

GBP: The pressure is building

Sterling continues its descent as concerns about the Brexit outlook intensify. While there is already a 3% risk premium in EUR/GBP, this is still below the 4% level seen in 3Q18 after Chequers, making it consistent with our 3Q19 forecast of 0.92 for EUR/GBP. The likely election of Boris Johnson as the next Conservative leader will add pressure to GBP



Source: Shutterstock

More negative news ahead

In the month ahead, we expect headline news to continue to negatively impact sterling. First, the likely confirmation of Boris Johnson as the next Conservative leader and thus prime minister next Tuesday won't be helpful for GBP. The Conservative party conference in late September will also add pressure to GBP, with peak pressure building in October ahead of the 31 October Article 50 extension deadline.

While the outlook for GBP does not look great, sterling has already moved considerably. Below we look at the technicals such as risk premium, positioning and the option market and conclude that despite the bad news already being reflected in sterling, there is still scope for further GBP decline. This is consistent with our forecast of EUR/GBP 0.92 and GBP/USD 1.22 this summer. Risks to our GBP forecasts remain on the downside, stemming from both risks of a hard Brexit or early

elections.

If elections are called early, we see EUR/GBP approaching the 0.95 level.

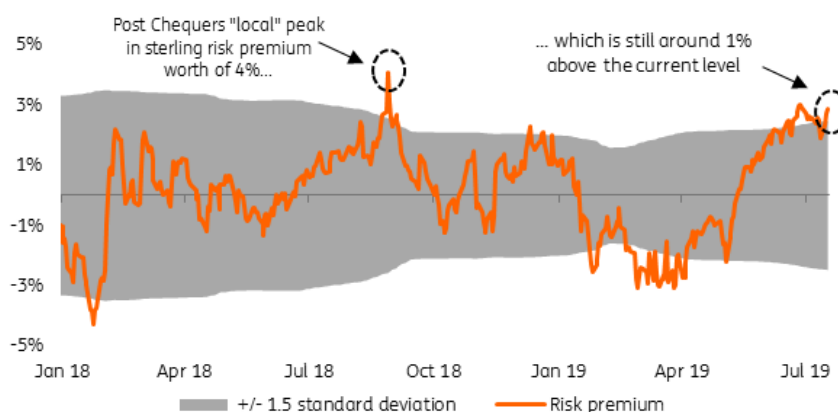
Risk premium

Following the recent sterling decline, a fair degree of risk premium is priced into sterling. Based on our short term financial fair value model, we estimate the risk premium is currently worth around 3%, which is elevated and outside of the usual 1.5 standard deviation band – as the figure above shows. However, the same chart shows, this is still below the GBP risk premium highs observed in 3Q18 after the Chequers cabinet meeting, which was followed by the resignation of Boris Johnson. At that time the risk premium was worth 4%, suggesting another 1% decline in GBP could be still on cards and consistent with our forecast of 0.92 this summer.

In the case of early elections (a meaningfully rising probability), we can see EUR/GBP at 0.95 as the prospects of a potential Labour government or a hard Brexit are unlikely to go down well with global investors.

GBP risk premium on the rise

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

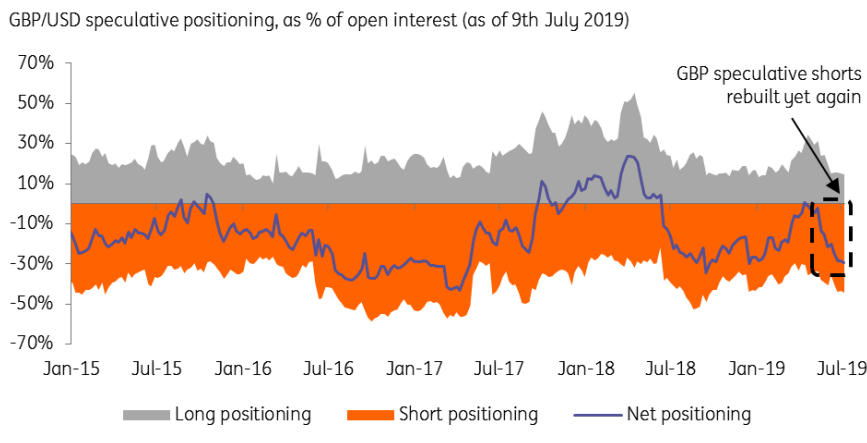


Source: ING

Speculative positioning

Market concerns about the Eurosceptic prime minister have led to a meaningful build-up / re-building of speculative sterling shorts, 30% of open interest currently, as the figure above shows. This exceeds the level of speculative shorts in January this year and has been only surpassed by the level of speculative shorts in the post Chequer's period (around 35% of open interest at the time). As the figure below shows, only rarely have GBP/USD speculative shorts exceeded the 35%-40% level (in terms of open interest). This means that while there is still some scope for a build-up of short GBP positions, the pace of the increase in GBP shorts should slow versus the aggressive build-up over the past months. This also suggests EUR/GBP trades to 0.92 this summer unless we see meaningful news (i.e., sharply rising probability of hard Brexit or early elections).

GBP speculative shorts on the rise

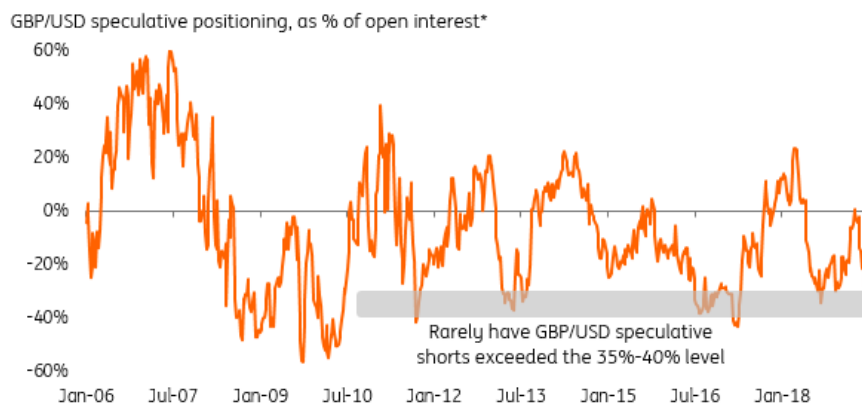


Source: ING

Option market / volatility

The rising perceived probability of a disorderly Brexit after the 31 October deadline (in response to the comments from Boris Johnson, the leading Conservative leadership candidate) is reflected in the option market, with the sterling implied volatility curve heavily kinked around the deadline date (that is the 3-4 months tenors) versus the close-to-normally upward sloping shape of the curve 2-3 months ago. This is evident in the figure below. Sterling risk reversals also surged, but are still below the March highs, suggesting a further increase over coming months

Rarely have GBP/USD speculative shorts exceeded the 35%-40% level

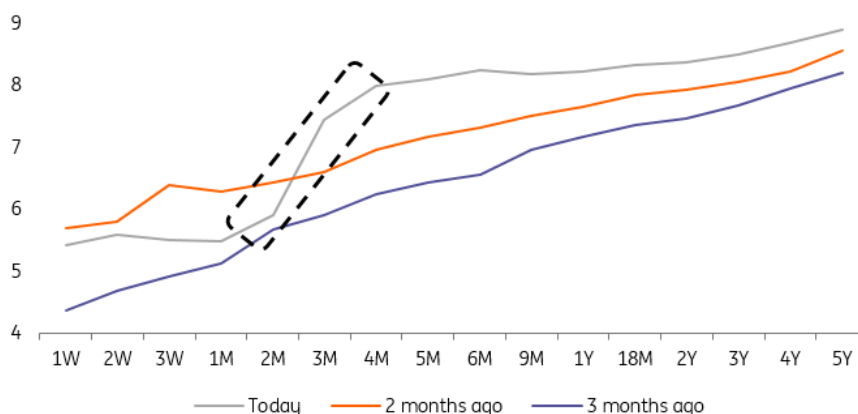


* As of 9th July 2019 (data are reported with a lag)

Source: CFTC, ING

Sterling volatility curve heavily kinked around the deadline date

EUR/GBP ATM implied volatility term structure



Source: ING, Bloomberg

Author

Alissa Lefebvre

Economist

alissa.lefebvre@ing.com

Deepali Bhargava

Regional Head of Research, Asia-Pacific

Deepali.Bhargava@ing.com

Ruben Dewitte

Economist

+32495364780

ruben.dewitte@ing.com

Kinga Havasi

Economic research trainee

kinga.havasi@ing.com

Marten van Garderen

Consumer Economist, Netherlands

marten.van.garderen@ing.com

David Havrlant

Chief Economist, Czech Republic

420 770 321 486

david.havrlant@ing.com

Sander Burgers

Senior Economist, Dutch Housing

sander.burgers@ing.com

Lynn Song

Chief Economist, Greater China

lynn.song@asia.ing.com

Michiel Tukker

Senior European Rates Strategist

michiel.tukker@ing.com

Michal Rubaszek

Senior Economist, Poland

michal.rubaszek@ing.pl

This is a test author

Stefan Posea

Economist, Romania

tiberiu-stefan.posea@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Jesse Norcross

Senior Sector Strategist, Real Estate

jesse.norcross@ing.com

Teise Stellema

Research Assistant, Energy Transition

teise.stellema@ing.com

Diederik Stadig

Sector Economist, TMT & Healthcare

diederik.stadig@ing.com

Diogo Gouveia

Sector Economist

diogo.duarte.vieira.de.gouveia@ing.com

Marine Leleux

Sector Strategist, Financials

marine.leleux2@ing.com

Ewa Manthey

Commodities Strategist

ewa.manthey@ing.com

ING Analysts

James Wilson

EM Sovereign Strategist

James.wilson@ing.com

Sophie Smith

Digital Editor

sophie.smith@ing.com

Frantisek Taborsky

EMEA FX & FI Strategist

frantisek.taborsky@ing.com

Adam Antoniak

Senior Economist, Poland

adam.antoniak@ing.pl

Min Joo Kang

Senior Economist, South Korea and Japan

min.joo.kang@asia.ing.com

Coco Zhang

ESG Research

coco.zhang@ing.com

Jan Frederik Slijkerman

Senior Sector Strategist, TMT

jan.frederik.slijkerman@ing.com

Katinka Jongkind

Senior Economist, Services and Leisure

Katinka.Jongkind@ing.com

Marina Le Blanc

Sector Strategist, Financials

Marina.Le.Blanc@ing.com

Samuel Abettan

Junior Economist

samuel.abettan@ing.com

Franziska Biehl

Senior Economist, Germany

Franziska.Marie.Biehl@ing.de

Rebecca Byrne

Senior Editor and Supervisory Analyst

rebecca.byrne@ing.com

Mirjam Bani

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

mirjam.bani@ing.com

Timothy Rahill

Credit Strategist

timothy.rahill@ing.com

Leszek Kasek

Senior Economist, Poland

leszek.kasek@ing.pl

Oleksiy Soroka, CFA

Senior High Yield Credit Strategist

oleksiy.soroka@ing.com

Antoine Bouvet

Head of European Rates Strategy

antoine.bouvet@ing.com

Jeroen van den Broek

Global Head of Sector Research

jeroen.van.den.broek@ing.com

Edse Dantuma

Senior Sector Economist, Industry and Healthcare

edse.dantuma@ing.com

Francesco Pesole

FX Strategist

francesco.pesole@ing.com

Rico Luman

Senior Sector Economist, Transport and Logistics

Rico.Luman@ing.com

Jurjen Witteveen

Sector Economist

jurjen.witteveen@ing.com

Dmitry Dolgin

Chief Economist, CIS

dmitry.dolgin@ing.de

Nicholas Mapa

Senior Economist, Philippines

nicholas.antonio.mapa@asia.ing.com

Egor Fedorov

Senior Credit Analyst
egor.fedorov@ing.com

Sebastian Franke

Consumer Economist
sebastian.franke@ing.de

Gerben Hieminga

Senior Sector Economist, Energy
gerben.hieminga@ing.com

Nadège Tillier

Head of Corporates Sector Strategy
nadege.tillier@ing.com

Charlotte de Montpellier

Senior Economist, France and Switzerland
charlotte.de.montpellier@ing.com

Laura Straeter

Behavioural Scientist
+31(0)611172684
laura.Straeter@ing.com

Valentin Tataru

Chief Economist, Romania
valentin.tataru@ing.com

James Smith

Developed Markets Economist, UK
james.smith@ing.com

Suvi Platerink Kosonen

Senior Sector Strategist, Financials
suvi.platerink-kosonen@ing.com

Thijs Geijer

Senior Sector Economist, Food & Agri
thijs.geijer@ing.com

Maurice van Sante

Senior Economist Construction & Team Lead Sectors
maurice.van.sante@ing.com

Marcel Klokk

Senior Economist, Netherlands
marcel.klokk@ing.com

Piotr Poplawski

Senior Economist, Poland

piotr.poplawski@ing.pl

Paolo Pizzoli

Senior Economist, Italy, Greece

paolo.pizzoli@ing.com

Marieke Blom

Chief Economist and Global Head of Research

marieke.blom@ing.com

Raoul Leering

Senior Macro Economist

raoul.leering@ing.com

Maarten Leen

Head of Global IFRS9 ME Scenarios

maarten.leen@ing.com

Maureen Schuller

Head of Financials Sector Strategy

Maureen.Schuller@ing.com

Warren Patterson

Head of Commodities Strategy

Warren.Patterson@asia.ing.com

Rafal Benecki

Chief Economist, Poland

rafal.benecki@ing.pl

Philippe Ledent

Senior Economist, Belgium, Luxembourg

philippe.ledent@ing.com

Peter Virovacz

Senior Economist, Hungary

peter.virovacz@ing.com

Inga Fechner

Senior Economist, Germany, Global Trade

inga.fechner@ing.de

Dimitry Fleming

Senior Data Analyst, Netherlands

Dimitry.Fleming@ing.com

Ciprian Dascalu

Chief Economist, Romania

+40 31 406 8990

ciprian.dascalu@ing.com

Muhammet Mercan

Chief Economist, Turkey

muhammet.mercan@ingbank.com.tr

Iris Pang

Chief Economist, Greater China

iris.pang@asia.ing.com

Sophie Freeman

Writer, Group Research

+44 20 7767 6209

Sophie.Freeman@uk.ing.com

Padhraic Garvey, CFA

Regional Head of Research, Americas

padhraic.garvey@ing.com

James Knightley

Chief International Economist, US

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

Karol Pogorzelski

Senior Economist, Poland

Karol.Pogorzelski@ing.pl

Carsten Brzeski

Global Head of Macro

carsten.brzeski@ing.de

Viraj Patel

Foreign Exchange Strategist

+44 20 7767 6405

viraj.patel@ing.com

Owen Thomas

Global Head of Editorial Content

+44 (0) 207 767 5331

owen.thomas@ing.com

Bert Colijn

Chief Economist, Netherlands

bert.colijn@ing.com

Peter Vanden Houte

Chief Economist, Belgium, Luxembourg, Eurozone

peter.vandenhoute@ing.com

Benjamin Schroeder

Senior Rates Strategist

benjamin.schroeder@ing.com

Chris Turner

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

chris.turner@ing.com

Gustavo Rangel

Chief Economist, LATAM

+1 646 424 6464

gustavo.rangel@ing.com

Carlo Cocuzzo

Economist, Digital Finance

+44 20 7767 5306

carlo.cocuzzo@ing.com