

GBP: More downside but at a slower pace

The outlook for sterling remains bleak. The currency is set to continue depreciating but the recent rise in (a) GBP risk premium; and (b) short GBP speculative positioning now suggests a slower pace of depreciation

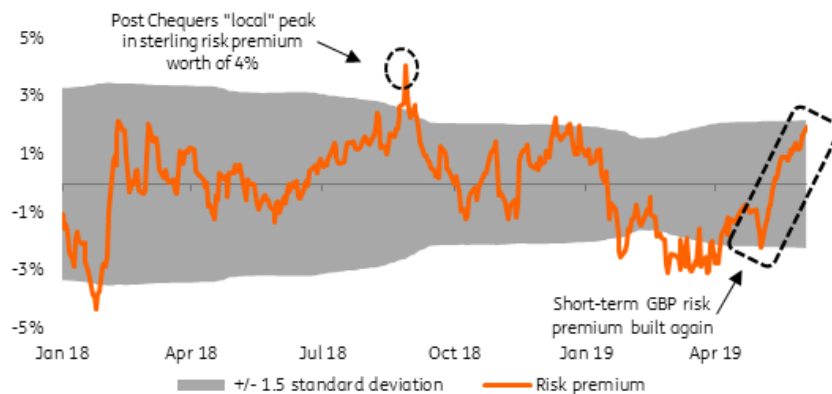


Pressure on GBP continues to build as the soft UK data (such as [yesterday's disappointing UK Manufacturing PMI](#) which slipped into contractionary territory) and the rising perceived odds of a hard Brexit (given that the next Conservative leader is likely to be a Eurosceptic) have been weighing on the pound. This is in line with our negative view on GBP expressed after the extensions of Article 50 in early April – see [Brexit: We expect sterling gains to stall](#).

While these two factors (softer UK data and political noise) should remain in place and in turn keep the pressure on GBP (we target EUR/GBP 0.90 this summer), we expect the pace of sterling depreciation to slow (vs its sharp decline during May). This is largely for two reasons:

Figure 1: Re-emerging GBP risk premium

The estimate of EUR/GBP risk premium. A residual between EUR/GBP fair value and spot.



Source: ING

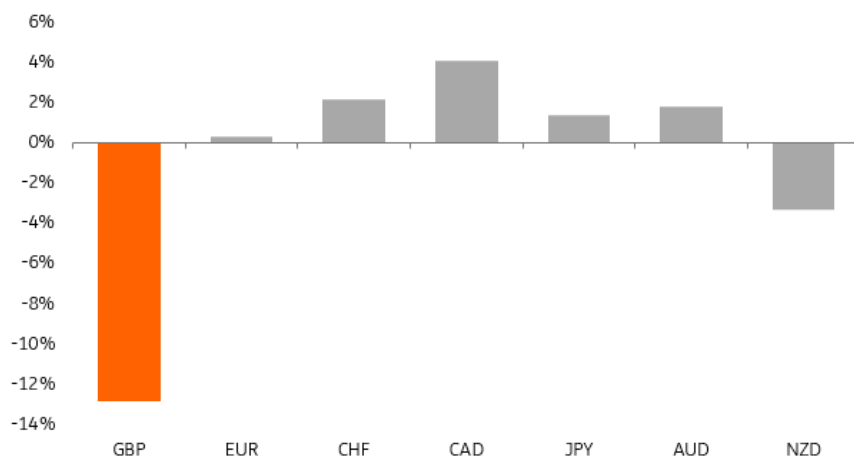
1 Risk premium already back in sterling

The market has already rebuilt a risk premium into sterling. As Figure 1 shows, EUR/GBP currently trades with around a 2% risk premium, which was built up during May. While this is still below the peak of the sterling risk premium seen last year (worth around 4% following the post Chequers resignation of ministers), this means that the bar for a fast GBP depreciation is now higher, particularly considering that EUR/GBP entered May being close to 1-2% undervalued (and is now 2% overvalued).

We base the sterling risk premia measure on our short-term financial fair value model, which measures the deviation of the currency from its fair value (based on high-frequency data such as rate spreads or a gauge for risk appetite).

Figure 2: Relative rise in GBP speculative shorts

Change in net speculative positioning (expressed as % of open interest) during the last two reported weeks. CFTC data

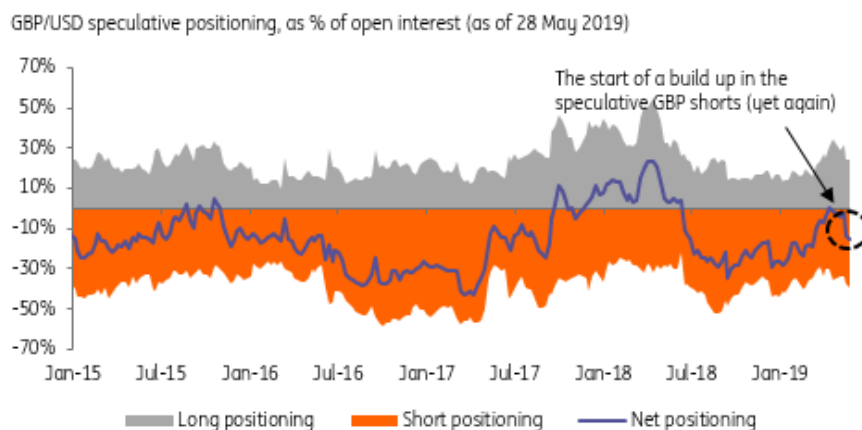


Source: CFTC

Speculative positioning no longer neutral

After turning neutral on GBP, the speculative community built up net shorts again over the past two weeks. As Figure 2 shows, this was the largest build-up of net short positioning (vs USD) in the G10 FX space over the two-week period (for those currencies covered by the CFTC data). This also suggests that the pace of GBP depreciation may slow from here, although like with the risk premium, the GBP shorts are still well below the highs seen earlier this year when market short positioning was close to 30% of open interest (Figure 3).

Figure 3: GBP shorts still far way from January highs



Source: CFTC

Still more GBP downside to come

We continue to expect EUR/GBP to reach 0.90 this summer, but the pace of depreciation should be more orderly from here and less aggressive than seen during May (which was worth of close to 3% vs EUR, making GBP the weakest currency in the G10 FX space).