



## British pound

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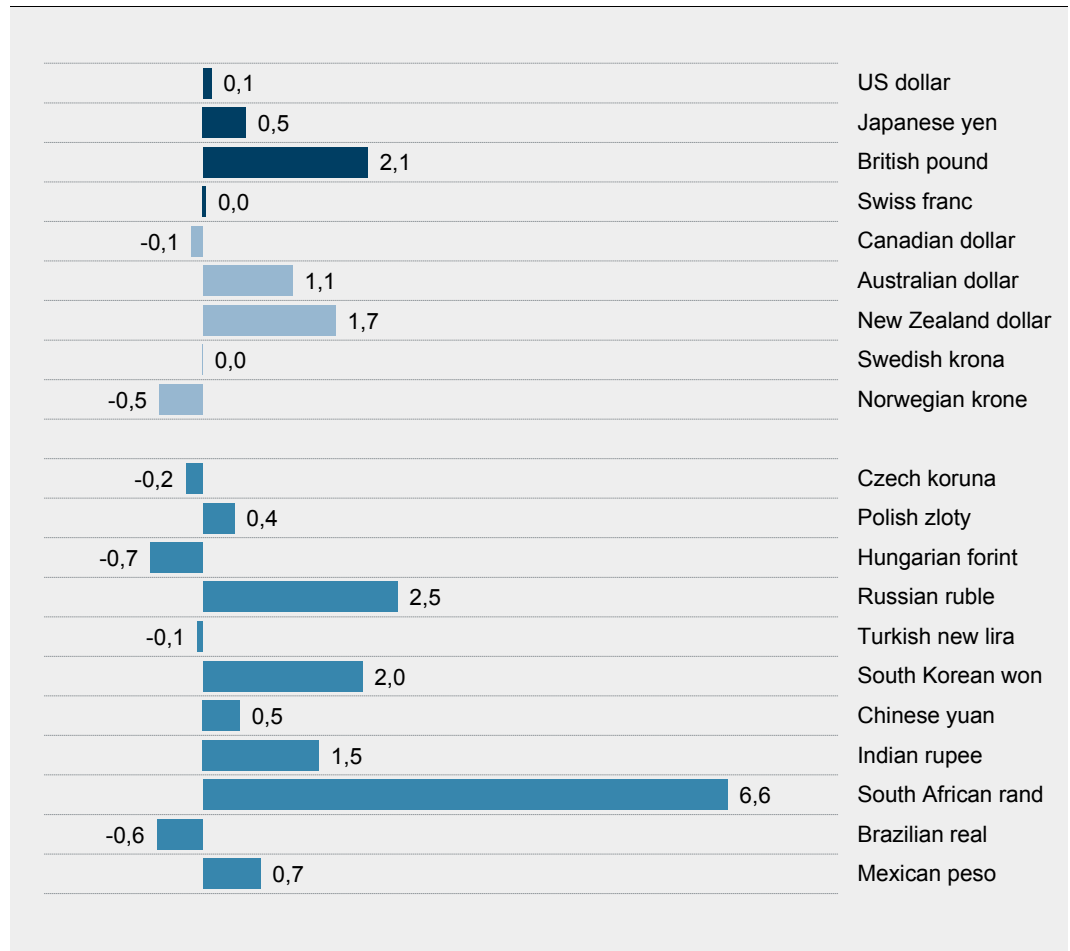
- The euro-dollar exchange rate was trading water most recently. The British pound gained ground. Most emerging market currencies appreciated, especially the South African rand.
- The British pound has been on a slight recovery path over the last few months. In addition to the interest rate hike by the Bank of England, progress in the Brexit negotiations has helped the currency. After the conclusion of the first phase, more difficult talks about the future relationship of the UK to the EU are ahead. Setbacks should be expected, and they will weigh on the pound. However, the signs of Britain's willingness to compromise suggest that there will be an agreement in the end, and the British currency should profit from that.
- Helaba Currency Forecasts

**"We can now move on to the next stage of humiliation."**

Nigel Farage

### Performance on a month-over-month basis

% vs. euro compared to the previous month (from 11/15 to 12/14/17)



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

Sources: Bloomberg, Helaba Research

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## GBP: let round two begin

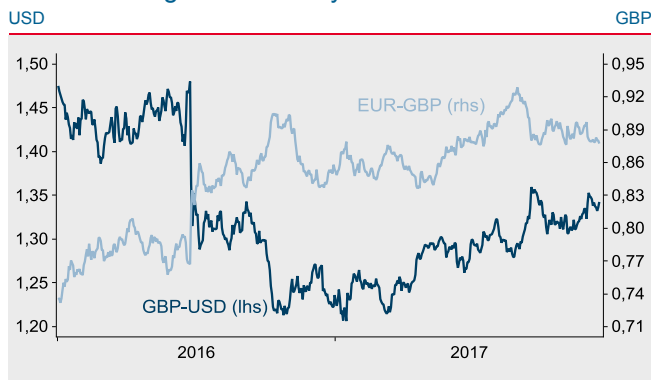
It's about time! The Brexit negotiations have finally seen some movement. Given the EU summit in the middle of December, the talks *had* to produce some first results. After all, the EU had demanded that a conclusion to the first phase of the negotiations was the necessary condition before talks could begin in the next round about the more important, future relationships between the UK and the European Union. The British pound reacted with a leap of joy. However, the decline of the euro-pound exchange rate to below 0.87 was only a brief interlude, and the rate subsequently climbed back up to 0.88.

First phase of negotiations concluded

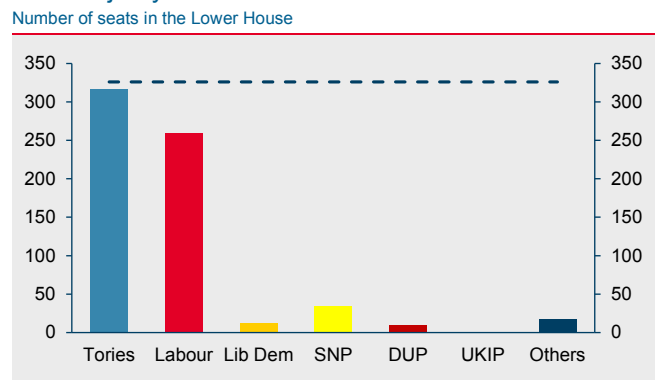
Three issues were to be settled in the first phase of the negotiations: the “divorce bill”, the status of EU citizens in the UK and vice versa, and the border between Ireland and Northern Ireland. The British have substantially accepted their financial obligations toward the EU, though precise sums were not published. According to estimates, the demands could be between 40 and 50 billion euro. The status of the foreigners was not fundamentally controversial, to begin with. The Northern Ireland question is more complicated, the leader of the Northern Irish DUP, Arlene Foster, initially delayed a solution after an intervention. Now the border is to remain open, that is, without controls, though at the same time Northern Ireland, as a member of the United Kingdom, will exit the EU domestic market. This is like squaring the circle, even if certain differentiations can be made with the help of regulatory differences. In spite of the agreement, many uncertainties persist on this issue.

The main reason why the negotiations produced a result is because they had to – the next round has to be opened. As it is, after the fact there were statements from the British side that the results will be seen as valid only if there is an overall Brexit agreement. Meanwhile, Prime Minister May is fighting for her own majority. According to the latest decision by the House of Commons, Parliament may not vote on the final agreement with the EU after the motto “Take it or leave it,” but may actively accompany the negotiation process. Still: the decision about the exit from the EU has long since been made, Parliament only has more of a voice about the manner in which it will take place.

### Pound sterling with recovery trend



### Slim majority of Conservatives and the DUP



British showing willingness to compromise

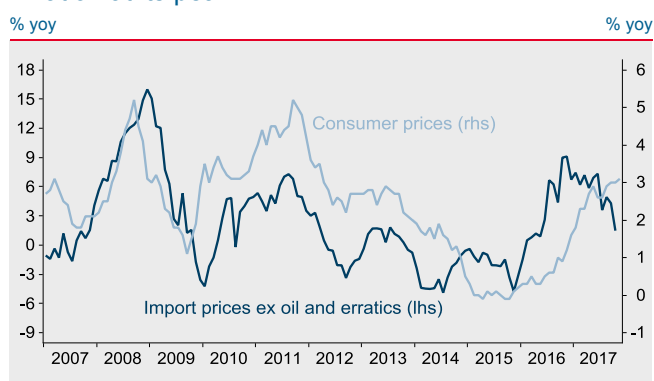
Since the Lower House as a whole is considered more EU friendly, it is becoming more difficult for May against this backdrop to play the Brexit hardliner. The most important result of the first phase of the negotiations is a different one: instead of the early failure of talks that many had feared, the British government is showing that, under pressure, it is very willing to compromise, after all. Let us recall: in the beginning, financial obligations toward the EU were still rejected on principle. This should be a signpost for the next round of negotiations. Because of the difference in sheer size, alone, the UK is in a worse position than the EU. As a result, the British will have to bend more in the end than vice versa, even if at times they should show little willingness to compromise.

The negotiations about the future relationship are set to begin in earnest only in March of next year. It is possible that the initial point of discussion could be a transition phase that is in the interest of both sides. That way one could avoid an abrupt change without a sufficient period of preparation in regulatory matters, for example in foreign trade. There is talk of a period of two years, or until the end of 2020. During this phase, most EU rules would continue to be in force in the UK, in spite of the official exit from the EU in March of 2019. However, the precondition for a slow transition is still a final agreement between the UK and the EU.

#### Rocky road to an agreement

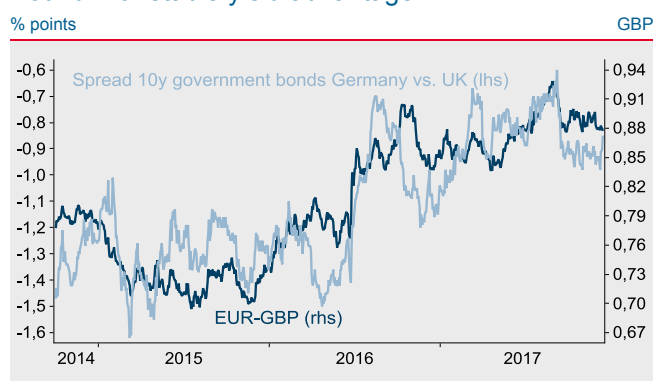
At the heart of the next round of negotiations are above all the trade relationships. The British government prefers as few changes as possible to the status – with the crucial difference of a limitation on the free movement of workers. That is why the British are pursuing the exit from the single market and the tariff union and are seeking a free-trade agreement instead. The EU is resisting that and will in fact accept reductions in foreign trade, even if its own exporters will suffer losses. One compromise could encompass a limited freedom of movement by workers, restrictions on trade in services (since it is chiefly the British who profit from it), as well as trade in goods with few limitations. We posit that in the end this kind of deal will be achieved, even if the road there will be rocky. In addition to problems in internal British politics – a departure from office by the vulnerable Prime Minister May could upset the already very tight timetable – there are also risks when it comes to ratification within the EU.

#### Inflation at its peak



Sources: Macrobond, Helaba Research

#### Pound with stable yield advantage



Sources: Macrobond, Helaba Research

#### Bank of England in wait-and-see position

The British pound has trended upward in recent months. In addition to the somewhat easing concerns about the Brexit, the British currency was also helped by the rate hike at the beginning of November. The British interest rate advantage over the euro has grown. However, at its latest decision the Bank of England showed that it was rather in a wait-and-see stance. It is maintaining the prospect of slow, limited interest rate hikes. It is possible that the central bank will not raise its key rate at all in the coming year. After all, inflation – most recently at 3.1 % – has probably peaked. The rise in import prices triggered by the depreciation of the pound is easing, which means that inflation will gradually move in the direction of 2 % again. Moreover, the surprisingly solid economic growth so far should lose momentum in 2018. In spite of the progress in the negotiations, the economic uncertainty linked to the approaching Brexit is carrying increasing weight and is dampening the willingness to make investments.

However, since the ECB, too, will continue to move cautiously, the British interest rate advantage will persist. As it is, longer-term valuation indicators support the British pound. With a little more optimism about the next round of negotiations, the euro-pound rate could slide to 0.85. However, setbacks are pre-programmed in the coming year both for the Brexit talks and for the pound sterling. As a result, the euro-pound exchange rate should continue to hover in the range of 0.85 to 0.90, with a certain downward trend. The pound is likely to weaken at times against the US dollar, and the pound-dollar exchange rate will fall just below the level of 1.30.

## Helaba Currency Forecasts

	Performance			Forecast horizon at end ...			
	year to date	1 month	current*	Q4/2017	Q1/2018	Q2/2018	Q3/2018
<b>vs. Euro</b> (vs. Euro, %)							
US dollar	-10,7	0,1	1,18	1,15	1,10	1,15	1,15
Japanese yen	-7,1	0,5	132	130	127	125	125
British pound	-2,7	2,1	0,88	0,85	0,85	0,90	0,90
Swiss franc	-8,0	0,0	1,16	1,15	1,12	1,15	1,17
Canadian dollar	-6,2	-0,1	1,51	1,48	1,44	1,50	1,47
Australian dollar	-5,0	1,1	1,54	1,51	1,47	1,49	1,47
Swedish krona	-3,7	0,0	9,94	9,70	9,50	9,40	9,20
Norwegian krone	-7,0	-0,5	9,77	9,40	9,10	9,00	8,90
Chinese yuan	-5,8	0,5	7,79	7,71	7,48	7,88	7,88
<b>vs. US-Dollar</b> (vs. USD, %)							
Japanese yen	4,1	0,4	112	113	115	109	109
Swiss franc	3,0	-0,1	0,99	1,00	1,02	1,00	1,02
Canadian dollar	5,0	-0,3	1,28	1,29	1,31	1,30	1,28
Swedish krona	7,9	-0,1	8,44	8,43	8,64	8,17	8,00
Norwegian krone	4,1	-0,6	8,30	8,17	8,27	7,83	7,74
Chinese yuan	5,1	0,2	6,61	6,70	6,80	6,85	6,85
<b>US-Dollar vs. ...</b> (vs. USD, %)							
British pound	8,8	2,0	1,34	1,35	1,29	1,28	1,28
Australian dollar	6,4	1,0	0,77	0,76	0,75	0,77	0,78

\*14.12.2017

Sources: Bloomberg, Helaba Research ■

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Diese Publikation wurde erstmals am 20.12.2017 um 14:04 Uhr weitergegeben.

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