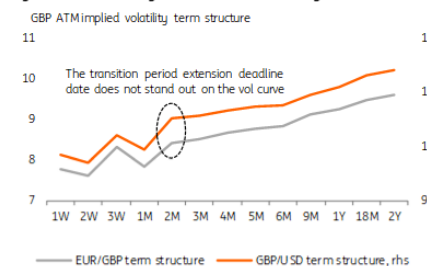
Prospects of a double-dip recession, more BoE easing and the general uncertainty about the relationship with its main trading partner would all pose a downside risk to GBP. Even if some form of a free trade agreement between the EU and the UK is eventually reached, the uncertainty about its form is likely to weigh on GBP. This is not great news for GBP when the UK economy is already facing a larger negative impact on 2Q GDP (vs 1Q GDP) than the eurozone (see [Lockdowns lifted...](#)).

## GBP downside seems heavily under-priced

We believe such a downside risk is heavily under-priced by the market as is evident in i) the GBP implied volatility term structure, ii) speculative positioning and iii) the lack of risk premia in the GBP spot market.

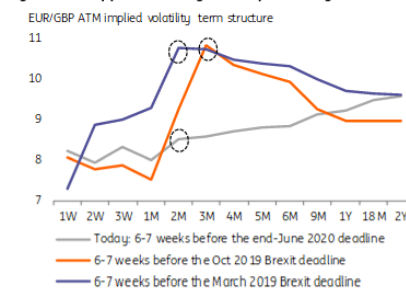
- EUR/GBP and GBP/USD implied volatility curves provide a case in point. As Figure 1 shows, there is virtually no kink in sterling implied volatility curves around the June deadline date. Neither it is the case for the year-end volatility levels. This is in contrast with previous occasions of Brexit-related risk, which showed some degree of uncertainty about the key deadline dates (as per Figure 2).

**Fig 1 GBP volatility curves don't show any kinks ...**



Source: ING, Bloomberg

**Fig 2 ... as opposed to large kinks previously**

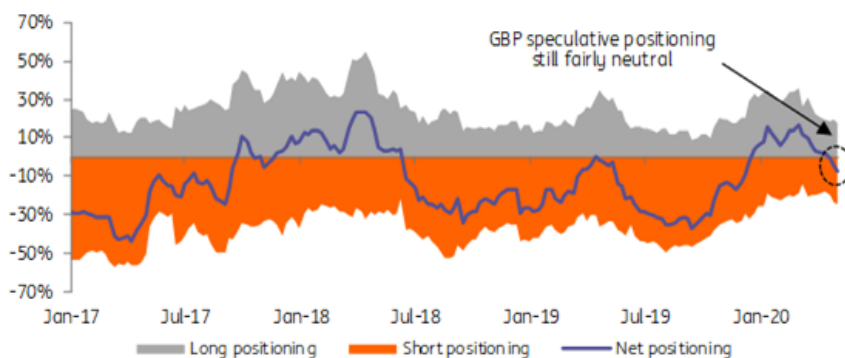


Source: ING, Bloomberg

- Speculative positioning also points to the same conclusion. Although GBP longs have been declining since the start of the Covid-19 crisis (primarily as GBP was hit on the USD funding squeeze in March), speculative positioning remains close to neutral (Figure 3) and has more scope for a decline – as we have observed during the previous Brexit-related events.

**Fig 3 GBP speculative positioning is fairly neutral**

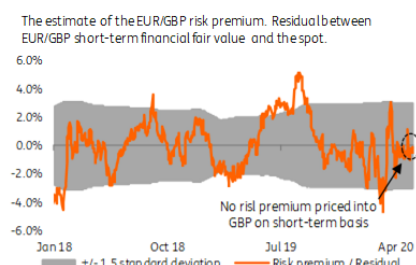
GBP/USD speculative positioning, as % of open interest (as of 5th May 2020). Negative number means the speculative community is net short GBP vs USD



Source: ING, CFTC

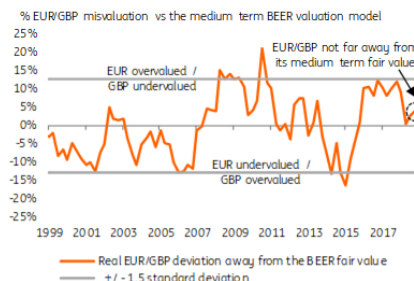
- As the GBP spot market does not exhibit signs of mis-valuation either (as Figures 4 and 5 show, GBP does not exert a meaningful risk premium / under-valuation either within our short-term or medium-term valuation framework) the risk of the transition period not being extended has plenty of potential to weigh on GBP.

**Fig 4 No risk premia evident in the GBP spot**



Source: ING

**Fig 5 Medium-term GBP valuation also not stretched**



Source: ING

Therefore, should the UK government fail to ask for an extension, given the complacency evident

in the sterling market, EUR/GBP would likely move above the 0.90 level by end-June and possibly even higher thereafter depending on the newsflow about a potential free trade agreement (the details and depth of which would be uncertain).

## EUR: The ECB containing risk premium via the top-up to the PEPP programme

On the EUR side, and despite the German constitutional court ruling, our economists expect the ECB to top up its Pandemic Emergency Purchase Programme at the June ECB meeting. The programme, in its current size, is already running out of money and such a decision would signal that the ECB is dealing with the European Court of Justice but not the national courts. Such action should keep any EUR fiscal risk premia at bay and allow for the GBP driven rise in EUR/GBP.

## Forecast: Downside risks to the GBP year-end outlook growing

The extension of the transition period was one of the key assumptions for our constructive EUR/GBP year-end forecast of 0.85. As this is now looking less-and-less likely, we see meaningful upside risks to our year-end forecast (that is towards weaker GBP levels). We will look at a formal revision in our next round of FX forecasts.

### Author

**Alissa Lefebvre**

Economist

[alissa.lefebvre@ing.com](mailto:alissa.lefebvre@ing.com)**Deepali Bhargava**

Regional Head of Research, Asia-Pacific

[Deepali.Bhargava@ing.com](mailto:Deepali.Bhargava@ing.com)**Ruben Dewitte**

Economist

+32495364780

[ruben.dewitte@ing.com](mailto:ruben.dewitte@ing.com)**Kinga Havasi**

Economic research trainee

[kinga.havasi@ing.com](mailto:kinga.havasi@ing.com)**Marten van Garderen**

Consumer Economist, Netherlands

[marten.van.garderen@ing.com](mailto:marten.van.garderen@ing.com)**David Havrlant**

Chief Economist, Czech Republic

420 770 321 486

[david.havrlant@ing.com](mailto:david.havrlant@ing.com)

**Sander Burgers**

Senior Economist, Dutch Housing

[sander.burgers@ing.com](mailto:sander.burgers@ing.com)

**Lynn Song**

Chief Economist, Greater China

[lynn.song@asia.ing.com](mailto:lynn.song@asia.ing.com)

**Michiel Tukker**

Senior European Rates Strategist

[michiel.tukker@ing.com](mailto:michiel.tukker@ing.com)

**Michal Rubaszek**

Senior Economist, Poland

[michal.rubaszek@ing.pl](mailto:michal.rubaszek@ing.pl)

**This is a test author**

**Stefan Posea**

Economist, Romania

[tiberiu-stefan.posea@ing.com](mailto:tiberiu-stefan.posea@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Jesse Norcross**

Senior Sector Strategist, Real Estate

[jesse.norcross@ing.com](mailto:jesse.norcross@ing.com)

**Teise Stellema**

Research Assistant, Energy Transition

[teise.stellema@ing.com](mailto:teise.stellema@ing.com)

**Diederik Stadig**

Sector Economist, TMT & Healthcare

[diederik.stadig@ing.com](mailto:diederik.stadig@ing.com)

**Diogo Gouveia**

Sector Economist

[diogo.duarte.vieira.de.gouveia@ing.com](mailto:diogo.duarte.vieira.de.gouveia@ing.com)

**Marine Leleux**

Sector Strategist, Financials

[marine.leleux2@ing.com](mailto:marine.leleux2@ing.com)

**Ewa Manthey**

Commodities Strategist  
[ewa.manthey@ing.com](mailto:ewa.manthey@ing.com)

## ING Analysts

**James Wilson**  
EM Sovereign Strategist  
[James.wilson@ing.com](mailto:James.wilson@ing.com)

**Sophie Smith**  
Digital Editor  
[sophie.smith@ing.com](mailto:sophie.smith@ing.com)

**Frantisek Taborsky**  
EMEA FX & FI Strategist  
[frantisek.taborsky@ing.com](mailto:frantisek.taborsky@ing.com)

**Adam Antoniak**  
Senior Economist, Poland  
[adam.antoniak@ing.pl](mailto:adam.antoniak@ing.pl)

**Min Joo Kang**  
Senior Economist, South Korea and Japan  
[min.joo.kang@asia.ing.com](mailto:min.joo.kang@asia.ing.com)

**Coco Zhang**  
ESG Research  
[coco.zhang@ing.com](mailto:coco.zhang@ing.com)

**Jan Frederik Slijkerman**  
Senior Sector Strategist, TMT  
[jan.frederik.slijkerman@ing.com](mailto:jan.frederik.slijkerman@ing.com)

**Katinka Jongkind**  
Senior Economist, Services and Leisure  
[Katinka.Jongkind@ing.com](mailto:Katinka.Jongkind@ing.com)

**Marina Le Blanc**  
Sector Strategist, Financials  
[Marina.Le.Blanc@ing.com](mailto:Marina.Le.Blanc@ing.com)

**Samuel Abettan**  
Junior Economist  
[samuel.abettan@ing.com](mailto:samuel.abettan@ing.com)

**Franziska Biehl**  
Economist, Germany

[Franziska.Marie.Biehl@ing.de](mailto:Franziska.Marie.Biehl@ing.de)

**Rebecca Byrne**

Senior Editor and Supervisory Analyst

[rebecca.byrne@ing.com](mailto:rebecca.byrne@ing.com)

**Mirjam Bani**

Sector Economist, Commercial Real Estate & Public Sector (Netherlands)

[mirjam.bani@ing.com](mailto:mirjam.bani@ing.com)

**Timothy Rahill**

Credit Strategist

[timothy.rahill@ing.com](mailto:timothy.rahill@ing.com)

**Leszek Kasek**

Senior Economist, Poland

[leszek.kasek@ing.pl](mailto:leszek.kasek@ing.pl)

**Oleksiy Soroka, CFA**

Senior High Yield Credit Strategist

[oleksiy.soroka@ing.com](mailto:oleksiy.soroka@ing.com)

**Antoine Bouvet**

Head of European Rates Strategy

[antoine.bouvet@ing.com](mailto:antoine.bouvet@ing.com)

**Jeroen van den Broek**

Global Head of Sector Research

[jeroen.van.den.broek@ing.com](mailto:jeroen.van.den.broek@ing.com)

**Edse Dantuma**

Senior Sector Economist, Industry and Healthcare

[edse.dantuma@ing.com](mailto:edse.dantuma@ing.com)

**Francesco Pesole**

FX Strategist

[francesco.pesole@ing.com](mailto:francesco.pesole@ing.com)

**Rico Luman**

Senior Sector Economist, Transport and Logistics

[Rico.Luman@ing.com](mailto:Rico.Luman@ing.com)

**Jurjen Witteveen**

Sector Economist

[jurjen.witteveen@ing.com](mailto:jurjen.witteveen@ing.com)

**Dmitry Dolgin**

Chief Economist, CIS

[dmitry.dolgin@ing.de](mailto:dmitry.dolgin@ing.de)

**Nicholas Mapa**

Senior Economist, Philippines

[nicholas.antonio.mapa@asia.ing.com](mailto:nicholas.antonio.mapa@asia.ing.com)

**Egor Fedorov**

Senior Credit Analyst

[egor.fedorov@ing.com](mailto:egor.fedorov@ing.com)

**Sebastian Franke**

Consumer Economist

[sebastian.franke@ing.de](mailto:sebastian.franke@ing.de)

**Gerben Hieminga**

Senior Sector Economist, Energy

[gerben.hieminga@ing.com](mailto:gerben.hieminga@ing.com)

**Nadège Tillier**

Head of Corporates Sector Strategy

[nadege.tillier@ing.com](mailto:nadege.tillier@ing.com)

**Charlotte de Montpellier**

Senior Economist, France and Switzerland

[charlotte.de.montpellier@ing.com](mailto:charlotte.de.montpellier@ing.com)

**Laura Straeter**

Behavioural Scientist

+31(0)611172684

[laura.Straeter@ing.com](mailto:laura.Straeter@ing.com)

**Valentin Tataru**

Chief Economist, Romania

[valentin.tataru@ing.com](mailto:valentin.tataru@ing.com)

**James Smith**

Developed Markets Economist, UK

[james.smith@ing.com](mailto:james.smith@ing.com)

**Suvi Platerink Kosonen**

Senior Sector Strategist, Financials

[suvi.platerink-kosonen@ing.com](mailto:suvi.platerink-kosonen@ing.com)

**Thijs Geijer**

Senior Sector Economist, Food & Agri

[thijs.geijer@ing.com](mailto:thijs.geijer@ing.com)

**Maurice van Sante**



Senior Economist Construction & Team Lead Sectors  
[maurice.van.sante@ing.com](mailto:maurice.van.sante@ing.com)

**Marcel Klok**  
Senior Economist, Netherlands  
[marcel.klok@ing.com](mailto:marcel.klok@ing.com)

**Piotr Poplawski**  
Senior Economist, Poland  
[piotr.poplawski@ing.pl](mailto:piotr.poplawski@ing.pl)

**Paolo Pizzoli**  
Senior Economist, Italy, Greece  
[paolo.pizzoli@ing.com](mailto:paolo.pizzoli@ing.com)

**Marieke Blom**  
Chief Economist and Global Head of Research  
[marieke.blom@ing.com](mailto:marieke.blom@ing.com)

**Raoul Leering**  
Senior Macro Economist  
[raoul.leering@ing.com](mailto:raoul.leering@ing.com)

**Maarten Leen**  
Head of Global IFRS9 ME Scenarios  
[maarten.leen@ing.com](mailto:maarten.leen@ing.com)

**Maureen Schuller**  
Head of Financials Sector Strategy  
[Maureen.Schuller@ing.com](mailto:Maureen.Schuller@ing.com)

**Warren Patterson**  
Head of Commodities Strategy  
[Warren.Patterson@asia.ing.com](mailto:Warren.Patterson@asia.ing.com)

**Rafal Benecki**  
Chief Economist, Poland  
[rafal.benecki@ing.pl](mailto:rafal.benecki@ing.pl)

**Philippe Ledent**  
Senior Economist, Belgium, Luxembourg  
[philippe.ledent@ing.com](mailto:philippe.ledent@ing.com)

**Peter Virovacz**  
Senior Economist, Hungary  
[peter.virovacz@ing.com](mailto:peter.virovacz@ing.com)

**Inga Fechner**

Senior Economist, Germany, Global Trade  
[inga.fechner@ing.de](mailto:inga.fechner@ing.de)

**Dimitry Fleming**

Senior Data Analyst, Netherlands  
[Dimitry.Fleming@ing.com](mailto:Dimitry.Fleming@ing.com)

**Ciprian Dascalu**

Chief Economist, Romania  
+40 31 406 8990  
[ciprian.dascalu@ing.com](mailto:ciprian.dascalu@ing.com)

**Muhammet Mercan**

Chief Economist, Turkey  
[muhammet.mercan@ingbank.com.tr](mailto:muhammet.mercan@ingbank.com.tr)

**Iris Pang**

Chief Economist, Greater China  
[iris.pang@asia.ing.com](mailto:iris.pang@asia.ing.com)

**Sophie Freeman**

Writer, Group Research  
+44 20 7767 6209  
[Sophie.Freeman@uk.ing.com](mailto:Sophie.Freeman@uk.ing.com)

**Padhraic Garvey, CFA**

Regional Head of Research, Americas  
[padhraic.garvey@ing.com](mailto:padhraic.garvey@ing.com)

**James Knightley**

Chief International Economist, US  
[james.knightley@ing.com](mailto: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](mailto:martin.van.vliet@ing.com)

**Robert Carnell**

Regional Head of Research, Asia-Pacific  
[robert.carnell@asia.ing.com](mailto:robert.carnell@asia.ing.com)

**Karol Pogorzelski**

Senior Economist, Poland

[Karol.Pogorzelski@ing.pl](mailto:Karol.Pogorzelski@ing.pl)

**Carsten Brzeski**

Global Head of Macro

[carsten.brzeski@ing.de](mailto:carsten.brzeski@ing.de)

**Viraj Patel**

Foreign Exchange Strategist

+44 20 7767 6405

[viraj.patel@ing.com](mailto:viraj.patel@ing.com)

**Owen Thomas**

Global Head of Editorial Content

+44 (0) 207 767 5331

[owen.thomas@ing.com](mailto:owen.thomas@ing.com)

**Bert Colijn**

Chief Economist, Netherlands

[bert.colijn@ing.com](mailto:bert.colijn@ing.com)

**Peter Vanden Houte**

Chief Economist, Belgium, Luxembourg, Eurozone

[peter.vandenhoute@ing.com](mailto:peter.vandenhoute@ing.com)

**Benjamin Schroeder**

Senior Rates Strategist

[benjamin.schroeder@ing.com](mailto:benjamin.schroeder@ing.com)

**Chris Turner**

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

[chris.turner@ing.com](mailto:chris.turner@ing.com)

**Gustavo Rangel**

Chief Economist, LATAM

+1 646 424 6464

[gustavo.rangel@ing.com](mailto:gustavo.rangel@ing.com)

**Carlo Cocuzzo**

Economist, Digital Finance

+44 20 7767 5306

[carlo.cocuzzo@ing.com](mailto:carlo.cocuzzo@ing.com)