Market Insights & Strategy

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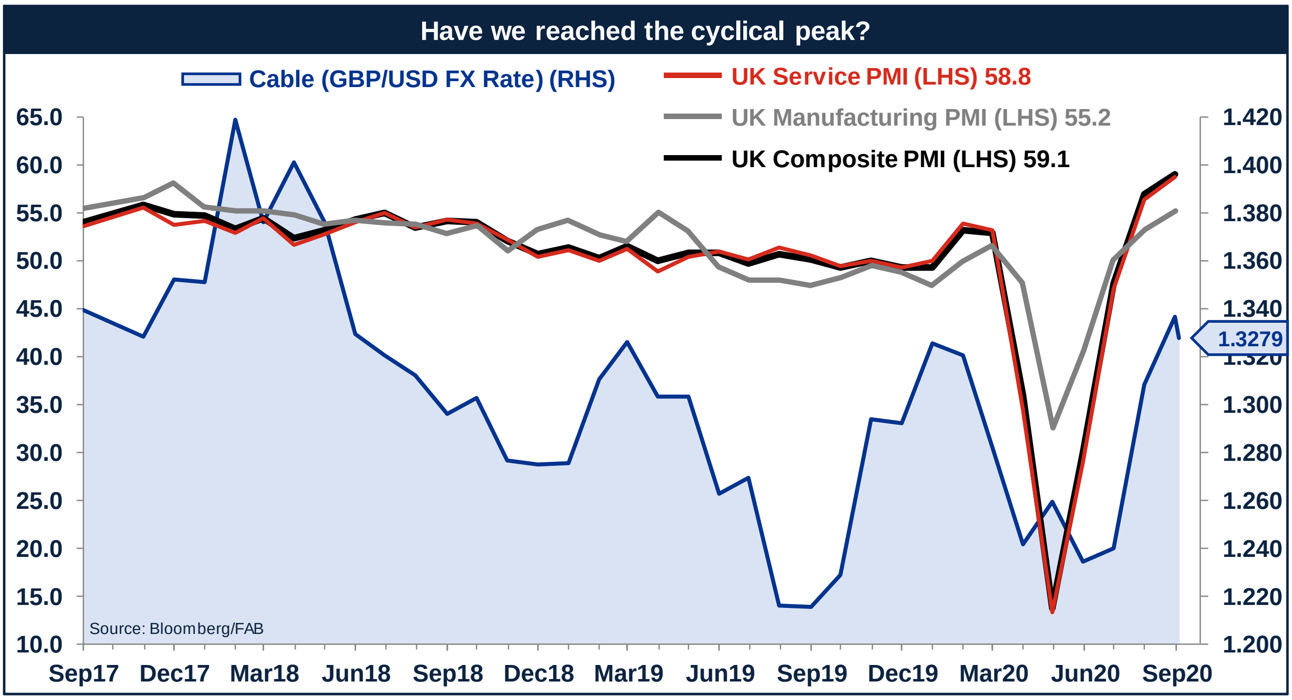
FAB Macro Strategy:
Time for U.K. fundamentals and valuations to realign

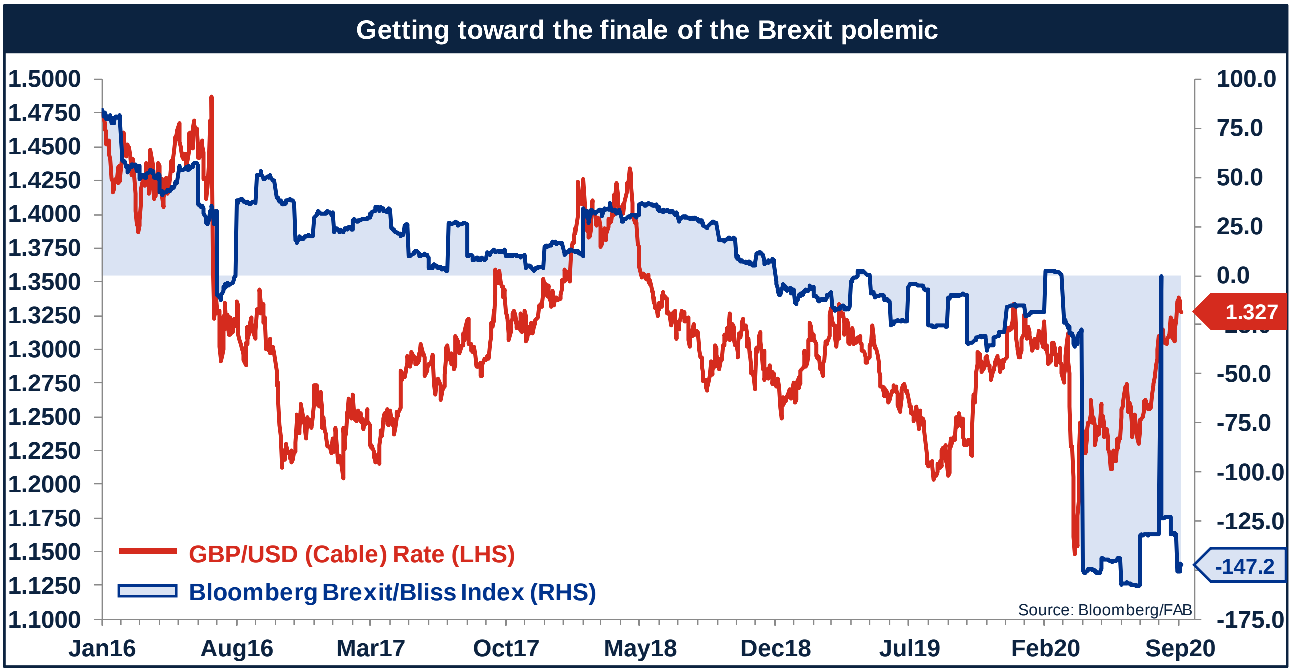
- **Has U.K. macro hit a cyclical peak?**
- **GBP on the verge of a correction phase versus USD and EUR?**
- **Labour market to face harsh reality as furlough scheme winds down**
- **Something fishy about Brexit, with the spectre of 'no deal' rising by the day**

The latest final UK PMI data for August may have come in stronger than the prior month, but critically it was down sharply from preliminary forecasts. Combining this with the modest pullback seen in GBP over the past few sessions, we would suggest that the U.K. market may now be poised to enter a more significant correction phase, a scenario under which we would expect GBP to decline versus both the USD and the EUR. From the current levels of around $1.3280 and EUR1.1220 at the time of writing, we believe that cable could trend back to test the March low of $1.15 again in the coming months, while GBPEUR could revisit EUR1.06 as fundamentals are more accurately priced in.



The key drivers of our bearish view on the U.K. macro outlook are twofold. On the one hand there are persistent uncertainties and caution with regard to how the U.K. economy and labour market will hold up as the government's coronavirus-battling fiscal stimuli are withdrawn by the end of next month. As we have written previously, while the employment furlough scheme has without doubt been a tremendous life-support system for the U.K. labour market and the broader economy during the Covid-19 fuelled economic downturn, the structural damage done to the economy by the pandemic means that in reality the scheme has really only created a delay to inevitable, eventual job losses and a rise in unemployment. While the nadir of the economic cycle surely lay in early Q2, the extent of the long-term damage will only become apparent over the coming months.

Our second area of concern is with the end of the Brexit transition period on December 31 this year. We have long held the view that the default outcome of the U.K.'s departure from the EU would be a no-trade deal Brexit and with the latest standoff between the two sides over fishing rights in U.K. waters becoming increasingly unresolvable, we are convinced more than ever that this will be the default scenario. With time running out and neither side willing to yield in the negotiations, the spectre of a 'no deal' outcome is rising by the day.



Overall therefore, we would conjecture that while the latest PMI data confirms that business confidence has reached a multi-year high, the high is not as high as previously expected. As such, as fiscal stimuli are unwound in the next few months and as the U.K. staggers toward a no-deal Brexit in December, we believe that evidence will show that the August data marked the high point of the U.K. economy's post-Covid-19 rebound. From the top, the only way is usually down.

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