

FX Insight

GBP - A Calculated Move or Gamble?

General Election Scheduled for 8 Jun 2017

PM Theresa May secured an overwhelming backing from MPs (522 - 13) on Wed (19 Apr) to hold snap elections on 8 Jun. Parliament is likely to be dissolved on 3rd May (typically the 25th working day before General election). Local elections are scheduled for 4th May where 4,581 council seats are up for grabs in England, Scotland and Wales. Voting for 6 new metro mayors will also take place. Though local election is different from the General Election, the local election results may provide a rough indication of how various parties may fare in the upcoming General Election.

Hopes Running High for Conservatives' Victory

Early opinion polls and betting odds are suggesting a strong inclination towards a big margin victory for the Conservative party and for PM Theresa May. The belief is that a larger majority (than current 17 seat slim majority) will squash deep rooted divisions and bring about greater unity in Westminster. PM May will then have a stronger hand as to forge a good deal for UK during negotiations with the EU. On FX, this has seen an impulsive move higher for GBP (from 1.2530 to above 1.28-handle on 18 Apr).

GBP 2-Way Risks but Bias to Fade Into; Option Vols 'Relatively Cheap' to Position for Fluid Politics Play

We question if PM May's surprise move for snap election is a calculated move or a gamble. Miscalculation will almost certainly jeopardize PM May's political career and unleash a new realm of uncertainty in the event of a change in leadership (GBP can re-test below 1.20). Though this is not our base case scenario, we do not rule out any possibility given that politics is fluid. Nothing can be too certain (as what vols are implying - still relatively cheap) and it remains too early to pass judgement and be complacent. Given relatively cheap vols environment, we suggest option strategies to play event risk. If client is optimistic on UK elections and expect further GBP upside, we suggest buying GBP seagull structure (with KO) or OT option but for clients who think it is too soon to pass judgement based on early opinion polls, we suggest buying GBP put spread or low delta put (for further details, please page 6-7). Technically, GBPUSD and GBPSGD look tentatively poised for further upside. Key resistance levels to watch at 1.3055 and 1.8080 for GBPUSD and GBPSGD, respectively. We look for opportunities on GBPUSD rally to fade into. GBPMYR price action saw a breakaway gap towards 5.65 levels. We think it remains too soon to judge and prefer to wait for further price action, including weekly close to confirm if that is indeed a breakaway.

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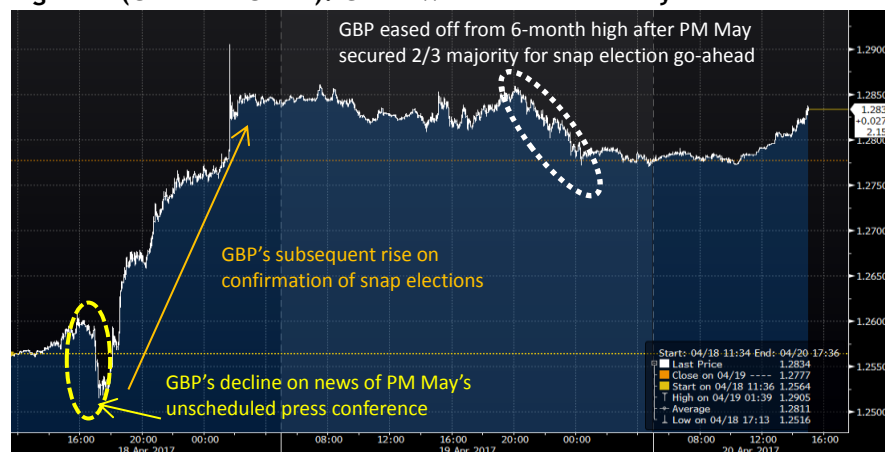
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Second General Election since 2015

GBP had a wild day on 18-Apr: falling to 1.2530 levels (from above 1.26-handle) in reaction to news of PM Theresa May's unscheduled press conference (rumors of PM May resigning due to poor health, snap elections, etc.) but rocketed to 6-month high above 1.28-handle on confirmation of a snap election on 8 Jun 2017, three years ahead of the next General Election originally scheduled for May 2020.

Figure 1 (GBP Tick Chart): GBP's Wild Ride Past 2 Days



Source: Bloomberg, Maybank FX Research

Under the Fixed term Parliaments Act (laws passed by former PM David Cameron), PM May cannot call an election directly but will need to lay down a motion in the House of Commons, requiring a 2/3 majority support from the Members of Parliament. Yesterday (19-Apr), PM Theresa May secured an overwhelming backing from MPs (522 - 13) to hold snap elections on 8 Jun. This now paves the way for the second General Election for UK since 2015.

Local Election Scheduled for 4th May

Parliament is likely to be dissolved on 3rd May (typically the 25th working day before General election). Local elections are scheduled for 4th May where 4,581 council seats are up for grabs in England, Scotland and Wales. Voting for 6 new metro mayors will also take place. Though local election is different from the General Election, the **local election results may provide a rough indication of how various parties may fare in the upcoming General Election** (Outcome could potentially swing GBP).

Why Did PM May Call for an Election Now?

"There should be no general election until 2020".

- PM Theresa May at the Launch of Conservative Leadership Bid, 30 Jun 2016

"I'm not going to be calling a snap election... I've been very clear that I think we need that period of time, that stability, to be able to deal with the issues that the country is facing and have that election in 2020."

- PM Theresa May's interview on BBC's Andrew Marr show, 4 Sep 2016

"no change in our position on an early general election... there isn't going to be one... It is not going to happen,"

- PM Theresa May's spokesperson told a Westminster media briefing, 20 Mar 2017

She had stood firm in ruling out early election previously but abruptly and reluctantly reversed her stand due to “too many divisions” within Parliament. She said *that “At this moment of enormous national significance there should be unity here in Westminster, but instead there is division. The country is coming together, but Westminster is not... the only way to guarantee certainty and security for years ahead is to hold the elections and seek support for the decisions she must take”*.

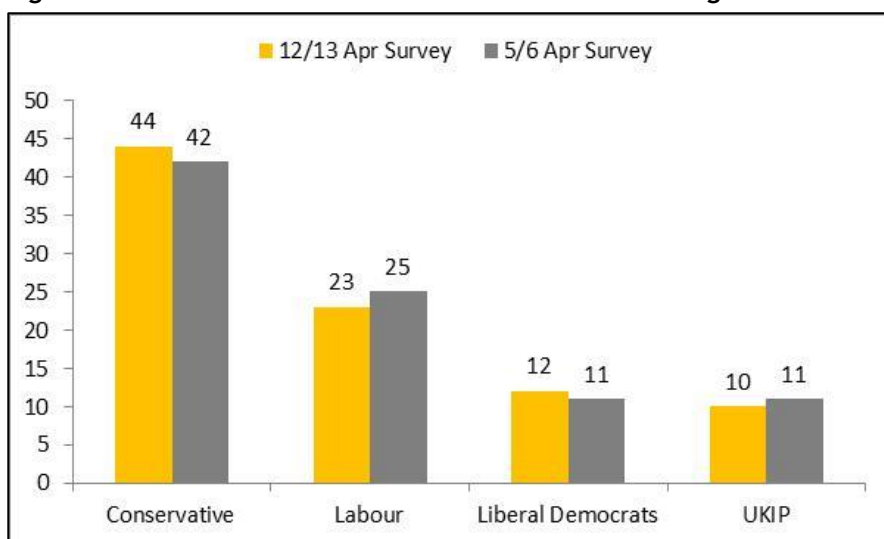
Recall back in Jul-2016, Theresa May was appointed as PM after UK voted to leave the EU and former PM David Cameron stepped down. She was subsequently appointed by the Conservative party to be PM but was not elected by the people.

The upcoming elections will be an **attempt for PM May and her party (the Conservatives) to seek a stronger Brexit mandate** from the British people and **to have a larger majority in the House (if she has it her way)**. The belief is that a larger majority (than current 17 seat slim majority) will squash deep rooted divisions and bring about greater unity in Westminster. PM May will then have a stronger hand as to forge a good deal for UK during negotiations with the EU.

A Calculated Move or a Gamble?

Going by opinion polls, **early results showed a strong lead (of 21 points) for the Conservative party over Labour party**. This is the **widest lead Conservative party ever has over Labour party since 2010** and recent polls continue to show increasing support for the Conservative (disclaimer: recent polls were all conducted before the announcement of election date)

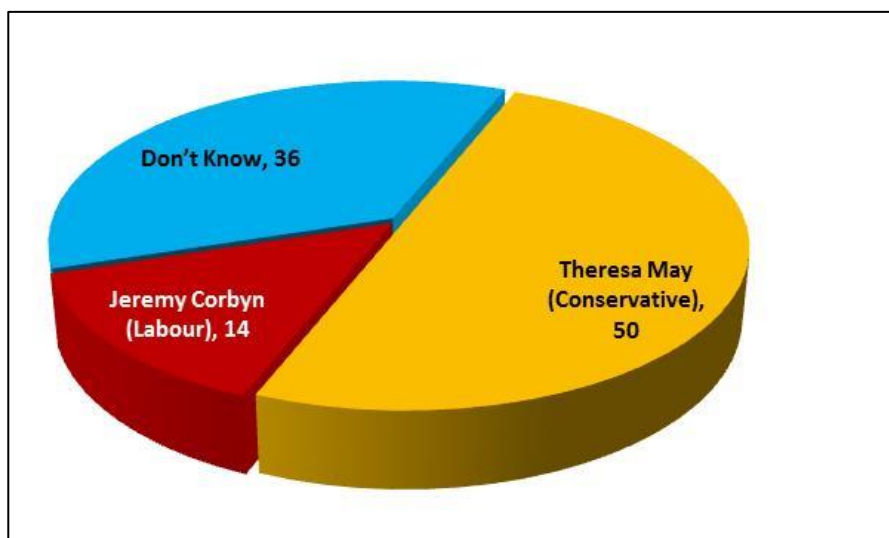
Figure 2: Polls - To Believe Once More or to be Fooled Again?



Source: YouGov/Times Voting Intent, Maybank FX Research

The most recent poll by Yougov surveyed on 12-13 Apr showed support for the Conservative stood at 44% while support for the Labour party stood at 23%. Those results also represent the **lowest voting intention share for Labour party since Jun 2009** (when leader Gordon Brown was then-PM). 50% of the electorate also think that PM Theresa May would make the best PM, compared to Labour’s Jeremy Corbyn (14%) and another 36% said they don’t know.

Figure 3: Which of the following do you think would make the best Prime Minister? (12-13 Apr Poll)



Source: Yougov, Maybank FX Research

Current polls results suggest that the **wide lead could translate into a comfortable win for the Conservative party**. Based on opinion polls from 10 - 27 Mar, sampling from 10,972 respondents, the **Electoral calculus predicted that Conservative party could win by 112-seats majority**. Even bookmaker William Hill says the Conservatives have an **84% chance of winning with an overall majority**.

We question if PM May's surprise move for snap election is a calculated move or a gamble. So far polls and even bookmakers suggest PM May's move to call for snap election is a calculated move but we also know matters of politics are fluid and fickle. Miscalculation will almost certainly jeopardise PM May's political career and unleash a new realm of uncertainty especially in the event of a change in country leadership (GBP can re-test below 1.20). Though this is not our base case scenario, we do not rule out any possibility given than politics is fluid.

As of now, we prefer not to over-interpret opinion polls and prediction, especially when there are still 7 weeks to go and the most recent poll was conducted before the 8-Jun election date was announced. We still think opinion polls are at best a rough guide and not the Holy Grail, given how opinion polls got it so wrong in 2015 - recall that almost all opinion polls pointed to a hung parliament for UK while the actual elections outcome was a victory for the Conservatives.

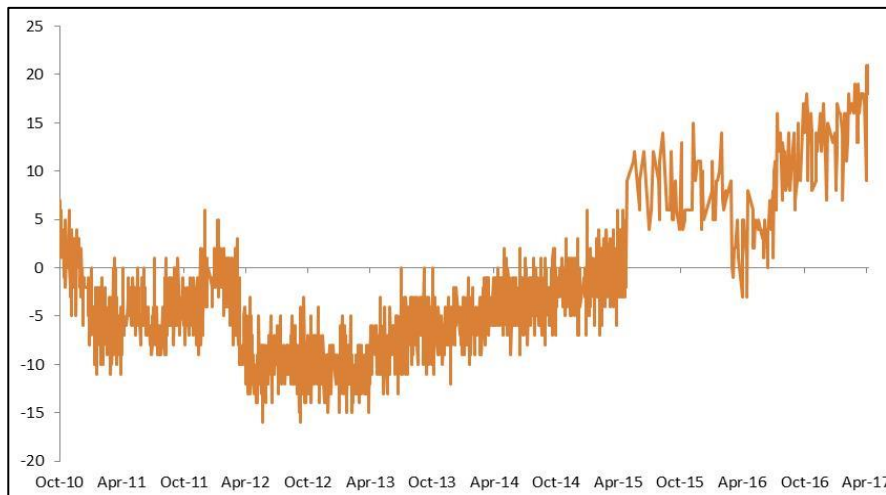
While the focus has mainly been placed on the Conservative and Labour Parties, much remains unknown how the Liberal Democrats and Scottish National Party may fare. Although Liberal Democrats lost badly in the 2015 general elections from 57 seats to just 8 seats in Parliament, they may pose some risks for PM Theresa May and her party in the upcoming elections. Recent polls have shown slow but increasing support and there is a chance the Liberal Democrats (the only party committed to *Bremain*) can garner support in the South-West region and those supporting *Bremain*.

Narrowing/Widening of the Lead to See Swings in GBP

That said we believe the lead (that Conservative has over Labour) matters for the GBP. The current wide lead (21%) that Conservatives have over Labour party will serve as a starting point and the narrowing or widening in the lead is likely to lead to swings in GBP.

Given that the current level of GBP already reflects a Conservative victory by a wide margin, we believe a **narrowing of the lead will weigh on GBP** while an **extension of the lead could unwind stagnant GBP shorts and lead to further upside**.

Figure 4: Conservative Leading Labour Party by a Large Margin (21%)

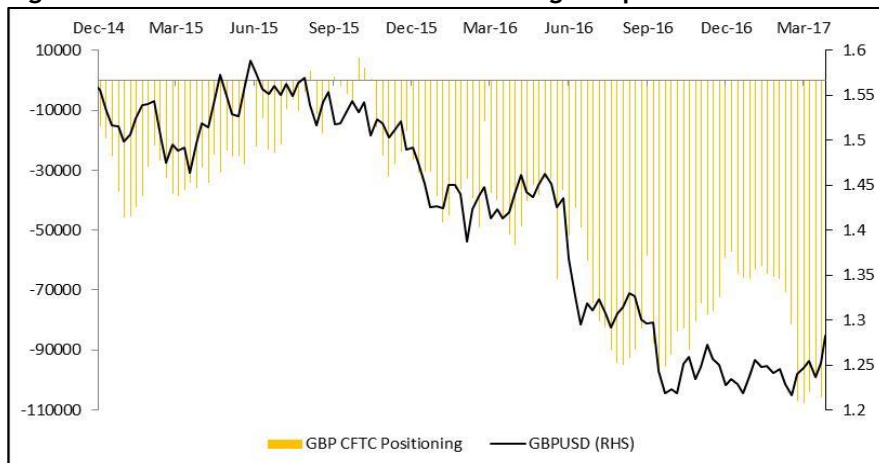


Source: UK Polling Report (as of 19 Apr 2017), Maybank FX Research

GBP CFTC Positioning - Too Many GBP Bears Out There

Hopes and expectations for Conservatives to win by a large margin should continue to lend support to the GBP especially in an environment of broad USD weakness and French elections uncertainty this weekend. But we caution against excessive optimism on UK election outcome based on early opinion polls. We do however acknowledge that **GBP short positioning (as seen from CFTC) remains at record short levels**. Early optimism on UK elections could force stale GBP short positions to unwind and that may fuel GBP higher in the short term.

Figure 5: GBP Shorts Risk Further Unwinding -> Upside Risks for GBP

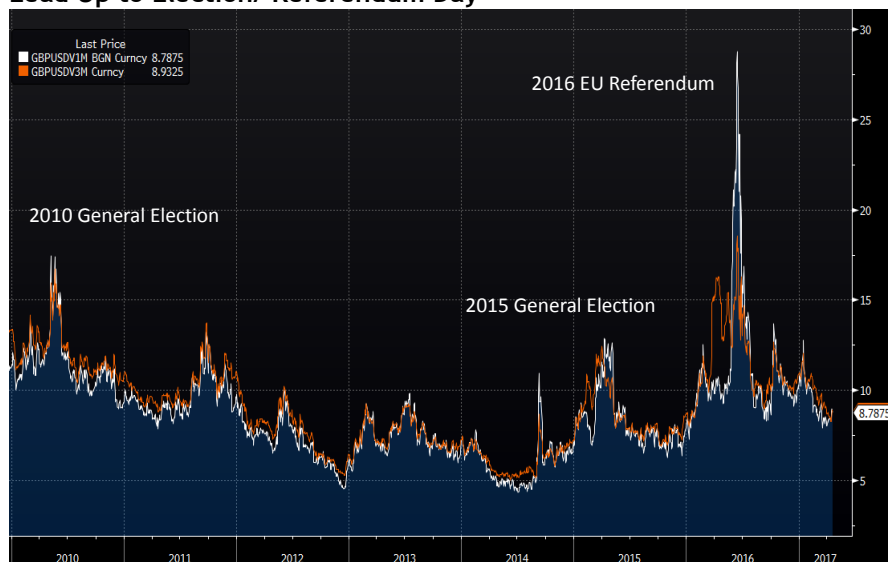


Source: Bloomberg, Maybank FX Research

GBP Vols Suggest Markets' Complacency amid Key Event Risk

GBP1m and 3m vols have risen slightly from 8.5-handle to around the 9-handle after the announcement of the election date. These levels remain far too mild relative to 2015 General Election where vols hit 13-levels, UK referendum 2016 where vols hit above 20-handle and in 2010 General Election where vols hit above 15-levels.

Figure 6: GBP Vols Relatively Cheap Now; Vols Tend to Rise in the Lead Up to Election/ Referendum Day



Source: Bloomberg, Maybank FX Research

While we are not implying that vols could re-visit extreme levels beyond 20-handle, the vols at current levels of sub-9-handle do suggest some degree of market complacency of key event risk. We think it could be worthwhile to take advantage of the low FX vols environment to position for event risk.

Potential Option Plays to Play Event Risk

For clients who are more optimistic and believe GBP can rise further amid stretched GBP short positioning, we suggest the following FX option plays:

- (1) Buy 3-month GBPUSD One Touch (OT), with strike at 1.3750. Premium at GBP16.5%.
 - An attractive risk-reward profile of 6x if GBP spot hits 1.3750 within the next 3 months. Client also benefit when vols start to rise as this option play (via OT) is an expression of long vols
 - Recall that option vols typically run higher in the lead up to election and referendum day. And vols during those period punched above 10-levels
 - Assume if GBP spot rises towards 1.3240 levels over the next 1-month, the OT is estimated to be worth 33%. This is double the cost of 16.5%, with 2 more months remaining (assuming vols stay unchanged). Should vols climb higher, the value of the OT will be worth higher.

(2) Buy 3-month seagull (modified with KO), with maximum payout of 3.7% if GBP spot rises to 1.3450 within the 3-month period. Zero cost premium. All 3 legs are in equal notional.

- Client buys GBP Call Strike 1.2950, Client sells GBP Call Strike 1.3450, and Client sells GBP Put Strike 1.2600 that early terminates (KO) if 1.3250 is triggered. All 3 legs are in equal notional.
- Unlike a normal Seagull, in this structure, if spot were to trade to at or above 1.3250 anytime before the expiry date, the liability leg on the downside will early terminate. Hence thereafter, client will not be disadvantage should there be a turnaround in spot.
- Risk to this structure is GBP did not trade higher towards 1.3250. Instead GBP traded lower and beyond 1.26. This means client will need to buy GBP higher than prevailing spot.

For clients who are less optimistic and wishes to position for GBP downside perhaps due to belief that opinion polls' indication remains too early to foretell outcome; that Labour and/or Liberal Democrats may narrow the gap with Conservative or a case of PM May's miscalculation which may result in the change of country leadership (black swan event), we suggest the following strategies:

(1) Buy 3-month GBP put spread, with maximum payout of 500 pips at premium of USD130pips.

- Client buys GBP Put Strike 1.27 and Client sells Put Strike 1.22. Both legs in equal notional
- Attractive risk-reward profile of 4x.

(2) Buy 3-month GBP Put Strike 1.20, with premium at USD38pips

- A low cost plain vanilla option to position for black swan event. Breakeven at 1.1962.

The above were indicative prices and were priced off GBP spot ref of 1.2775.

For further details on pricing, please contact our Structuring desk in Global Markets, Singapore.

Our GBP View - Upside Risks but Biased to Sell on Rally

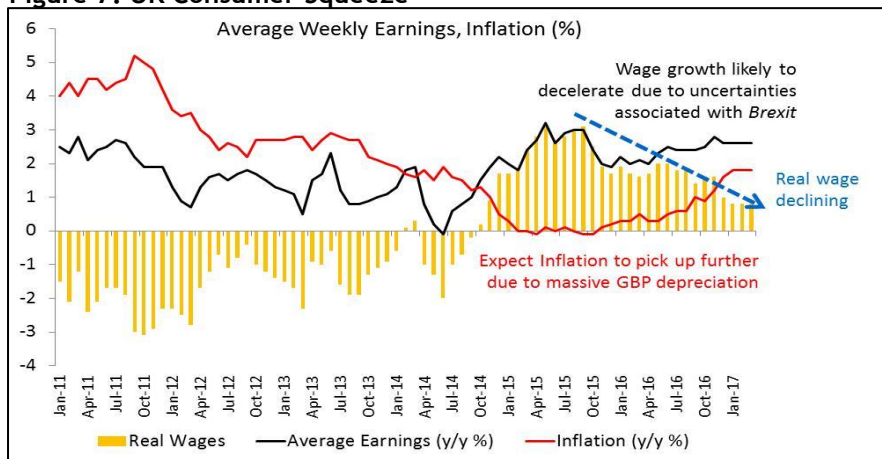
We believe the current level of GBP is a reflection of market expectations for a Conservative victory at the upcoming General election (8 Jun). **Rising hopes and expectation for the Conservatives' lead to widen over Labour party should continue to drive GBP higher** over the next few weeks, especially given stretched GBP shorts positioning.

But hopes and expectations have to be validated by future opinion polls and local election results (4 May). **While a Conservative victory is priced in to some extent, the potential downside scenarios including other parties getting their act together and play catch up with Conservative, the risk of Scottish referendum, etc. are not priced in. A narrowing of the lead should dampen market complacency and weigh on the GBP.**

Moreover, we have flagged out that potential downside surprise to economic data in coming weeks to months should also weigh on GBP. We

had also shared (in our last monthly outlook) that the strong 4Q 2016 GDP (+0.7% vs. +0.6%) was due to the jump in net exports while fixed investments declined and household consumption fell. Rising inflation (+2.3% y/y in Mar), possibly faster than wage growth will depress real wages and eat into household budget (consumer squeeze).

Figure 7: UK Consumer Squeeze



Source: CEIC, Maybank FX Research

While the UK economy may show resilience for now, we caution that the Brexit journey is only about to begin. Negotiating trade deals can take a long time (especially with the EU) and much remains unknown over London's status as a financial hub; if it can continue to attract foreign inflow of funds and investments, if MNCs will relocate their HQs and result in job losses. We see these uncertainties returning and re-exert downside pressure on the GBP, beyond the elections.

GBPUSD Technical: Watch 1.3055 Resistance

GBP broke above key resistance (200DMA at 1.2620) on Tue. Last seen at 1.2810 levels. Weekly, daily momentum indicators are bullish bias. Next area of resistance at 1.30 - 1.3055 (38.2% fibo retracement of Jun high to Oct low). Decisive move beyond that area of resistance could potentially see room for further upside towards 1.3430 (50% fibo). Stochastics suggests GBP is approaching overbought conditions - an indication that upside momentum maybe moderating. Support at 1.2620 (200 DMA). We look for opportunities on rally to fade into.

Figure 8: GBP Upside Risks; Support at 1.2620



Source: Bloomberg, Maybank FX Research

GBPSGD Technical: Next Resistance at 1.8080 Levels

GBPSGD traded 3-month high following PM Theresa May's announcement for 8 Jun elections. Last seen at 1.7920 levels. Weekly, daily momentum indicators are bullish bias. Next resistance at 1.8080 levels (50% fibo retracement of Jun high to Oct low). A decisive close above that puts next resistance at 1.8550 levels (61.8% fibo). Stochastics is also showing signs of entering overbought conditions. Retracement could visit 1.7620 (38.2% fibo, 200 DMA).

Figure 9: GBPSGD Upside Risks



Source: Bloomberg, Maybank FX Research

GBPMYR - Breakaway Gap? Watch Further Price Action to Confirm

GBPMYR price action saw a breakaway gap towards 5.65 levels. We think it remains too soon to judge and prefer to wait for further price action, including weekly close to confirm if that is indeed a breakaway or if the gap closes (and become an exhaustion gap). Key resistance to watch: 5.7120 (38.2% fibo retracement of Sep-2015 high to Oct-2016 low). Support at 5.56 (before the opening gap).

Figure 10: GBPMYR - Watch Price Action



Source: Bloomberg, Maybank FX Research

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