

GBP: Deal or No Deal

Steps towards a signed Brexit transition deal holds the key to sterling sentiment in the near-term



Source: Shutterstock, EPP

Brexit transition deal + Hawkish BoE = A powerful elixir for GBP bulls

- GBP's whipsaw price action yesterday is indicative of the currency's somewhat inexplicable sensitivity to Brexit-related headlines. Markets had seemingly priced in a higher probability of a 'no deal' Brexit as the fifth round of talks between the UK and EU concluded with the latter stating that discussions are at a 'deadlock'. Yet, fears of a 'hard' Brexit were quickly reassessed – with GBP reversing its 1% fall on the day following reports that the EU's chief negotiator Michel Barnier is willing to offer a two-year Brexit transition deal.
- None of this should be new news for GBP markets; contingency planning around a 'no deal' Brexit by UK officials seems logical, but in our view should not be a central scenario priced into currency markets. At best it serves as a tail risk, keeping the extent of GBP upside potential limited.

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being GBP

- We continue to see progressive steps towards a Brexit transition deal as being GBP supportive via three channels – in particular via the channel of higher short-term UK rates.
- Indeed, expect the narrative for GBP to slowly shift towards the Nov ‘Super Thursday’ BoE meeting after next week’s EU leaders summit. Here we see upside risks as the Bank are not only likely to hike by 25bp, but the risks are that Governor Carney signals that this is more than a ‘withdrawal of stimulus’ hiking cycle.

For more details on Brexit transition deal effects see [GBP: May's Florentine Renaissance](#)

We look for GBP/USD to move up towards 1.35-1.36 on a steeper UK curve in and around the Nov BoE meeting. EUR/GBP is set to remain within the 0.88-0.90 range over the coming weeks as hawkish ECB and BoE policy steps are likely to counteract each other in the near-term. A sustained breakout above 0.90 would only materialise if discussions over a Brexit transition deal were thwarted or delayed in some way.

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