GBP: The ‘Carney Put’

Despite a tricky month of politics for GBP, speculation of a Bank of England rate hike has provided a backstop to the currency sliding lower. As long as the 'Carney put' stays in place, we remain constructive on GBP heading into year-end and look for GBP/USD at 1.35-1.36 on a steeper UK rate curve.

Source: Bank of England

BoE rate hike talk has been a backstop to GBP sliding lower

- **It would be a major surprise if the Bank of England (BoE) did not hike this week given their recent signals.** We expect to see the 'Carney put' in full force for GBP, with the BoE hiking by 25bp and keeping the currency supported. Indeed, amid the heightened political uncertainty, speculation of a BoE rate hike has provided a backstop to GBP falling meaningfully. In the absence of this 'Carney put', GBP would have conceivably been trading much lower than it currently is.
- **If there's one central bank not concerned about the macro effects of a stronger currency it’s the BoE.** Sure the activity data has been a bit mixed of late (understandable given the economic uncertainty), but it’s becoming clear that the Bank wants to prevent the emergence of a genuine stagflationary environment. A couple of rate hikes may not derail UK economic growth, but could certainly keep price pressures in check – especially when

currency dynamics have been playing a stronger inflationary role. Some BoE officials may also see the effects of GBP's post-Brexit depreciation as being less transitory – and more persistent – than originally thought. Be it directly or indirectly, a weak GBP is playing a more prominent role in the BoE's policy thinking.

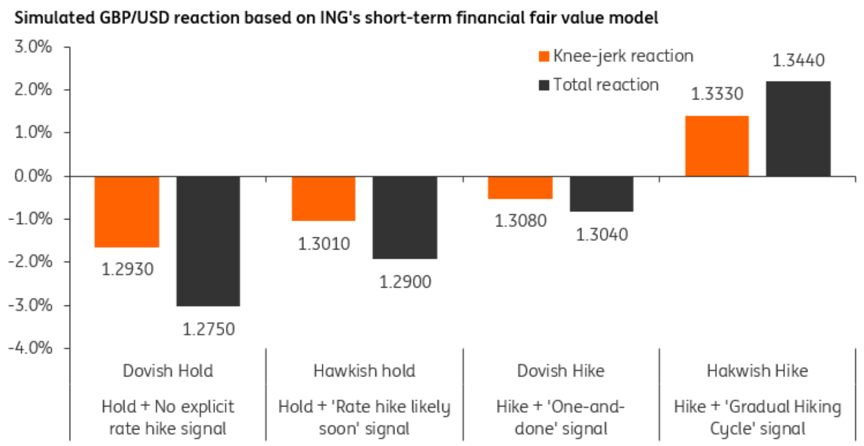
'Gradual tightening' signal gives the BoE policy flexibility

- **With a rate hike all but priced in, what matters this week is the type of tightening cycle the Bank signals.** Markets have got a bit of cold feet in recent weeks, so the follow through of a 25bp rate hike should be mildly GBP supportive.
- **But what could really drive GBP higher is if the Bank signals that this is more than just a 'one-and-done' move** and instead the start of a gradual tightening cycle. Gradual is a pretty fluid concept – and while the next rate hike will inevitably be data-dependent, this laissez-faire forward guidance won't stop markets from bringing forward their expectations for additional BoE rate hikes.

- **Assuming we get a 25bp rate hike this week, we would only expect GBP to move lower** if there were (a) more than two dissenters or (b) an explicit statement ruling out another rate hike in the near-term – both of which would see the UK rate curve flatten as markets price out additional BoE tightening. The latter option seems highly unlikely – and somewhat inconsistent with typical central bank forward guidance that aims to retain an element of policy flexibility.
- Moreover, for the idea of the 'Carney put' to work – and the pound to remain supported – the BoE will need to at least give off the illusion that additional rate hikes are warranted. This can be wrapped with the usual data- and Brexit-dependent caveats, but shouldn't necessarily see markets price out further tightening following this week's meeting.

1.35 GBP/USD year-end target under a steeper UK rate curve

GBP/USD reaction under various Nov BoE meeting scenarios



Source: Source: ING model estimates, Bloomberg. Note: Spot reference for GBP/USD is 1.3150 (as of 30 Oct 2017)

Bottom line

We look for GBP/USD at 1.35-1.36 over the next month as the front-end of the UK rate curve steepens, while speculation of additional BoE rate hikes should prevent any meaningful move below 1.30. For EUR/GBP, we remain comfortable with the 0.88-0.90 trading range for now. We're not exactly shooting for the stars because we're aware of the Brexit-related risks stemming from the December EU summit – which could be a make-or-break moment for GBP.