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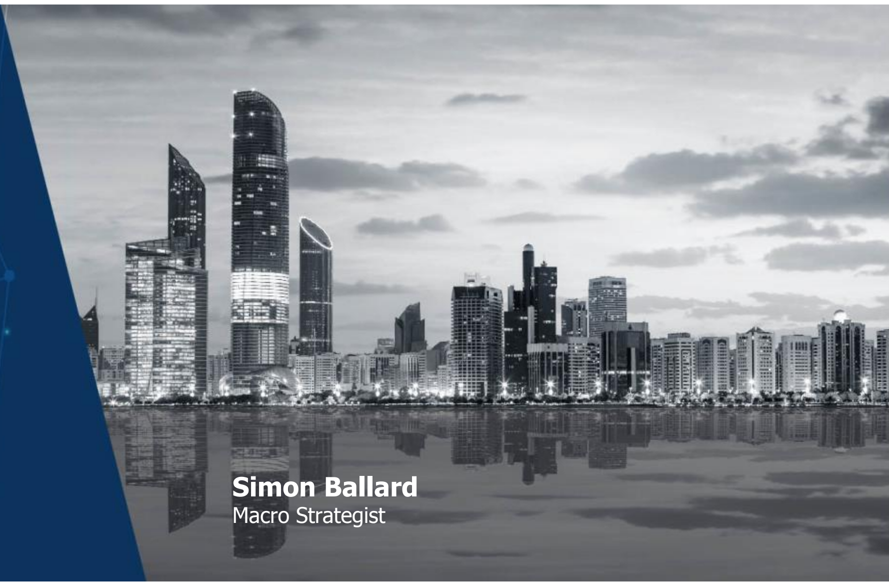

Market Insights & Strategy

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Simon Ballard
Macro Strategist

Macro Strategy - Brexit Bulletin

I love it when a (hard Brexit) plan comes together

- In the venerable words of the fictitious Col. Hannibal Smith in the television series 'The A Team', "I love it when a plan comes together". We have long held the view that given the split, divisive nature of the Brexit polemic that a hard, no-deal result would likely be the only feasible outcome. We see no way for a compromise to be achieved in time and of late, with the installation of the new Boris Johnson pro-Brexit administration, the market seems to be increasingly in agreement with us.
- The new U.K. government has set delivering Brexit on 31 October as its holy grail; a political commitment. This being the case, it may only be achievable by going 'hard' and we would suggest that a no-deal divorce scenario is still not priced into cable.
- The path of least resistance for GBP will surely be lower over the next 2 months as we now career toward that October 31 deadline. Indeed, sterling has declined almost 10% ytd as 'hard Brexit' rhetoric has gained more listeners; from a high of $1.3338, cable now sits just shy of $1.2000 ($1.2083 as of 4pm UAE time on Aug 20, 2019).

- We believe that $1.1500 should be the next target for the currency as we head to the Brexit deadline, with sub-$1.1000 territory possible in the case of a particularly messy no-deal outcome, as alluded to above.
- That said, while GBP will likely remain weak in a post hard Brexit environment, we would expect an element of investor bottom fishing to then lend the currency some support and therefore for the absolute lows in GBP to be only transitory.
- Moreover, a hard Brexit scenario will also weigh on the UK rates outlook as growth estimates are scaled back. The implied economic fallout and volatility of a hard Brexit result would therefore be expected to spur the Bank of England back firmly into easing mode. Expect investors to eye up to 50bps of rate cuts from the central bank post a no deal divorce on October 31, adding further downside potential to cable.
- But contrary to public opinion, it may not be Boris Johnson and his government that triggers the 'no-deal' divorce, but rather the intransigent EU. As BoJo pushes, albeit perhaps only symbolically, for an amended deal, so as to avoid the threatened economic cliff edge of a hard Brexit, we believe the EU may say that 'enough is enough'.
- Indeed, Brussels has consistently and vehemently stated that the current withdrawal agreement has no room for re-negotiation. It may therefore eventually lose patience with the UK, forcing it into a no-deal departure. Paradoxically, Boris Johnson's reputation could then be strengthened by such a result as he portrays himself as the victim.

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