Sterling Update – 28th August 2019

Although our monthly bulletin will be issued early next month, we thought that we'd bring a quick market update.

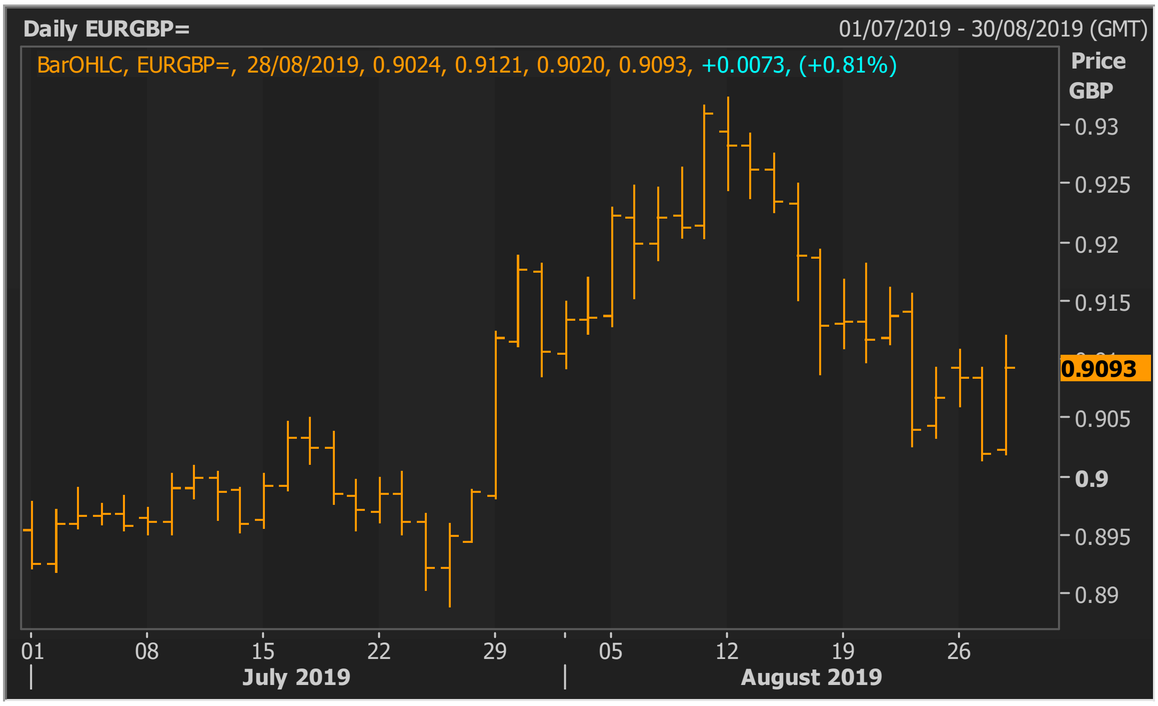
This morning Boris Johnson has announced that he intends to suspend parliament from mid-September. This will likely lead to a no-confidence vote next week when parliament returns (the Government cannot call an election under recent UK law….but they can provoke one).

This leads to a 2-week period within which an alternative government may be formed but this is seen as unlikely therefore leading to a general election. But that, in turn, may not happen until after October 31st which leaves the Brexit issue in limbo and the probability of a hard Brexit higher.

The move has taken anti-Brexit MPs by surprise (even those within the Tory Party) but would be consistent with the view that the PM wanted a general election and a mandate (without the support of the DUP). The last point in particular could be relevant as if the October 31st date does not crystallise as a hard Brexit, and the Tories achieve an overall majority, then they would have more flexibility on the NI front.

Sterling opened at EUR/GBP0.9024 this morning but has softened very quickly as the markets digest the news. The first graph below shows the trend for Q3 to date.

Chart 1. EUR/GBP Q3 trend (Source: Reuters)



What does this mean? What it does is bring the probability of increased volatility into early September rather than pushing it into end-September/end-October. Next week will be very active in the UK parliament and the markets will follow every move carefully.

The second graph is the 5-year Sterling Interest Rate Swap for 2019. This has been steadily decreasing over the course of the year and is 16bp lower than on Friday last – falling rates usually indicate deteriorating economic outlook.

Chart 2. EUR/GBP 5-year trend (Source: Reuters)

The key takeaway from all of the above is that any hope that we had of some level of relative stability in the financial markets until October giving breathing space for strategy consideration has probably disappeared this morning. If you can't hedge forward, you're rapidly running out of time to enable yourself to do so. If you can, then what's the plan? Don't think it can be put off any longer. "Wait and see" is increasingly looking like the wrong strategy. Even if not executed immediately, one needs a plan that can be implemented at short notice.

On a non-financial point, the prospect of civil disobedience in the UK has also been brought forward. The coming weeks could be the most challenging that the UK has seen for decades. We are looking at a constitutional crisis not seen for a long, long time in the UK. All of these events ultimately have consequences for financial markets. Fasten your seatbelts.