

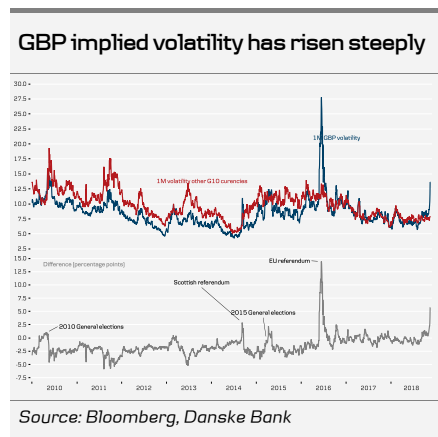
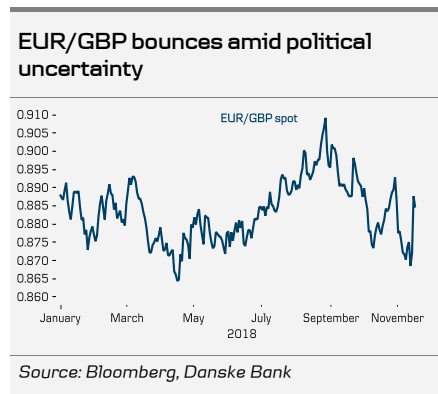
FX Strategy

Brexit scenarios and outcomes for EUR/GBP

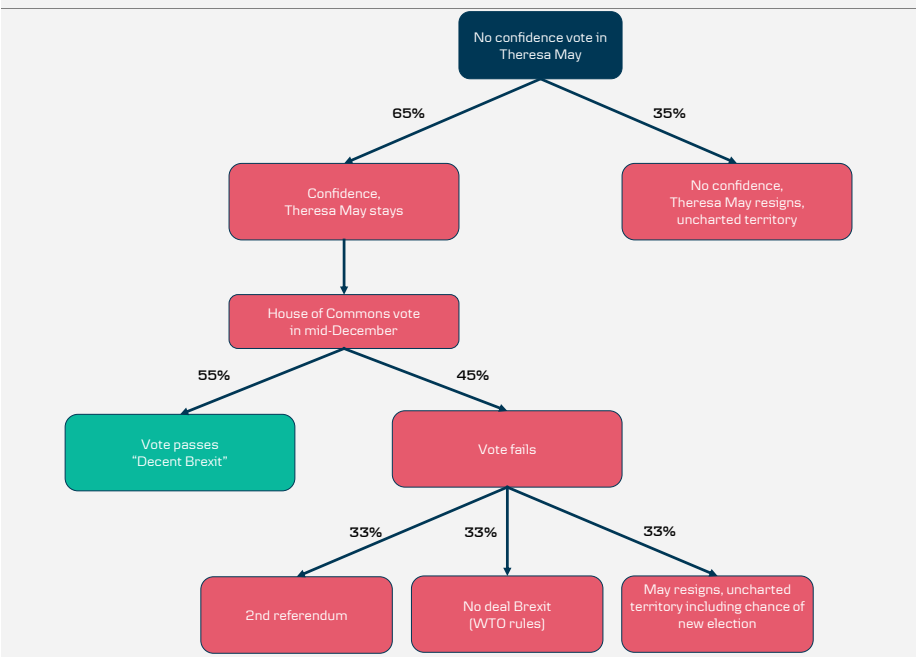
- Near term, the political situation in the UK will be pivotal for the GBP. We expect EUR/GBP to stabilise and fall back into in the 0.865-0.88 range if, as we expect, Theresa May survives a vote of confidence. However, EUR/GBP is likely to remain volatile ahead of a Brexit vote in the House of Commons.
- In our main scenario, where we expect a decent Brexit, we expect EUR/GBP to break lower and settle around 0.83 in 3M.
- However, the likelihood of our main scenario has declined substantially, while the probability of other scenarios, such as a no-deal scenario, has increased.
- We expect EUR/GBP to test 1.00 in a no-deal scenario, while we expect EUR/GBP to break lower into the 0.82-0.86 range if the UK calls a second referendum.

GBP sold off significantly yesterday and implied EUR/GBP volatility has risen steeply as opposition to UK Prime Minister Theresa May’s draft Brexit deal increased and as a leadership challenge within the Conservative Party appears to be moving closer.

Yesterday, in *FX Forecast Update – GBP cheer is here – but mind the risk of the Commons*, we lowered our 1M EUR/GBP forecast from 0.88 to 0.84, as it remains our main scenario that the House of Commons will eventually vote in favour of Theresa May’s Brexit deal (vote expected mid-December). However, we stress that the likelihood of our main scenario has declined substantially, while the probability of other scenarios, such as a no-deal scenario, has increased.



Brexit Scenarios (Danske Bank’s estimates)



Source: Danske Bank

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Brexit scenarios

In the following text, we present our expectations of the outcomes for EUR/GBP in different Brexit scenarios.

Decent Brexit (main scenario)

We think it is more likely than not that Theresa May will survive a vote of confidence (we estimate that the probability is 65/35 in May's favour) and we maintain our long-held view that EUR/GBP will break lower if/when a Brexit is finalised (and accepted in the House of Commons). We expect EUR/GBP to settle around 0.83 in 3M.

No-deal Brexit

A no-deal Brexit is the worst outcome for GBP and the knee-jerk reaction in EUR/GBP would be likely to be a test of 1.00 in this scenario.

Theresa May resignation or loss of vote of confidence

The initial knee-jerk reaction to Theresa May stepping down would be a jump higher in EUR/GBP – most likely into the 0.92-0.95 area. This scenario could materialise either because the Prime Minister loses a vote of confidence by the Conservative Party or if the House of Commons votes down the Brexit deal.

It remains very uncertain what would happen in this scenario. We cannot rule out either a decent Brexit, a no-deal Brexit, a new general election or a second Brexit referendum. Hence, the medium-term outlook for the GBP in this scenario depends on the actual situation.

Second Brexit referendum

We expect EUR/GBP to break lower into the 0.82-0.86 range if the UK calls a second referendum. The pre-referendum GBP appreciation potential depends on the actual subject of a vote. Looking at the opinion polls, it seems the remain camp has more tailwind currently, suggesting Britons may vote to reverse Brexit if 'remain' is an option. We expect EUR/GBP to break below 0.80 if there is a vote in favour of remain.

FX strategy

Near term, the political situation in the UK will be pivotal for the GBP and we still see risks skewed on the upside for EUR/GBP ahead of a likely leadership challenge in the Conservative Party. We expect EUR/GBP to stabilise and fall back into in the 0.865-0.880 range if as we expect Theresa May survives a vote of confidence. Even if Theresa May survives a vote of confidence, the near-term outlook for GBP remains uncertain and thus we expect EUR/GBP to remain volatile ahead of a Brexit vote in the House of Commons.

Hedge GBP income via (ratioed) risk reversals

We recommend clients hedging GBP income/assets to maintain a high hedge ratio. From a risk/reward perspective, we favour hedging via 1:2 ratioed risk reversals, which benefit from the high implied volatility and enable greater profit potential in the event of GBP appreciation compared with a regular risk reversal.

Hedge GBP expenses via risk reversals

Clients with GBP payables should take advantage of the recent bounce in EUR/GBP and hedge 2019 exposure via risk reversals. Use potential bounces above 0.90 to restructure risk reversals into FX forwards and/or increase hedge ratio via FX forwards.

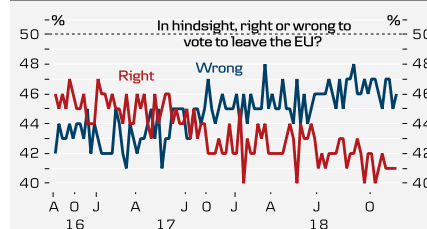
See *Corporate Hedger – Strong November could turn to cold December for GBP* (12 November) for more details on GBP hedging.

GBP forecasts (main scenario)

	Spot	Forecast			
		+1m	+3m	+6m	+12m
Exchange rates vs GBP					
GBP/USD	1.28	1.35	1.36	1.42	1.51
EUR/GBP	0.89	0.840	0.83	0.83	0.83
GBP/DKK	8.43	8.88	8.98	8.98	8.98
GBP/SEK	11.60	12.14	12.17	12.05	12.05
GBP/NOK	10.86	11.43	11.33	11.08	10.96

Source: Danske Bank

Remain camp has tailwind in opinion polls



Source: NatCen Social Research, Macrobond Financial

Disclosures

This research report has been prepared by Danske Bank A/S ('Danske Bank'). The authors of this research report are Morten Thrane Helt, Senior Analyst, and Mikael Olai Milhøj, Senior Analyst.

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Expected updates

None.

Date of first publication

See the front page of this research report for the date of first publication.

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