Subject: [/] Brexit update + Trade Idea [I]
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Morning Paul,

Our GM strategist George Saravelos published an update on Brexit this morning arguing the direction of travel is towards a very “soft” Brexit. As such, it makes sense to look at upside GBPUSD and downside EURGBP plays. George argues for staying long GBP. We also discuss long GBP in our updated FX Blueprint (published by GM research) from a few days ago here:

https://research.db.com/Research/Article?rid=ca0a1eb8-b342-4d9c-a35f-f63f1559f82e-604&kid=RP0001&documentType=R

Rationale (George Saravelos):

1. THE BACKSTOP

This is the UK’s counter-proposal to resolving the Northern Irish border issue. It is the most important one because Northern Ireland is the sticking point to getting the overall Withdrawal Agreement. Theresa May said the UK government would never sign up to Northern Ireland staying in the customs union so her counter-proposal is for all of the UK to stay in until an alternative solution has been found. This is defacto extending the UK’s membership of the EU to beyond the two-year transition. Reports overnight suggest it is causing very large tension within cabinet with the sub-committee due to meet again today. Publication of the White Paper would be very bullish because it means the cabinet Brexiteers have signed off. Delay would be more negative but so long as there is no resignation it would not change the direction of travel. Note that the EU has its own objections on the proposal (there cannot be a fixed date to the backstop), but the UK has been moving towards the EU position (as with everything else).

(B) THE LORDS AMENDMENTS

This is a vote in the House of Commons on various amendments that have been proposed by the Lords that are pro-EU. The government is trying to force all the votes within twelve hours next Tuesday. Baseline is that they don't pass because there are other crucial votes happening in coming months (eg the Customs Union Bill) where the pro-Europeans can make their voices heard. BUT – if these amendments pass, it will in our opinion be a positive because it will provide further ammunition to Theresa May to move towards a softer Brexit stance.

(C) THE FUTURE RELATIONSHIP

This is the government's counter-proposal to the EU's offer of a Canada-style deal. Press reports have been that this has been indefinitely delayed amid disagreements. Least consequential because highly dependent on (a) and (b) above. In particular, if you end up with a non-time-bound transition, the transition ends up being the permanent new relationship.

Putting it all together, it is clear the direction of travel is towards a major softening of Brexit. The risks to watch are (a) a revolt by the backbench hard Brexiteers forcing a leadership challenge on Theresa May or (b) a cabinet resignation from the Brexit war cabinet. (b) would be worse than (a) because the odds of an early election would be higher. We do not view either as the baseline because the outcome may be an even softer Brexit and both (a) and (b) know this. It would however initially be negative for GBP because the market may start to price in risks of a Corbyn government.

Trade Idea (all levels indicative):

1. GBPUSD – spot ref 1.3400

a. You can buy 6m GBPUSD 1.5000 One Touch for 9.5%

b. You can buy 9m GBPUSD 1.5000 One Touch for 16.5%

c. You can buy 9m GBPUSD 1.4000/1.5500 Call Spread and sell 1.3000 Put to cheapen it – cost is 0.20%

(risks: the risks to these trades are a loss of initial premium in a+b and potential losses if GBPUSD is below 1.3000 at expiry)

2.   EURGBP – spot ref 0.8825

a.   You can buy 9m EURGBP 0.8700 Put vs selling 0.9100 Call – zero cost

b.   You can buy 9m EURGBP 0.8700/0.7950 Put spread vs selling 0.9150 Call – zero cost

c.   You can buy 6m EURGBP 0.8200 One Touch for 15%

(risks: investor has to sell EURGBP at 0.9100 (a) or 0.9150 (b) at expiry if EURGBP is above these level. Loss of initial premium spent in (c))

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