FX

Global

FX Insight

GBP, EUR: UK Labour Win; French Elections Up Next

Labour Storms to Victory in UK

The UK has a new government with the Labour Party returning to power after a 14-year hiatus. We examine the possible implications of the Labour win on the GBP and suggest that the GBP could consolidate, with Labour fiscal plans yet to be announced. In our view, a Labour victory had very much been priced and any positive impetus for the GBP from this landslide victory could be short-lived.

At time of writing, Labour has won 412 (of 650) seats with 99.7% of constituencies declared. This margin of victory suggests that Labour will have the political will to implement the changes they wish. Labour had earlier pledged to improve healthcare, education, security, reduce immigration and regulate energy companies. Key for the GBP would be the funding plans for these changes. Labour has claimed that these plans will be fully funded and have pledged to be fiscally responsible. We await details of an official budget, which could take some time. The new government is required to provide the Office for Budget Responsibility (OBR) 10-weeks' notice and include a complete economic and fiscal forecast with the planned budget. This places the earliest possible date for a budget in mid-Sep 2024.

Nevertheless, we look at the possible shifts in fiscal policy for the UK with the new change of government and suggest that there could be some boost for the GBP on a longer horizon. We caution that there are still risks for the GBP, given that fiscal space remains tight and the lingering effects of Brexit on its economy.

French Elections Up Next

We also examine some scenarios for the French elections (due 7 Jul), with the EUR having recovered most of the political overhang. We suggest to fade the political overhang in EURUSD and continue to see a positive path for the EUR in the quarters ahead amid an improvement to economic growth and the stabilization of inflation.

ECB and BOE - Cuts on the Cards

The next question on everyone's minds is how the ECB and BOE will move going forward. We see BOE cutting rates three times (starting in Aug) and think the ECB cuts two more times in 2024. We see opportunity to buy EURGBP to express the view that the two central banks, which were previously seen as divergent in terms of rate cuts, will now converge.

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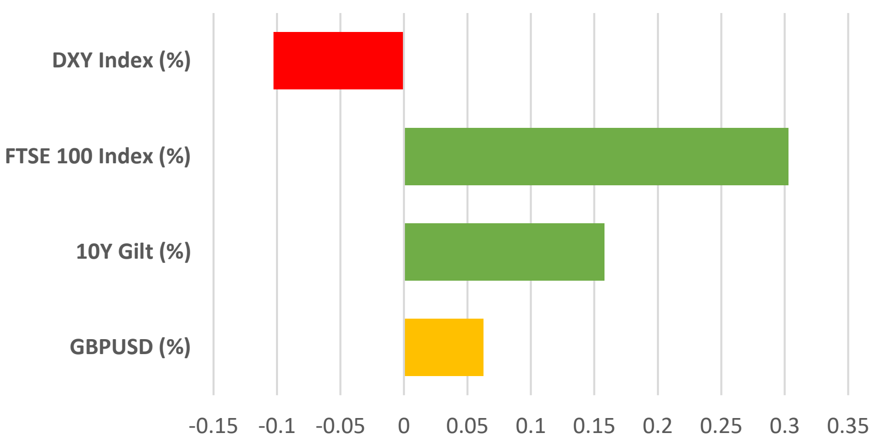
Labour Victory in the UK - Optimism Priced In

The preliminary polls suggested that a Labour victory in the UK was likely, but this large margin of victory was never guaranteed. It seems that most of the optimism was priced in for GBPUSD, with the GBPUSD only marginally higher after the announcement of the results and is broadly in line with the broadly softer USD (Chart 1). UK Equities and bonds however have had larger moves following the announcement.

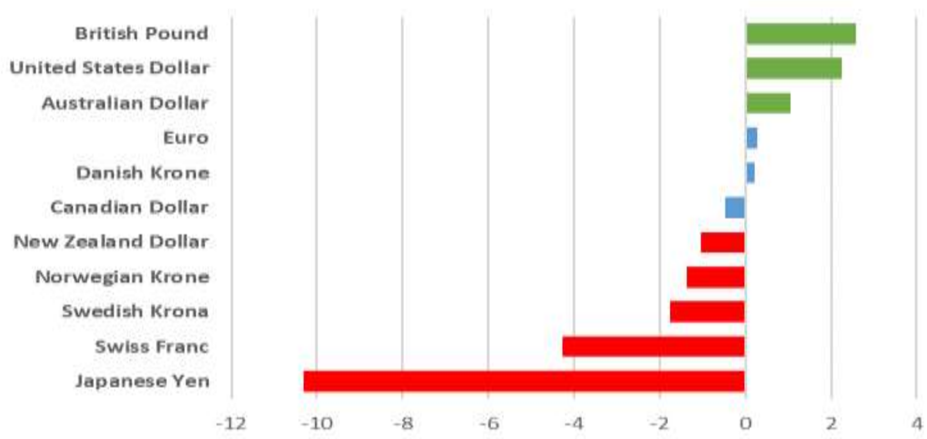
Chart 1: GBPUSD Remains Fairly Stable in Wake of Results (% change from 4 Jul close)



Source: Bloomberg, Maybank FX Research and Strategy

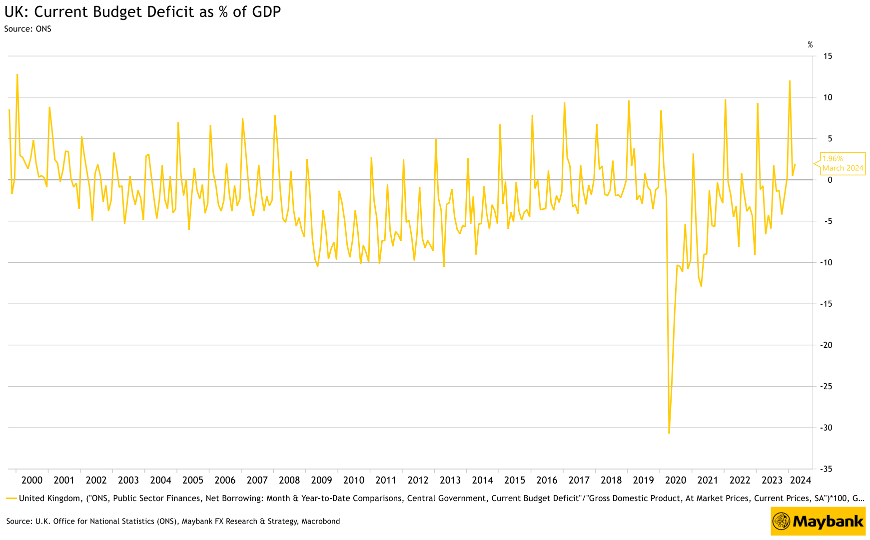
We think optimism for the GBPUSD has been priced in and is currently the best performing G10 currency YTD (Chart 2). However, for all of Labour's election pledges and grand plans, we have yet to see a concrete budget plan. Fiscal space in the UK remains tight with budget deficits in Sunak's administration remaining high (Chart 3). As such, Labour will face a challenge to manage their election promises with fiscal constraints. As such, the actual budget that the new Labour government unveils remains key for the future path for the GBP.

Chart 2: GBP is the Outperformer in the G10 FX Space (YTD % Spot Returns vs SGD)



Source: Bloomberg, Maybank FX Research and Strategy

Chart 3: Sunak Administration Budget Deficits Were Relatively High



Source: ONS, Macrobond, Maybank FX Research and Strategy

Labour Promises Fiscal Responsibility and Has Been More Fiscally Responsible Historically

Against this backdrop, Labour has promised that it would be fiscally responsible and all its plans to improve the UK would be fully funded. Historically, Labour has been more fiscally responsible than the Conservatives (Table 1). If Labour sticks to its election promises and manages to successfully navigate the challenges then there could be greater impetus for a stronger GBP moving forward. The key to the outlook for the GBP moving forward is Labour's concrete fiscal plans, which as we mentioned would be out earliest in mid-Sep 2024. Till then, we summarize Labour's election promises and preliminary fiscal plans, for reference (Table 2).

Table 1: Historically, Labour has Been More Fiscally Responsible

	Labour	Conservative	Which one was higher
Years in office prior to Global Financial Crisis (GFC)	26	36	Conservative
Average **borrowing** for each year in office excluding the GFC- 2021 prices	22.9	23.0	Conservative
Total **borrowing** for each year in office excluding the GFC- 2021 prices	596.3	828.3	Conservative
Average **repayments** made- 2021 prices	16.5	5.6	Labour
Total **repayments** made- 2021 prices	115.3	22.4	Labour

Source: Tax Research UK, Maybank FX Research and Strategy

Table 2: Labour Party Initiatives and Fiscal Plans/Implications

Labour Party Initiative	Fiscal Plans/Implications	FX Implications
Wealth Creation for working people - Encouraging investment	£3.5b of public "green" investments	Longer term positive for UK economy and GBP
No tax cuts	Not having to find extra money to fund tax cuts	Likely neutral for GBP, although potentially marginally positive for confidence
Hire extra state school teachers	Private school fee taxes of 20%	Likely neutral for GBP, although potentially marginally positive for confidence
Spending for green initiatives	£24b to be spent on green initiatives such as improving energy efficiency	Long term positive for economy and for GBP, although plans to fund could be called to question
Healthcare improvements - extra 40k/week NHS appointments	Funded by increasing tax revenue by rolling back non-domiciled tax arrangements	Unclear, could be net-negative if rolling back non-dom deters investment

Source: Labour Party, BBC, Maybank FX Research and Strategy

Risks Remain for the GBP

Ultimately, other risks remain for the GBP. As established, fiscal space remains tight and it remains to be seen how Labour navigates the challenges here. Should their fiscal plans be seen as unsustainable or unsound, we cannot rule out a sell-off in the GBP, although it does seem unlikely that we will see a repeat of the sell-off seen in the Truss administration. Furthermore, there remain lingering issues from Brexit such as the loss of the common market. We see two-way risks on this front. While Starmer has been relatively silent on Brexit, likely for political reasons, there is speculation that EU-UK relations could improve with a Labour victory. Some political analysts have even suggested that the UK could seek to re-establish some form of access to the common market. There is therefore upside risks to positive negotiation with the EU and downside risks should negotiations fail to resolve issues.

French Elections up Next

Elsewhere in Europe, the second round of the French Elections are up next on 7 Jul. First round of 30 Jun showed that the far-right National Rally (NR) won 34% of votes, with the left-wing coalition New Popular Front (NFP) in second at 28% and the incumbent centrists Ensemble in third at 20%. Upon news that the NFP and Ensemble have banded together to prevent NR from winning an absolute majority and taking power, the EUR has partially faded the election overhang and EURUSD trades above the 1.08 figure, albeit amid a broad softening in the USD as well. Options are also showing greater signs of relief (Chart 4). French elections have seen the far-right lose ground in the second round historically and we think that the French parliament could be quite evenly split. The most likely outcome as of now seems like a hung parliament with no clear majority. NR Leader Bardella has said that he would not accept the Prime Minister role without a clear majority, although that could be political posturing prior to the vote. We suggest to continue fading the political overhang in the EUR, with a hung parliament and no absolute majority for either the far-right or far-left meaning that no party can be excessively fiscally loose, which should therefore be EUR-positive. The most EUR-positive outcome of a centrist victory and most EUR-negative outcome of a left-wing victory both look unlikely. Nevertheless, we stay constructive on EUR as growth improves and inflation stabilizes.

Table 3: French Parties/Coalitions and Their Fiscal Leanings

Party/Coalition	**Fiscal Leanings**	**Likely EUR Impact if they obtain majority**
National Rally (RN)	Likely less responsible than Ensemble	EUR Neutral to EUR Negative
Ensemble	Already being censured by EU fiscal watchdog for flouting rules	EUR Neutral to EUR Positive
New Popular Front (NFP	Most fiscally loose	EUR Negative

Source: Maybank FX Research and Strategy

Chart 4: EUR Options are Showing Greater Relief

Source: Bloomberg, Maybank FX Research and Strategy

ECB and BOE - Cuts on the Cards

We see cuts on the horizon for both the ECB and BOE with a caveat that the earlier divergence we saw in ECB and BOE cut pricing should now narrow and converge.

For BOE, we see cuts of 75bps in 2024 with the disinflationary path largely intact and the BOE tilting even more dovish on 20 Jun. We think the first cut can happen on 1 Aug 2024 with current market pricing for that at about 67%. Preliminarily, we also see 75bps of cuts for BOE in 2025.

For ECB, we see 50bps more of cuts in 2024 although we think successive cuts by the ECB are unlikely. As such, we do think that ECB stands pat at the 18 Jul meeting. Current market pricing is at 5.7% for this meeting. Preliminarily, we see a further 75bps of cuts for ECB in 2025.

We see opportunity to buy EURGBP to express the view that the two central banks, which were previously seen as divergent in terms of rate cuts, will now converge. EURGBP continues to trade below the key 0.8500 level, which was formerly a support now turned resistance for the pairs. This strategy is also in line with our forecasts (Table 4).

Maintain our GBP and EUR Forecasts

On balance, while we maintain our GBPUSD and EURUSD forecasts (Table 4). While there are two-way risks for both currencies, we think that the GBP could consolidate around the 1.27 figure for the next few quarters before appreciating. We remain constructive on EURUSD on an improvement to growth and as inflation stabilizes in the quarters ahead.

Table 4: FX Forecasts

Forecast	3Q 2024	4Q 2024	1Q 2025	2Q 2025
GBP/USD	1.2700	1.2700	1.2700	1.2800
EUR/USD	1.0900	1.1000	1.1100	1.1200
EUR/GBP	0.8583	0.8661	0.8740	0.8750

Source: Maybank FX Research & Strategy Estimates

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