

UK pound tumbles on 'no-deal' Brexit fears

SUMMARY

- GBP/USD has fallen sharply as new Prime Minister Boris Johnson embarks on an aggressive negotiating strategy with the EU. The EU's current unwillingness to revisit the Withdrawal Agreement and "Irish Backstop" provision is perceived by markets to increase the risk of a no-deal Brexit.
- Parliamentary safeguards against a no-deal Brexit can only potentially occur once the UK parliament returns from recess, increasing uncertainty.
- Capitulation of long GBP positions has likely weighed on the market. While there may be additional short-term pressure, we believe that longer-term risk-reward still favours GBP/USD. We are bullish on a 12-month time horizon.

BACKGROUND

- The pound has fallen more than 4% this month (around 2% in the past two days) amid heightened concerns that the UK will crash out of the EU without a deal. Most investors have until now expected the UK to reach a last-minute agreement to avert a hard Brexit, but new PM Boris Johnson and his new cabinet's shift to an aggressive negotiating strategy with the EU has thrown that into doubt.

WHAT DOES THIS MEAN FOR INVESTORS?

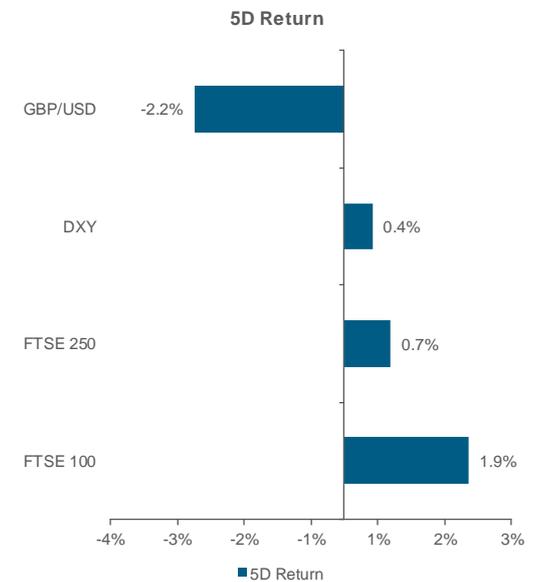
- Since the UK parliament is now in recess until 3rd September, the two options for MP's to potentially avert a no-deal Brexit - a vote of no confidence in the government or a vote to revoke Article 50 - cannot occur for over a month. Uncertainty is therefore likely to remain elevated in the near-term if the EU does not agree to negotiate the Withdrawal Agreement and the key "Irish backstop" provision - or the UK PM changes negotiating strategy.

WHAT NEXT?

- On technical charts, GBP/USD's fall on Monday below key support at the end-2018 and early-2019 lows of 1.2436-1.2478 exacerbated the decline (down 2% since Friday at the time of writing). This has been reflected in the spike in near-term volatility (1 to 3 months), which is now at the highest since April, while the far-end volatility (6 months and beyond) is at the highest since February.
- Volatility could stay elevated in the short term as GBP/USD approaches major support at the 2017 low of 1.1979, roughly coinciding with the psychological 1.2000 mark. Below that, there is the 2016 low of 1.1450, seen in the aftermath of the Brexit referendum, and the peak of pessimism. A no-deal Brexit would likely see GBP/USD fall to around 1.15, whereas a deal or no Brexit could see a spike to 1.35 or 1.43 if the USD weakens broadly.
- Barring intraday/intra-week swings, the probability of holding above 1.2000 is reasonably high, in our assessment, especially if the US Fed cuts interest rates at its two-day meeting ending tomorrow. Moreover, the pace and the extent of the decline in GBP/USD suggests capitulation as the Brexit end-game nears. We see risk-reward as positive in the longer term and we continue to be bullish on the GBP on a 12-month basis.

GBP/USD has suffered under the new UK PM

Performance of selected asset classes from 23-30 July



Source: Bloomberg, Standard Chartered

Support at 1.2380 has broken, triggering position squaring; Next support lies around 1.20

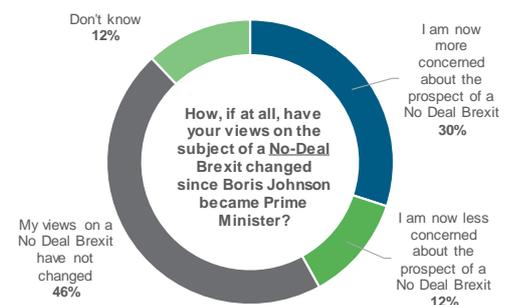
GBP/USD (weekly) with technical levels



Source: Bloomberg, Standard Chartered

Concerns are rising over the new PM's strategy

WhatUKthinks poll; Field work dates (25-27 Jul)



Source: WhatUKthinks, Standard Chartered

Disclosure Appendix

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ESG data			
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B	Good	D	Unsatisfactory

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