



British pound

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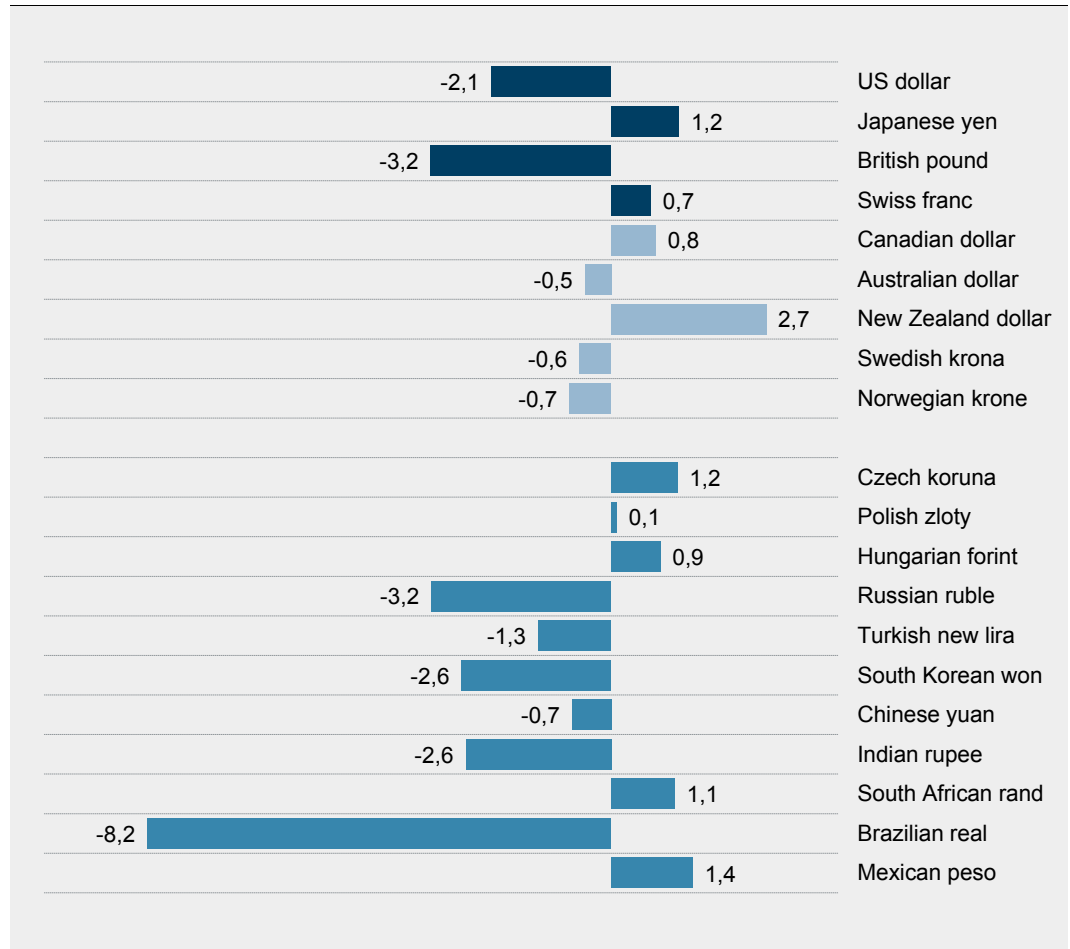
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- The British pound depreciated noticeably in recent weeks, and the dollar also lost ground. The biggest loser, however, was the Brazilian real.
- The pound sterling weakened further in the wake of the unclear outcome of parliamentary elections. Even if Prime Minister May can form a government with the help of the DUP, her term in office seems finite. The impending Brexit negotiations won't necessarily be made any easier by the unstable majorities. However, some British positions could soften a little. The pound could weaken further temporarily. Over the medium term, the favourable valuation and the hope for a less "hard" Brexit support the British currency.
- Helaba Currency Forecasts

Performance on a month-over-month basis

% vs. euro compared to the previous month (from 05/15 to 06/13/17)



■ Core currencies ■ Rest of G10 ■ Currencies of emerging markets

Sources: Bloomberg, Helaba Research

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GBP: “Soft” brexit?

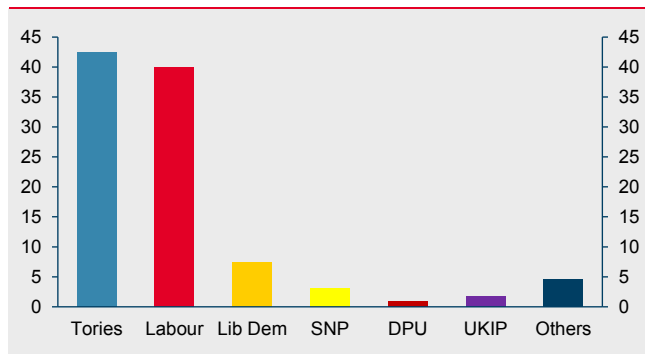
Quite a mess she has on her hands! Prime Minister Theresa May and her Conservative Party lost the majority in the parliamentary elections, instead of expanding it as they had hoped. The unnecessary election thus backfired, or worse, in words of a member of the Conservative Party, “we shot ourselves in the head”. May remains in office for now. Still, uncertainty prevails, and the British pound lost up to 2 % against the euro. The question arises how long the “dead woman walking” (in the words of former Chancellor of the Exchequer Osborne about May) can hang on to power, and what this means for the impending Brexit negotiations.

Conservatives and Labour
gain votes

The results of the parliamentary elections are remarkable in a number of ways. In contrast to the continent, the lack of majority situations in the “hung parliament” are uncommon thanks to the first-past-the-post voting system. The Conservative Party posted a gain of 5.5 % in this “election fiasco”. Incidentally, with its 42 % it captured 10 % points more than the triumphant winner of the elections in France, the party of President Emmanuel Macron. But since the opposition Labour Party gained nearly 10 % at the same time, the “Tories” lost 13 seats, and with its block of 318 seats it missed the absolute majority of 326. The addition of the Northern Irish Democratic Unionist Party just pushes the Conservatives over that threshold. The DUP is considered even more conservative than the Tories, it supports the Brexit, but for economic reasons it seeks a rather open border with the Republic of Ireland. A formal coalition is not to be expected, fundamentally the political differences between the two parties are not that pronounced. Labour’s gain of 30 seats is surprising, given the party’s move to the left under its leader Jeremy Corbyn. The independence party UKIP accomplished its mission with the Brexit vote and dropped from nearly 13 % to just below 2 %. The Liberal Democrats and the Scottish Nationalists (SNP), who positioned themselves against a Brexit, were both among the losers. The SNP even lost 21 of its 56 seats. The pursuit of independence for Scotland has thus received at least a damper, if not the first nails in the coffin.

Conservatives gain, but Labour even more

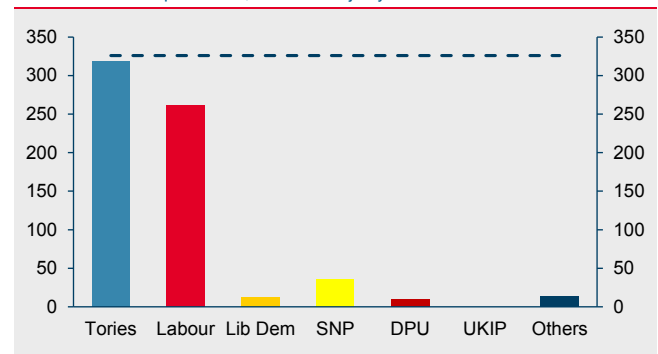
% of votes



Sources: BBC, Helaba Research

Conservative Party misses absolute majority

Number of seats in parliament, absolute majority at 326



Sources: BBC, Helaba Research

Theresa May with
limited future

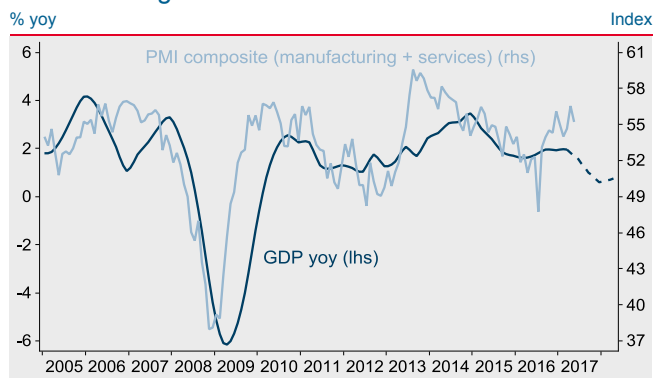
Theresa May emerges from the elections deeply compromised. She “needlessly squandered her majority”. The Tories are not famous for their kind dealings among “fellow party members”. In the absence of a clear successor, May can likely remain in office for now, since the country cannot afford a vacuum, however brief. The thin parliamentary majority with the DUP is very brittle given the important votes in the wake of the Brexit; the problem is presumably more likely to be the MPs of the Tories. It seems doubtful that Theresa May will still be the head of her party, and thus the head of the government, at the end of the year. The contest for a successor is open – candidates include Foreign Secretary Boris Johnson, Chancellor of the Exchequer Hammond, Brexit minister Davis, and Home Secretary Rudd. It is also unclear whether a new Prime Minister would want to solicit confirmation from the voters. New elections in the fall cannot be ruled out. A new head of the Conservative Party could then expand his or her parliamentary majority again, or congratulate Labour leader Corbyn on his new job as Prime Minister. Corbyn’s chances grow, the greater the chaos afflicting the government.

"Soft" Brexit?

The electoral chaos gets complicated thanks to the EU exit negotiations that are scheduled to start next week. Since the deadline for the negotiations expires at the end of March 2019, another postponement is critical, given the already tight time frame. In the meantime, speculations about what all of this means for the Brexit are running wild. An exit from the Brexit remains unrealistic. The result of the elections can hardly be read as a vote for a "hard" Brexit. As a result, voices favouring a "softer" Brexit should be growing louder within the Conservative Party. Labour has positioned itself in support of this kind of Brexit, in any case.

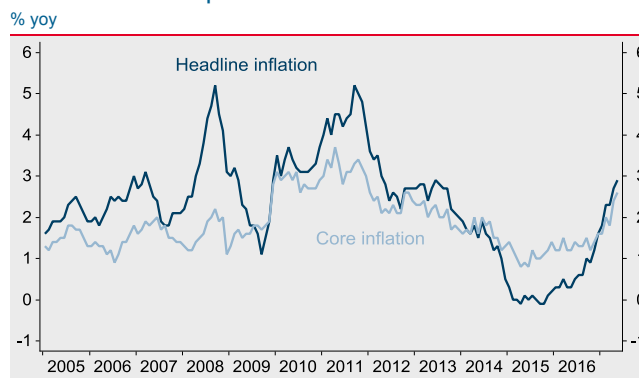
For now, however, the Conservatives are still in power. The government must pay heed to both its EU proponents and to its radical Brexit supporters. Participation in the European Single market, including an unrestricted movement of workers, remains unlikely. There are speculations about a participation in the customs union. With such a move the British would spare themselves talks about countless trade agreements. But in that case they could not enter into any agreements of their own in order to facilitate even freer trade, which is what some Conservatives want. For now, the British position has likely not changed in any fundamental way. In connection with the Brexit, the government must enact some legislative changes in addition to the final ratification of the Brexit. That will be difficult with the narrow majorities, and a cooperation with the opposition will be unavoidable at times. In that way, as well, the tone in the EU negotiations could become more moderate and the willingness to compromise could grow with respect to some issues. After all, so far the negotiators from the EU and the United Kingdom have been quite implacable in their dealings.

Growth losing steam



Sources: Macrobond, Helaba Research

Inflation near its peak



Sources: Macrobond, Helaba Research

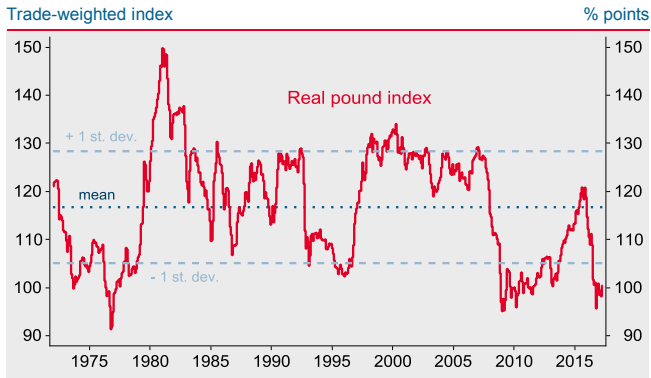
Deal still likely

The EU first wants to settle the conditions of the separation, that is, financial obligations and the status of EU foreigners. After that, the future relationship in the trading of goods and services should be discussed. In contrast, however, the British want to negotiate both at the same time. They seek a far-reaching free trade agreement beyond the Single market in order to limit the influx of EU citizens. In the EU states, as well, there is interest in preserving foreign trade with the United Kingdom. A deal with a rather free trade of goods but clear limits on services and the movement of workers could be possible in the end. But the road to get there will be a very bumpy one. There were already some speculations about a premature cessation of the talks. A new British Prime Minister would also have to negotiate with a hard line, at least on the outside. An intermittent failure is almost customary with EU negotiations. The real decisions are likely to be made only next year. The constrained time frame makes the talks more difficult. The EU is likely also using it as leverage, since the British need an agreement more urgently than the other way around. A premature extension of the deadline is thus not likely. In the end, however, the EU should accept interim solutions also out of self-interest. The ratification of an agreement bears additional risks in the EU, and also in Britain under the given parliamentary majorities. In spite of publically "hard" positions on both sides, and in spite of the governmental chaos in London, a compromise over the Brexit remains the most likely resolution.

Slight pound depreciation

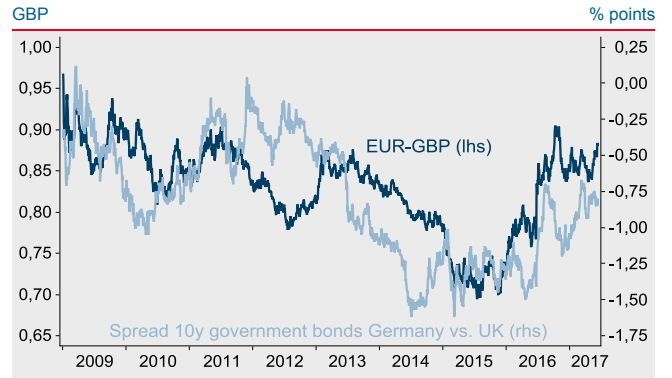
The British pound lost ground against the euro and the US dollar in the wake of the elections. However, at up to 2 %, the losses were by no means dramatic: after the Brexit referendum, the pound depreciated in the double-digit range within a few days. The political uncertainty is weighing on the pound, even though the hopes for a “softer” Brexit may have helped the British currency. Moreover, the favourable valuation limits the potential of the pound’s losses.

Pfund sterling favourably valued



Sources: Macrobond, Helaba Research

Political risk premium weighs on the pound sterling



Sources: Macrobond, Helaba Research

Pound will stabilize by the end of 2017

Temporarily the political uncertainty could still adversely affect the pound. While the British economy was still humming along in the second half of 2016, irrespective of the Brexit vote, most recently the gloomier indicators have been multiplying. The GDP grew in the first quarter by only around 0.2 % over the previous period, and things are not likely to be any better in the current quarter. To date, it has been more the “hard” data that has disappointed. The sentiment indicators are at an optimistic level, though they are already pointing downward. The labour market is still robust. The price increases for residential real estate have slowed noticeably. However, for the Bank of England the political uncertainty alone is probably the decisive reason to remain calm. To be sure, inflation did climb to 2.9 % in May: at that rate it is close to its peak, which means that the central bank need not embark on a more restrictive course. Thus, there will be no tailwind for the pound from monetary policy. However, the interest rate differentials point to a favourable valuation. Politics remains the chief flaw for the British currency. Given a certain level of easing political tensions, the euro-pound exchange rate should drop back down to 0.85 by the end of the year.

Helaba Currency Forecasts

	Performance			Forecast horizon at end ...			
	year to date	1 month	current*	Q2/2017	Q3/2017	Q4/2017	Q1/2018
vs. Euro	(vs. Euro, %)						
US dollar	-6,2	-2,1	1,12	1,10	1,15	1,10	1,10
Japanese yen	-0,3	1,2	123	121	121	115	120
British pound	-2,9	-3,2	0,88	0,90	0,90	0,85	0,85
Swiss franc	-1,3	0,7	1,09	1,08	1,10	1,10	1,10
Canadian dollar	-4,8	0,8	1,48	1,47	1,52	1,49	1,49
Australian dollar	-1,9	-0,5	1,49	1,47	1,47	1,45	1,47
Swedish krona	-1,8	-0,6	9,75	9,50	9,30	9,10	9,10
Norwegian krone	-3,9	-0,7	9,46	9,30	9,10	8,90	8,90
Chinese yuan	-3,7	-0,7	7,62	7,59	7,99	7,70	7,70
vs. US-Dollar	(vs. USD, %)						
Japanese yen	6,3	3,4	110	110	105	105	109
Swiss franc	5,2	2,9	0,97	0,98	0,96	1,00	1,00
Canadian dollar	1,5	3,0	1,32	1,34	1,32	1,35	1,35
Swedish krona	4,7	1,6	8,69	8,64	8,09	8,27	8,27
Norwegian krone	2,5	1,4	8,43	8,45	7,91	8,09	8,09
Chinese yuan	2,1	1,4	6,80	6,90	6,95	7,00	7,00
US-Dollar vs. ...	(vs. USD, %)						
British pound	3,4	-1,1	1,28	1,22	1,28	1,29	1,29
Australian dollar	4,6	1,7	0,75	0,75	0,78	0,76	0,75

*13.06.2017

Sources: Bloomberg, Helaba Research ■