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Economist's Weekly Market View

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Sterling under pressure

Sterling came under downward pressure again over the summer, with Theresa May stepping down as Prime Minister. Her replacement, Boris Johnson, is a leading Eurosceptic who is looking to take the UK out of the EU at end October, with or without an exit deal. Thus, the risk of a no-deal Brexit has risen considerably.

This saw the euro rise to as high as 93p against sterling in early August from a low of 85p at the start of May. Meanwhile, sterling has fallen from above $1.30 against the dollar to close on $1.20. Sterling has regained a bit of ground recently, with the euro dropping back below 91p.

However, this may prove just a temporary reprieve. With the new Prime Minster determined to take the UK out of the EU, we seem to be heading for another cliff-edge Brexit date at end October. A very fraught two months lies ahead in terms of UK-EU relations as efforts continue to try and avert a hard Brexit.

The default position is that the UK will leave the EU without a deal at end October unless there is a further extension to Article 50. Such an extension would again require the agreement of all EU 27 member states. However, there were signs at the April 10th EU summit that at least one country seems keen to bring a conclusion to the Brexit process. Furthermore, the new UK Prime Minister does not want an extension.

The UK Parliament has indicated that it wants to avoid a no deal Brexit. However, there are concerns that it may not be able to stop it happening. Simply voting against a no-deal Brexit does not require the government to act to prevent it. Instead, Parliament would need to amend or pass some legislation on the matter. The government controls most of the Commons timetable so there are limited opportunities for MPs to initiate or amend legislation. Despite this, we expect that Parliament will attempt to prevent a no-deal Brexit, as it did earlier this year.

Against this uncertain backdrop, sterling is likely to remain on the back foot over the next couple of months in the run-up to the end October Brexit deadline. There is strong support for the currency at the 93p level, so EUR/GBP may trade in a 91-93p range in the coming weeks.

If the 93p level gives way, there may be some support for the currency at around 94-95p, where it traded in late 2008/early 2009. Indeed, the euro briefly rose to as high as 97.5p at end 2008 during the financial crisis at that time.

Sterling would most likely come under even greater pressure this time, though, if a no-deal hard Brexit becomes an increasingly likely prospect, given that it would have very negative consequences for the UK economy. The currency could fall by 10 per cent from current levels, hitting parity against the euro.

Obviously, if a no deal Brexit is avoided, there should be scope for sterling to bounce, especially as market positioning is very short the currency. The euro could fall back towards the 85-86p level in these circumstances.

Thus, there is a broad range for sterling forecasts. However, the risks remain tilted to the downside in the near term, given all the uncertainty over Brexit and with the cliff-edge date of October 31st fast approaching.

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