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CURRENCIES & MORE
OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Pound: Political uncertainties and stalling Brexit negotiations will likely keep the Pound under pressure
Franc: Sight Deposits at the SNB show that the Franc is weakening in the absence of FX interventions
Lira: With diplomatic tensions escalating with the U.S., the Lira's descent is again gathering momentum

Pound: Political uncertainty persists

The headlines in many economic media yesterday regarding Brexit negotiations were reminiscent of boxing coverage: "Round five has started." While boxing rounds may differ from round to round, the Brexit rounds always appear to be a *déjà vu* from the previous round: Both sides present the same positions again and do not move.

What is on top of her mind?

Source: Thom Janssen / Cagle Cartoons

The European side has ruled out moving on to trade talks without "sufficient progress" in the divorce talks and key diplomats are clearly blocking any proposals to allow discussion on the transition deal that U.K. businesses urgently need. May continues to deliver flowery words as she said yesterday to lawmakers that she was offering Europe a "new, deep and special partnership," and then trying to push them by adding that "the ball is now in their court."

As we argued several times, with both sides in a mated situation – using chess terms this time – we still think a "no-deal scenario" is hurting Britain much more than the Continent as the U.K. is much more dependent on trade with the E.U. than the single market is on trade with Britain. Political plotting at home makes it more and more unlikely that May will survive long enough to ink the final deal. What will she do? There is an increasing expectation in FX markets that May will reshuffle her Cabinet after the 19–20 October European Council Summit in Brussels. May has seen her authority erode since calling and then bungling a snap election in June, which cost her Conservative Party their majority in Parliament. Next to her well-known disputes with Foreign Minister Boris Johnson, speculation is gathering momentum about the future of Chancellor of the Exchequer Philip Hammond, as he is seen as an electoral liability for May. However, he is also considered a rare ally of business in the Government. Any doubt about his future would unnerve investors, who are already selling the Pound because of political uncertainty.

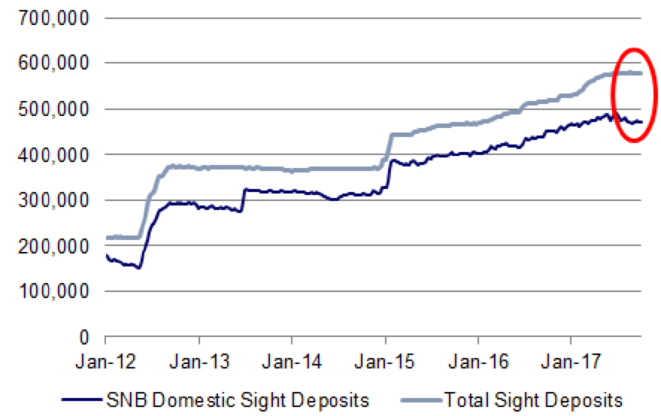
Conclusion: The chaos in Whitehall likely remains and we therefore stick to our short Pound recommendation.

Franc: Sight Deposits – boring but important

Similar to the ongoing rounds in Brexit talks without any alteration, some readers might perceive the development of Sight Deposits at the SNB as equally boring since nothing changes, week after week. Nevertheless, we think this is very important as it shows that Franc weakness – or less euphemistically: diminishing strength – is happening without interventions from the SNB. Total SD at the SNB are at SFr 578 billion since June and domestic SD even declined from the peak of more than SFr 490 billion to SFr 473 billion now. This pleasant development – for Swiss banks, tourism, industry and of course for the SNB –

evolves despite solid incoming data. For instance, SECO will likely announce at 07:45 that the unemployment rate stayed at 3.0 percent in September. Recent inflation data showed that CPI continue to increase slightly (0.7 percent in September year-on-year), making the real yield further negative, which should weigh on the Franc.

Sight Deposits at the SNB



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: It must be pleasing for the SNB that the Franc continues to remain "weak" in the absence of FX interventions.

QUICK NEWS HEADLINES (time in CEST)

The following four headlines might have an impact on currency markets today:

- Japan: The current account surplus for August came at ¥ 2.4 trillion vs. ¥ 2.2 trillion expected.
- Norway: CPI is expected to have increased by 1.7% in September y/y (08:00).
- Hungary: CPI is expected to have increased by 2.7% in September y/y (09:00).
- U.K.: Industrial production is expected to have risen 0.9% in August y/y, the trade deficit for August is expected at £ 11.2 billion (both 10:30).

Lira: Diplomatic tensions will continue to weigh

Regular readers recall that we have disliked the Lira already for quite some time. We always stated that we "recommend staying away from Lira exposure" but not "going short" as the cost of carry is quite substantial as long as the downtrend is not unfolding. With diplomatic tensions escalating between Turkey and the U.S., the Lira's descent is again gathering momentum. Being short the Lira against a more solid currency like the Ruble – at least in terms of a thorough monetary policy – makes sense in our view as the interest rate differential is not as huge as it would be against G-10 currencies. With the U.S. and Turkey suspending visa services for citizens visiting the other country, a further escalation regarding Fethuallah Güllen seems very likely. Arguably, the direct impact on tourism will be modest (37'000 Americans visited Turkey last year, representing 1.7 percent of total visitors), but investor sentiment will deteriorate along with diplomatic ties between Turkey and its NATO partners.

Lira heading lower vs. Ruble

Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We stick to our long-held recommendation to be long the Ruble and stay out/short the Lira.

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