

# Brexit Monitor #29

## What to watch in coming months

### Divided cabinet complicates Brexit negotiations

**The third round of Brexit negotiations is set to take place in Brussels between 28 August and 4 September.** Previously, the EU's chief negotiator Michel Barnier had said the negotiations were proceeding too slowly, meaning that negotiations in phase 1 (divorce bill, citizens' rights and Irish border) may not be concluded in October as hoped for. If not, the next possibility is in December, when the next EU summit after the one in October takes place.

**Due to the poor election result, PM Theresa May's position has weakened and the minority government is under pressure from both remainers and Brexiters.** This is the main reason we have seen very different statements from cabinet members, for example on whether to agree on a transitional deal or not. **The divided cabinet complicates the negotiations, as it is difficult to see what the UK wants to achieve from the negotiations.**

**The UK government is expected to publish a series of position papers on the divorce bill and the Irish border issue over the coming months – one tranche before the third round of the negotiations and the second before the fourth round (see *POLITICO EU*).** Markets will focus on whether the UK is willing to compromise in order to reach an agreement. *The Daily Telegraph* reported that the UK is ready to pay a divorce bill of EUR40bn (against the EU's estimates in the range of EUR60-100bn) but only if the EU starts negotiations about the future relationship. A Downing Street source later denied the story. In our view, the divorce bill remains the biggest obstacle to the negotiations, not least given the weak minority government in the UK.

**Due to PM May's weak position it is worth keeping an eye on the Conservative Party conference at the beginning of October,** where Conservative rebels may try to overthrow her.

Over the coming 1-3M, we expect EUR/GBP to move higher still on the back of a strong EUR, political uncertainty and BoE repricing. **We expect the cross to trade within the 0.90-0.92 trading range and specifically forecast it at 0.91 in 1M and 3M.** Over 3-12M, we expect EUR/GBP to drift back below 0.90 on the back of potential for some clarification regarding the Brexit negotiations and valuations. However, as relative growth and relative monetary policy are expected to remain EUR/GBP supportive in the medium term, we see only modest downside potential in the year ahead. We target 0.90 in 6M and 0.88 in 12M.

### Recent UK research

*Bank of England Review: More dovish but still too optimistic on growth*

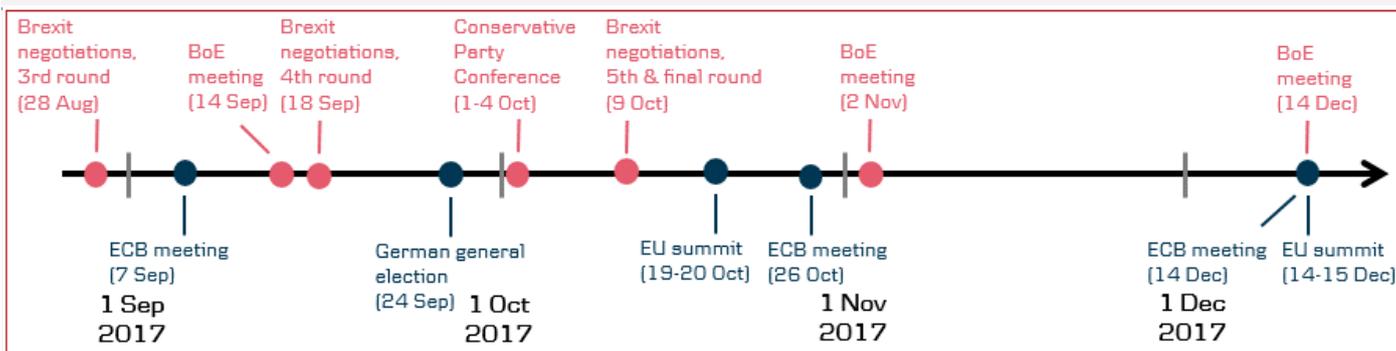
*Research UK: Negative real wage growth has slowed GDP growth*

### We target EUR/GBP at 0.91 in 1-3M



Source: Bloomberg

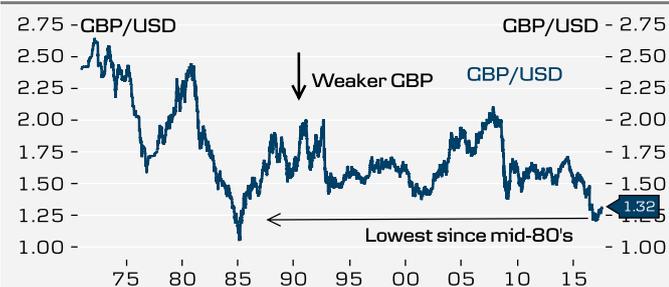
### Brexit - timeline



Source: Danske Bank Markets

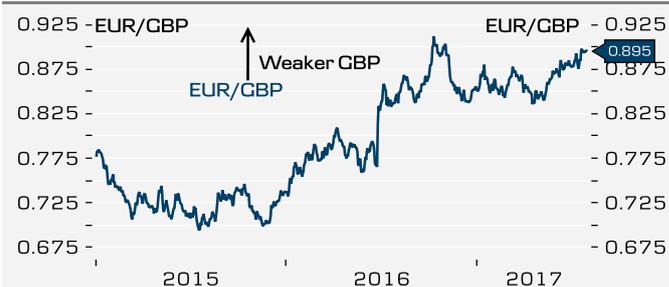
Financial market charts

GBP/USD moves up slightly due to weaker USD



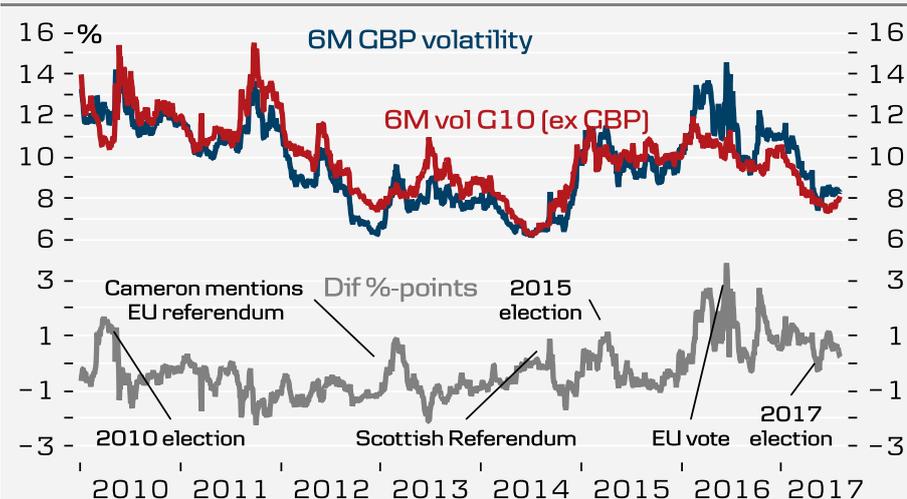
Source: Bloomberg, Macrobond Financial, Danske Bank Markets

EUR/GBP rises, mostly due to EUR strength



Source: Bloomberg, Macrobond Financial, Danske Bank Markets

GBP volatility vs G10



Source: Bloomberg, Macrobond Financial, Danske Bank Markets

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Report completed: 8 August 2017 at 00:15 CET

Report first disseminated: 8 August 2017 at 7:30 CET