

GBPUSD

Long Term Trend: 

It's all about Brexit

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Chief Investment Office GWM

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- Brexit uncertainty and a strong US economy should continue to favor the USD over the GBP for the next three months. Hedging currency risks looks attractive.
- We still expect a favorable outcome for Brexit negotiations, but the risk of a cliff-edge Brexit remains significant. In our base case, GBPUSD should recover over six to 12 months.
- We are maintaining our GBPUSD forecasts at 1.22 over three months, 1.30 over six months and 1.36 over 12 months.

USD momentum and Brexit risks

The downturn of GBPUSD since April has further room to go, in our view. After pausing in late summer, the greenback has gained momentum again and still offers carry. Both the options and futures market on sterling indicate that markets are taking a very cautious stance now, and we think justifiably so. But we are likely entering the final stages of this downtrend now. The deadline for EU and UK negotiators to agree on a Brexit transition deal should be in mid-January.

Our base case remains that a cliff-edge Brexit will be avoided, which should help GBPUSD rebound to levels above 1.30. Improved sentiment and cheap valuation should outweigh the large interest rate gap between the US and the UK, which is likely to rise further next year with the Federal Reserve hiking faster than the Bank of England (BoE). Currency markets should be more interested in globally improving risk sentiment than, which would suggest diversifying away from an overvalued greenback.

Eventually, we will have to roll the forecasts we set in August, amending our GBPUSD numbers. But we think it is not yet the right time to do so, given the ongoing political gridlock between the EU and the UK.

Investment considerations

Alpha: Given the high uncertainty around Brexit negotiations and the USD carry advantage, we think that the current GBPUSD forward curve makes hedging currency risks attractive.

Limits: Due to Brexit uncertainty, the situation is very much in flux. An agreement on a transition deal could quickly lift the upper limit above 1.40. In the case of a cliff-edge Brexit, a lower limit should be around 1.15 given sterling's already cheap valuation.

Risks: Key upside and downside risks include Brexit negotiations, the stability of the UK government, and central bank policy by the Fed and the BoE.

Currency forecast:GBPUSD

13.Nov.18	in 3 m	in 6 m	in 12 m	PPP*	TEER*
1.29	1.22	1.30	1.36	1.61	1.59

Thomson Reuters, Macrobond, UBS calculation.

*Purchasing Power Parity (PPP) is not a forecast per se, but a long-term equilibrium value for an exchange rate, calculated by UBS, TEER refers to the 'trend-extrapolated equilibrium exchange rate', which is a three-year projection of the PPP.

GBPUSD in last 5 years and our forecast

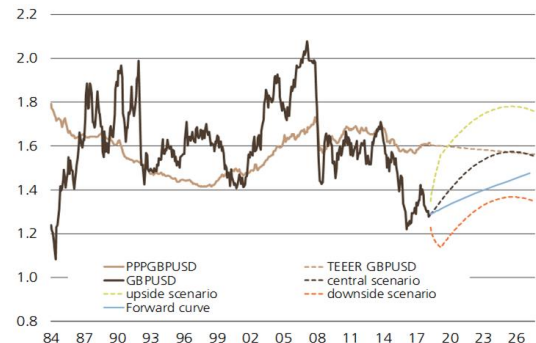
Price performance, forecast and implicit volatility



Source: Thomson Reuters, UBS

GBPUSD long-term development and fair value

PPP and TEER (see note in currency forecast table)



Source: Thomson Reuters, UBS

Fundamental influence

	Curr	GDP F	CPI F	3MLibor (1)	10Yield (1)
2019	GBP	1.8	2.1	0.9	1.7
2020	GBP	1.3	2.1	-	-
2019	USD	2.4	2.0	3.1	3.0
2020	USD	2.0	2.3	-	-

F=Forecast, (1) Year end

Source: UBS

Appendix

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