

What to expect from the pound after the UK election

There might be more for GBP to lose than gain...

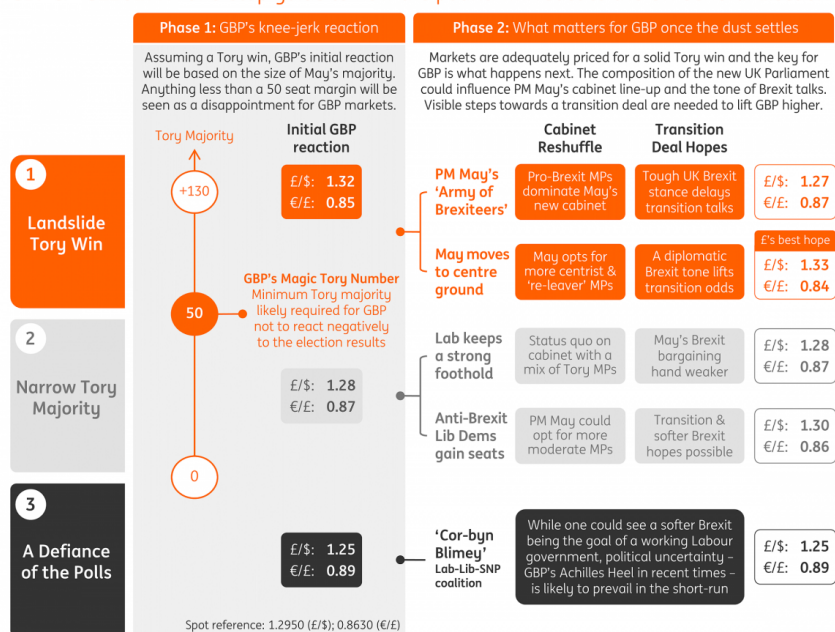


Source: iStock

Tory landslide = Sterling rally? Not that simple...

A narrative that sterling will rally on a landslide Tory win at the upcoming UK General Election may be a bit simplistic – especially after the recent short positioning adjustment. Assuming the polls are right and the Tories win, it is what happens next – and Mrs. May's initial post-election steps – that matters more for the pound.

GBP & #GE2017: A one-stop guide to how the pound will react to the UK General Election



Source: ING

50 = GBP's Magic Tory Number.

A working Tory majority of anything less than 50 would be seen as an outright disappointment for GBP markets. Our estimate is slightly conservative (no pun intended) given that the Electoral Calculus predicts a Tory majority of 142 based on the latest opinion polls*, while the average probability of a Tory majority of more than 50 is around 75-80% based on betting market odds**.

Even if PM May wins big, a scenario exists where GBP could fall after a knee-jerk move higher

Especially if a 'hard' Brexit line is formally adopted and there is evidence of political stalemate in early Brexit negotiations. Without a transition deal agreed, the passage of time is GBP negative – it pushes us closer towards the cliff-edge and this would see markets grow nervously impatient.

Visible steps towards a transition deal are needed for GBP to move higher

The election run-in so far has been a catalyst for markets to return to a more 'neutral' Brexit level – where the probabilities of a hard versus soft Brexit are slightly more evenly distributed. Hopes of a more orderly transition process have partly underpinned this sentiment. Still, the UK election is no guarantee that a transition deal will be signed, sealed and delivered – it is merely an assumption that markets are making based on logistical factors. A more conciliatory Brexit tone from the Prime Minister would be seen as a step in the right direction – and offers GBP's best hope. But we reiterate that it does take two to tango – and we still need to see whether the EU will be willing to offer a cost-free and painless transition.

And, what would happen to GBP if the polls are wrong again?

We think a Lab-Lib-SNP coalition risks having a Marmite effect on markets: either they'll 'love it or hate it'. On the one hand, a softer Brexit could be the goal of a Labour-led coalition government;

but on the other hand, it raises political uncertainty – which has proven to be GBP's Kryptonite over the past year. In the short-term, we would expect the uncertainty factor to prevail.

The bottom line

Our graphic shows how we think GBP could be affected by the outcome of the election. The emphasis is on the second stage; both a cabinet reshuffle (likely within a few days of the election result) and the UK's stance on a Brexit transition deal will give GBP markets greater directional steer. The bottom line is that GBP risks from the General Election look asymmetrically skewed to the downside – there is now more to lose than gain.