Sept 15, 2020

FX Flash

GBP: Two-Way Swings as BoJo Plays Rogue

Analysts
Saktiandi Supaat
(65) 6320 1379
saktiandi@maybank.com.sg

Christopher Wong
(65) 6320 1347
wongkl@maybank.com.sg

Fiona Lim
(65) 6320 1374
fionalim@maybank.com.sg

Tan Yanxi
(65) 6320 1378
tanyx@maybank.com.sg

Or Will This Accelerate Talks Towards a Deal?

Taking stock, GBP has declined by about 5% MTD from its peak despite USD softness seen elsewhere. This is due to fears of no-deal brexit after PM BoJo pushed for internal market bill that would alter some of UK's commitments made in the Brexit withdrawal agreement and Northern Ireland Protocol. EU had threatened legal actions in response. We acknowledged that the downside risks for GBP is growing due to perceived likelihood of no-deal brexit but it remains to be seen if this was BoJo's strategy to toughen UK's stance of negotiations with the hope of accelerating progress on trade talks or if he plays rogue and intends to break trust and renege on commitments. GBP is likely to be driven both ways directionally in the process of such. Our base case remains for a EU-UK FTA agreement before year-end.

GBP was last seen at 1.2880 levels. Bearish momentum on daily chart shows signs of fading while RSI is rising from oversold conditions. Risk of rebound not ruled out. Resistance at 1.2980 (50 DMA), 1.3020 levels (76.4% fibo) and 1.3130 levels (21 DMA). Support at 1.2740 (200 DMA) 1.2710 (61.8% fibo retracement of 2019 high to 2020 low) and 1.2690 (100 DMA). Look for 2-way trade in 1.27 – 1.30 range for now.

GBPUSD (Daily) - Signs of Technical Bounce in 1.27 - 1.30 Range

No-deal Brexit Uncertainties Re-surface

Since the start of Sep, GBP has traded lower by ~5% (vs. USD) from its peak of 1.3482 (1 Sep) as recent brexit developments caught markets by surprise.

PM BoJo had pushed for an **internal market bill that would alter some of UK's commitments on trade in goods and services made in the Brexit withdrawal agreement and Northern Ireland Protocol**. This includes provisions that would allow Ministers to over-ride parts of the Northern Ireland Protocol in the brexit withdrawal agreement to ensure that companies there have "unfettered access" to UK internal market, as well as to allow the UK to over-ride EU state aid rules.

The bill has passed the House of Commons (14 Sep) by 340 to 263 in its first main vote, advancing through to the next stage of parliamentary process (House of Lords) today.

PM BoJo argued this move is "essential" to maintain UK's economic and political integrity as he accused the EU of making "absurd" threats to stop food moving from mainland Great Britain to Northern Ireland.

Earlier PM BoJo had said that he is preparing to walk away from trade talks and let the deal fail rather than compromise on what he sees as core brexit principles. He also brought forward the deadline on when a deal should be concluded to 15 Oct 2020

Taken together these **latest developments re-ignited fears of no-deal disorderly brexit**.

Our Thoughts: Heightened Risk of No Deal but Do Not Jump the Gun

We acknowledged that the downside risks for GBP is growing due to perceived likelihood of no-deal hard brexit. But it remains to be seen if this was PM BoJo's strategy to (1) raise stakes and toughen UK's stance of negotiations with the hope of accelerating progress with talks (especially when there has been very little progress after 8 rounds of talks) or (2) if he intends to play rogue, breach trust and renege on commitments.

Recall back in Aug-2019, PM BoJo pulled out a tactic to suspend UK parliament. Intent was to limit the time for Opposition to pass any law to stop no-deal brexit and to afford less time for parliament to debate and chart the course of brexit. This gave PM BoJo the bargaining chips to toughen its stance against EU as UK was prepared for no-deal brexit and to force EU to come back to the negotiating table. Fear of no-deal brexit then saw GBP traded 2019 lows of 1.1959 (3 Sep 2019) before the subsequent recovery back above 1.30-handle as EU eventually agreed to brexit extension.

1. If the current episode is indeed another BoJo's art of negotiation in hope of accelerating progress, then perhaps the urgency from both sides may result in a deal, sooner than expected. This positive scenario would see GBP recover lost grounds and resume its appreciate path (our current base case scenario);
2. A case of PM BoJo playing rogue, breaching trust and reneging on commitments risk a disorderly break-up without a FTA. EU is

likely to sough legal actions and trade tariffs would suffice between UK and EU. This scenario could see more downside for GBP. (alternative scenario).

We reiterate that expectations of a deal soon remain low for now and negotiation intensity is likely to pick up, with more hard-talks from both sides.

GBP is likely to be driven both ways directionally in the process of such. Neither EU or UK want to concede too early in the game of negotiations but the case of deal deadline being brought forward could perhaps hasten a deal. Political bickering between EU and UK is not uncommon, as seen from the past 3 years of Brexit negotiations where both UK and EU started out their negotiation stances with plenty of differences and only to come to some compromise closer to the deadline.

Our base case scenario (1) remains for a EU-UK FTA before year-end. It is in EU's interests to strike a deal. Disruption to trade can affect Europe, in particular German, Spanish and French businesses. Vice versa, we believe the UK is probably also not prepared for no-deal brexit as well given that services exports to EU is about 7% of UK GDP. Both parties will stand to lose in no-deal brexit.

A United Nations Trade and Development (UNTAD) report showed that EU stands to be the biggest loser once UK leaves the EU. On brexit, it will change the ability of non-EU countries to export to the UK market. As of 2018, more than 50% of UK imports came from EU. This gives an idea why EU could lose more from a trade perspective.

The optimal outcome will be for both parties to ultimately compromise on a post-brexit FTA. In this base case scenario, hard brexit fears should fade and GBP could recover then.

At this point, we continue to monitor developments and maintain GBP forecasts and trajectory intact over the forecast horizon.

	End Q3-20	End Q4-20	End Q1-21	End Q2-21	End Q3-21	End Q4-21
GBPUSD	1.320	1.350	1.360	1.360	1.380	1.380

Forecast as of 31 Aug 2020
Current Spot ref at 1.2880 levels.

However, in the alternate scenario of no agreement on FTA and disorderly brexit, then GBP could be vulnerable for further downside. Looking at past GBP's performance in 2016 EU referendum as well as 2019-2020 fears of no-deal brexit, GBP depreciated between 15% and 20%. This puts a perspective on the extent of potential GBP decline in alternate scenario (2). Over a 3, 6 and 12-month horizon, we see likelihood of sharp GBP decline being front-loaded on no-deal brexit shock at 1.15 in 3-month, before gradually recovering towards 1.20 and 1.24 levels, in 6 and 12 months respectively as sentiment recovers and UK works out FTAs with other nations. As of now, UK has already secured a FTA with Japan.

Mutual recognition agreements (MRA) have also been signed with Australia, NZ and US. MRA is one in which countries recognise the results of one another's conformity assessment. UK has signed MRAs that replicate the effect of existing EU arrangements. These are expected to take effect from 1 January 2021. UK has also began negotiation with a further 18 countries which have existing EU trade deals including Canada, Mexico, Singapore, Vietnam. India is also in talks for limited trade deal with UK.

DISCLAIMER

Published by:

Malayan Banking Berhad
(Incorporated In Malaysia)

Foreign Exchange

Singapore

Saktiandi Supaat
Head, FX Research
saktiandi@maybank.com.sg
(+65) 6320 1379

Christopher Wong
Senior FX Strategist
Wongkl@maybank.com.sg
(+65) 6320 1347

Fiona Lim
Senior FX Strategist
Fionalim@maybank.com.sg
(+65) 6320 1374

Yanxi Tan
FX Strategist
tanyx@maybank.com.sg
(+65) 6320 1378

Indonesia

Juniman
Chief Economist, Indonesia
juniman@maybank.co.id
(+62) 21 2922 8888 ext 29682

Myrdal Gunarto
Industry Analyst
MGunarto@maybank.co.id
(+62) 21 2922 8888 ext 29695

Fixed Income

Malaysia

Winson Phoon Wai Kien
Fixed Income Analyst
winsonphoon@maybank-ke.com.sg
(+65) 6231 5831

Se Tho Mun Yi
Fixed Income Analyst
munyi.st@maybank-ib.com
(+60) 3 2074 7606

Sales

Malaysia

Adoni Mastura Bte Mohamed Idris
Head of Global Markets, KL
adonimastura@maybank.com
(+60) 3 27869106

Singapore

Janice Loh Ai Lin
Co-Head of Sales, Singapore
jloh@maybank.com.sg
(+65) 6536 1336

Joanna Leong Wan Yi
Co-Head of Sales, Singapore
JoannaLeong@maybank.com.sg
(+65) 6320 1511

Indonesia

Endang Yulianti Rahayu
Head of Sales, Indonesia
EYRahayu@maybank.co.id
(+62) 21 29936318 or
(+62) 2922 8888 ext 29611

China (Shanghai)

Dymond Tai
Head, Global Markets, Greater China
dymond.tai@maybank.com
(+852) 35188812

Joyce Ha
Senior Sales Dealer
joyce.ha@maybank.com
(+86) 21 28932588