Macro & FICC Research

# FX Ringside

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## Stronger GBP no matter what this weekend?

This weekend's vote on the withdrawal deal in the House of Commons will undoubtedly generate a reaction in the GBP. The knee-jerk reaction would be to bet on GBP-weakness in case the agreement would be rejected by Parliament, while we probably will se a stronger GBP if the deal is accepted. Then uncertainty would finally go away as the UK will then depart from the EU on 31 October. But is it really that simple?

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**Joint probabilities.** We have for a long time approached the complex Brexit problem by looking at different scenarios with probabilities attached to them. The joint probabilities and our EUR/GPB forecasts in each outcome provide us a good tool to analyse where the GBP would trade in a certain outcome. Considering the most likely options going forward ahead of this weekend's vote in Parliament, we would estimate that today the total joint probability that:

**Scen 1:** the UK at some point in the future would leave the EU, with or without a deal, is 75%, while it is roughly 25% probability the UK will revoke article 50 and stay in the EU (Column 1 in the table below). This is of course based on our subjective probabilities for different outcomes shown in the scenario tree below.
**Scen 2:** However, given the legislation, which will force the government to ask the EU for an extension if Parliament would reject the deal tomorrow, the joint probability the UK would leave the EU at some point in future will drop to around 60% if Parliament rejects the withdrawal deal tomorrow. (Column 2 44%+15%).
**Scen 3:** Would the outcome this weekend instead be that Parliament rejects the deal and approves a confirmatory referendum on the agreement, the likelihood the UK would revoke article 50 increases even further to around 55% (Column 4 in table below).

**GBP will react on any outcome.** The behaviour of the GBP related to this weekend's event in Parliament should be related to the final outcome of the Brexit mess and not only to what happens this weekend. We expect that the GBP will react very negatively on a no-deal departure from the EU and probably it would trade around parity against the EUR in such scenario. In contrast a scenario where the UK would revoke article 50 and remain in the EU would probably boost the GBP and in this case the EUR/GBP probably could trade towards 0.79. However, would Parliament approve the agreement tomorrow it is also likely to boost the GBP slightly and take the EUR/GBP towards 0.8350-level.

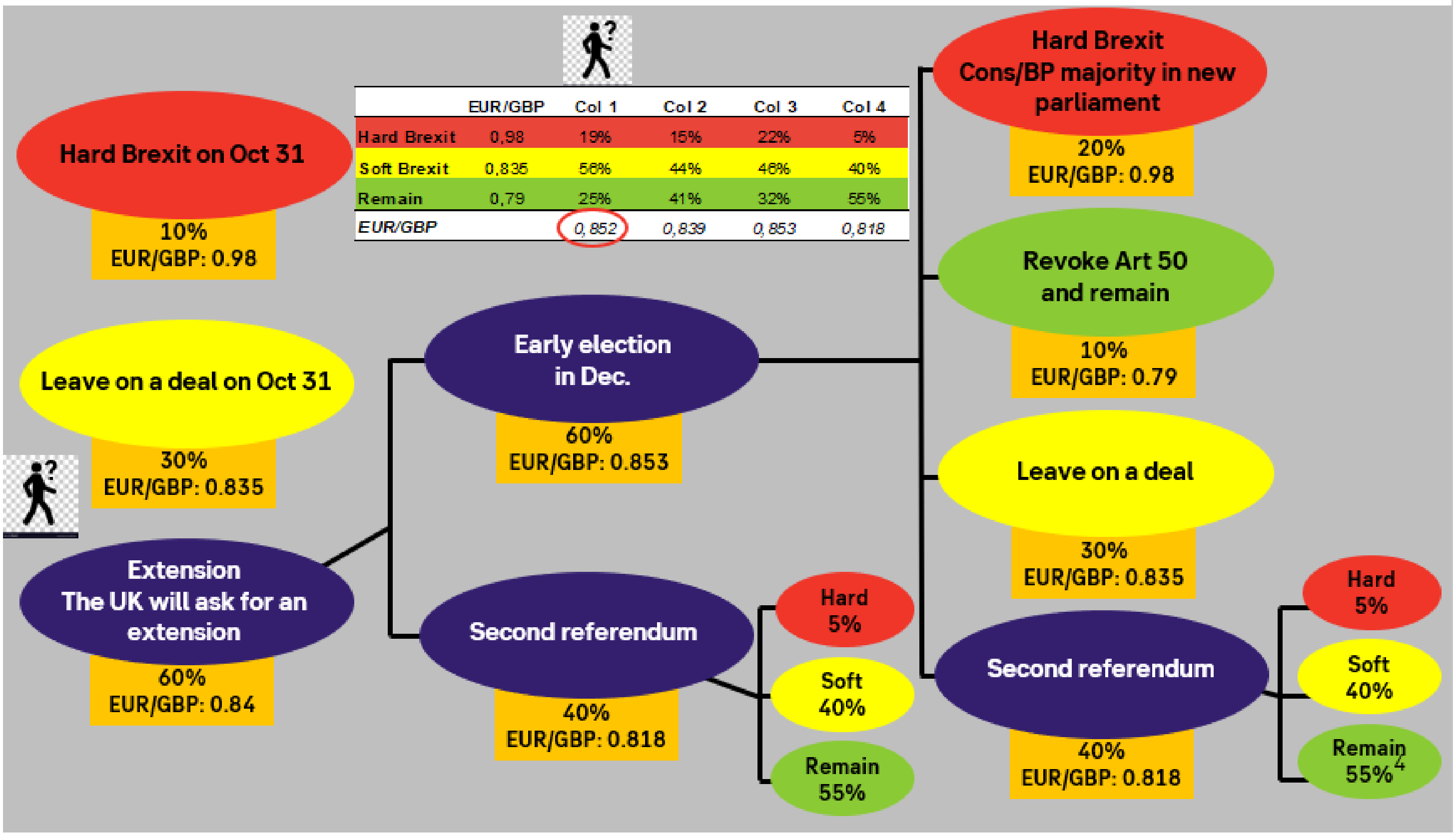
**Joint probabilities suggest a stronger GBP.** If we just simply combine these assumptions of where the EUR/GBP will head in different scenarios with the joint probabilities for these different outcomes, it is possible to calculate the expected level for the EUR/GBP on any outcome this weekend. The results suggest that there is an upside potential in the GBP from current level no matter what the outcome will be this weekend. This is why:

Would Parliament on the one hand accept the deal we should see the EUR/GBP trade down towards 0.8350 on Monday (scenario 1. on the left). Would Parliament on the other hand reject the deal or attach a confirmatory referendum to it, the government will be forced to ask the EU for an extension. This would open up new options going forward. In fact these should suggest that the joint probability the UK will remain an EU-member in the longer term has increased significantly, which ought to be positive for the GBP. Then the EUR/GBP should theoretically move to around 0.84-0.85 when markets begin to focus on the different options going forward following this outcome on Saturday (scenario 2 & 3 on the left). Maybe it will not be the knee-jerk reaction in EUR/GBP on Sunday night but eventually it should go this way.

We have focused on the EUR/GBP. However, from a trading perspective, buying the GBP/USD is probably a better choice as volatility can be expected to be even higher given that the EUR/USD will react on the outcome as well.

# The Brexit process and EUR/GBP

EUR/GBP can end up anywhere between 0.80 and 1.00 by end-Q4




| | EUR/GBP | Col 1 | Col 2 | Col 3 | Col 4 |
|---|---|---|---|---|---|
| Hard Brexit | 0,98 | 19% | 15% | 22% | 5% |
| Soft Brexit | 0,835 | 56% | 44% | 46% | 40% |
| Remain | 0,79 | 25% | 41% | 32% | 55% |
| *EUR/GBP* | | *0,852* | *0,839* | *0,853* | *0,818* |