The Real Worry for GBP

• There are growing indications that the focus for GBP is on political volatility rather than Brexit

• September is the month where stresses are most apparent in pricing

• Is election risk the continued threat?

The story for EUR/GBP has proved relatively straightforward this week. Understanding the forces that have been at work helps highlight were the real risks lie in the latter part of this year.

At around 08:30 GMT on Monday morning, the former UK Foreign Secretary Boris Johnson finally announced that he would be standing in the leadership race for the Conservative Party.

Just before the announcement GBP had been trading at around its strongest level since Thursday of last week. However, from this point on, GBP came under pressure with the only real respite coming outside of European trading hours.

So why might this have happened?

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that [Johnson] might be forced to hold an early election

With Boris Johnson now in the race (and currently in the lead in terms of MPs that have come out in support of him), there is a growing body of opinion that he will come out at the end of the leadership race as the next PM.

Such an outcome would probably be consistent with the view that the Conservative Party leadership is likely to pivot towards a harder stance on Brexit.

The reason why this matters for GBP comes down to concerns about the potential fallout from Boris Johnson-led Brexit negotiations. More specifically, what would happen should the EU reject an attempt by Mr Johnson to renegotiate the current deal and he then come back to the UK Parliament in order to ask for its backing for a no-deal exit.

Should this be rebuffed by Parliament (which, based upon, voting this year, it could well be) then it is certainly possible that he might be forced to hold an early election in order to break the deadlock - although yesterday he reportedly ruled out a snap general election if he becomes PM.

Alternatively, were a hard Brexit to be on the cards, then some of the Remain-supporting wing of the party might be prepared to support a no confidence motion in the government.

This comes at a time when the latest opinion polling shows the newly-formed Brexit Party vying directly with the Liberal Democrats and the Labour Party, while support for the Conservative Party struggles to make it beyond 20%.

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2. US: Federal Reserve Chairman Jerome Powell says: "We are closely monitoring the implications of these developments (in the trade war) for the U.S. economic outlook and, as always, we will act as appropriate to sustain the expansion, with a strong labor market and inflation near our symmetric 2% objective."

3. China: President Xi Jinping says: "Looking into the future, China’s economy bears the supporting conditions for stable, healthy and sustainable growth." He notes that China has ample room to manoeuvre in the macroeconomic policy space.

4. Australia: Q1 GDP rises 1.8% y/y, down from 2.3% y/y in Q4. This was the weakest reading since 2009.

5. New Zealand: RBNZ assistant governor, Christian Hawkesby, says: "Our central view is that New Zealand’s
Supporting the view that the focus is now shifting towards concerns about significant political uncertainty emerging in September, October and November has been the notable increase in the gap between six-month and three-month EUR/GBP at-the-money-forward implied volatility to the widest level ever seen.

Focusing in, it’s very noticeable that the sharpest widening within this period has come between the four-month and the three-month prices (See chart).

This equates pretty well with when Parliament is likely to return after summer and the fight is likely to commence.

In other words, it’s arguable that it’s not the fear of a hard Brexit that is the prime driver of investor concerns about GBP right now but, rather, uncertainty about the political future in the UK.

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