Weekly Update

C0 | EXTERNAL PUBLICATION


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Brexit kerfuffle

The publication by online news provider Buzzfeed of the UK government's assessment of the economic impact of various possible outcomes to the Brexit negotiations generated much media interest in recent days.

The report – entitled "EU Exit Analysis-Cross Whitehall Briefing" and dated January 2018 – outlines three scenarios:

1. European Economic Area membership offering access to the single market, but not the customs union;
2. a comprehensive free trade agreement with the EU; or
3. a "no-deal" exit.

Under the first and most favourable option, the UK economy would be 2% smaller after 15 years. Under the second, growth would have been reduced by 5 % and by 8% in the third scenario.

While the report was not destined for broad distribution, the range of outcomes should not have come as a surprise. They are in fact very close to the assessments of long-term impact which were published ahead of the June 2016 Brexit referendum.

Now of course, the impact of the referendum result has been much less dramatic than the Remain camp had suggested before the vote. The UK has not suffered a recession, the Bank of England has begun to hike base rates and unemployment currently stands at a 42-year low of 4.3%. Shouldn't we just ignore the experts?

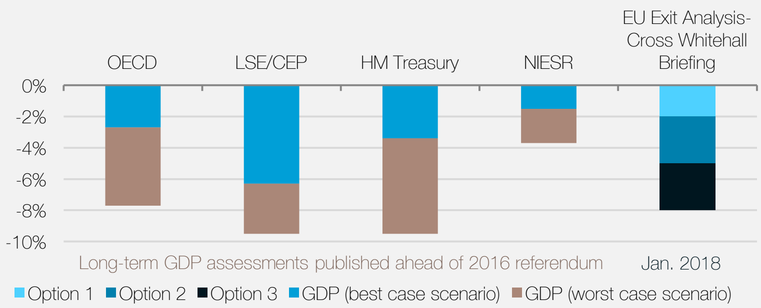
We think that might be unwise. First, the UK – a very open economy – has benefited from the recent pick-up in global growth and trade, especially within its most important client, the EU. Second, the UK remains an EU member and continues to benefit from full access to the single market and customs union. However, despite these advantages, the UK has slipped from the top of the G7 growth range in the four years before the referendum to the bottom (see chart below). In addition, retail sales growth has slid from over 4% YoY between 2014 and 2016 to 1.4% on most recent data.

We can thus appreciate that much will hinge on the actual outcome of the ongoing negotiations – which of course may well be different from the three options outlined above. Recent newsflow has sent conflicting signals. Headlines on Thursday suggested that Mrs May would harden the UK's stance on EU workers' rights during the transition phase. Later the same day, a leaked strategy paper from the EU-27 outlined potential tax penalties and sanctions if UK deregulation post-Brexit were deemed unfair competition by the remaining members.

Bottom line. Investors should not focus too much on the noise surrounding the negotiations. Little clarity as to the UK's future relationship with the EU is likely before the very end of the process. In the interim however, we do expect sterling to adjust lower against both the dollar and the euro, given the UK's slower growth and high twin deficits.

How will Brexit impact the UK?

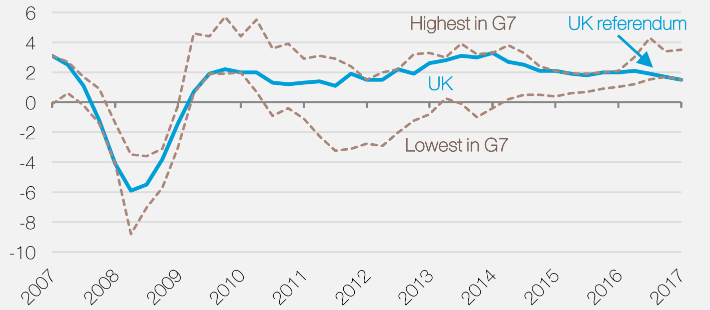
Recent studies on the impact of Brexit on the UK



Sources: SGPB, OECD, LSE/CEP, HMT, NIESR, Whitehall, 01/02/2018

UK growth slips from top of G7 range to bottom

UK growth rate (%) compared to G7



Sources: SGPB, Bloomberg, IMF, 01/02/2018

This week and next

EUROZONE

- The eurozone GDP growth estimate printed at 2.7% YoY in Q4. This bodes well for 2018.
- Although unchanged in December, the unemployment rate remains at an 8-year low. With consumer confidence at 1.3 – the highest since 2000 – the eurozone seems in good shape overall.

Next week's key events		Per.	Prev.	Cons.
2 Feb	Producer prices, YoY	Dec	0.6%	0.2%
5 Feb	Retail sales, YoY	Dec	2.8%	--

UNITED KINGDOM

- Because of weaker domestic demand, GDP growth slowed down to +1.5% in Q4 versus +1.7% YoY in Q3.
- Manufacturing confidence is eroding with the PMI down to 55.3 in January peaking at 58.1 two months ago. This is due to the negative impact of sterling strength on exporters.

Next week's key events		Per.	Prev.	Cons.
9 Feb	Industrial production, MoM	Dec	0.4%	-0.9%
9 Feb	Manufacturing production, MoM	Dec	0.4%	0.3%

UNITED STATES

- The initial estimate for Q4 GDP growth was +2.6% YoY, down from +3.2% in Q3 due to weakness in inventories and net trade.
- US consumer confidence improved in January, rising to 125.4.
- ISM manufacturing confidence eased from 59.3 to 59.1 in January.
- Durable goods orders in December rose 2.9 % MoM.

Next week's key events		Per.	Prev.	Cons.
02 Feb	Unemployment rate	Jan	4.1%	4.1%
02 Feb	Change in non-farm payrolls	Jan	148k	180k
08 Feb	Initial jobless claims	3 Feb	230k	--

ASIA & EMERGING COUNTRIES

- In China, the official PMI for manufacturing confidence disappointed in January, declining from 51.6 to 51.3.
- In Japan, headline inflation in Tokyo rose from 1.0% YoY to 1.3% in January, still below the central bank's target. Once again, industrial production surprised on the upside in December, printing at 2.7% MoM vs an expected 1.5%.

Next week's key events		Per.	Prev.	Cons.
05 Feb	Japan: composite PMI	Jan	52.2	--
08 Feb	China: exports, YoY	Jan	10.9%	14.5%

Sources: Datastream, Bloomberg, 2 February 2018, Note: YoY = year-on-year; QoQ = quarter-on-quarter; MoM = month-on-month, P = preliminary figure, A = advanced figure, F = final figure, seasonally adjusted, ECB = European Central Bank

Our 6-month targets

CURRENCIES & COMMODITIES

	Thursday close	6mth target
EUR/USD	1.24	1.25
GBP/USD	1.41	1.28
USD/RUB	55.9	60
AUD/USD	0.80	0.72
EUR/CHF	1.17	1.18
USD/CNY	6.32	7.1
USD/CAD	1.24	1.37
USD/JPY	109	118
Brent	$70.8	$55
Gold	$1359	$1225

No change to our 6-month targets this week.

Forecast figures are not a reliable indicator of future performance

Question time

Past performance should not been seen as a guarantee of future returns.

No Q&A this week.

Market performance

Past performance should not been seen as a guarantee of future returns.

Interest rates

Interest rates	Last	1wk		3mth	YTD	12mth
EONIA (EUR)	-36 bp	1 bp	→	0 bp	-2 bp	-1 bp
3mth Euribor (EUR)	-33 bp	0 bp	→	0 bp	0 bp	0 bp
3mth Libor (USD)	176 bp	2 bp	↑	39 bp	7 bp	72 bp
3mth Libor (GBP)	53 bp	1 bp	→	11 bp	1 bp	16 bp
10-year US Treasury bond	263 bp	1 bp	↑	18 bp	21 bp	10 bp
10-year German bond	55 bp	4 bp	↑	7 bp	13 bp	8 bp
10-year French bond	77 bp	5 bp	↑	4 bp	10 bp	-21 bp
10-year UK bond	145 bp	7 bp	↑	1 bp	22 bp	-3 bp

Credit

Credit	1wk		3mth	YTD	12mth
BAML EURO Corp. IG	0.0%	→	0.3 %	0.0 %	3.1 %
BAML EURO Corp HY	0.1%	→	0.7 %	0.7 %	6.6 %
BAML GBP Corp IG	-0.2%	↓	1.9 %	-0.3 %	6.1 %
BAML US IG	0.1%	↑	0.6 %	-0.6 %	5.9 %
BAML US HY	0.2%	↑	0.9 %	0.9 %	7.1 %
JPM Global EM Sov. Plus	0.2%	↑	1.9 %	0.7 %	11.3 %

Exchange rates

Exchange rates	Last	1wk		3mth	YTD	12mth
EUR/USD	1.24	1.3 %	↑	4.9 %	3.2 %	15.3%
EUR/CHF	1.17	-0.6 %	↓	-0.2 %	-0.3 %	8.6%
GBP/USD	1.41	1.8 %	↑	6.7 %	4.8 %	12.0%
USD/JPY	109	-1.5 %	↓	-3.8 %	-2.9 %	-3.4%
USD/BRL	3.15	-1.8 %	↓	-2.6 %	-4.9 %	-0.7%
USD/CNY	6.32	-1.5 %	↓	-4.7 %	-2.8 %	-8.1%
USD/RUB	55.9	-1.0 %	↓	-3.2 %	-3.0 %	-6.1%

Government bonds*

Government bonds*	1wk		3mth	YTD	12mth
United States (3-7yr)	0.0 %	→	-0.9 %	-0.8 %	0.6 %
United Kingdom (3-7yr)	-0.2 %	↓	-0.2 %	-0.8 %	0.0 %
Germany (3-7yr)	-0.2 %	↓	-0.9 %	-0.6 %	-1.0 %
Japan (3-7yr)	0.0 %	→	0.0 %	-0.1 %	-0.2 %

Equities*

Equities*	Last	1wk		3mth	YTD	12mth
MSCI AC World	547	1.9 %	↑	11.2 %	6.6 %	28.4 %
Eurostoxx 50	3 630	0.3 %	↑	1.4 %	3.7 %	12.8 %
DAX	13 298	0.1 %	↑	2.7 %	3.0 %	12.6 %
CAC 40	5 481	-0.3 %	↓	2.3 %	3.2 %	15.9 %
S&P 500	2 839	1.5 %	↑	11.6 %	6.3 %	26.0 %
FTSE 100	7 616	-1.1 %	↓	2.9 %	-0.9 %	10.6 %
SMI	9 483	0.3 %	↑	4.4 %	1.1 %	16.8 %
Topix	1 885	0.4 %	↑	7.8 %	3.7 %	26.5 %
IBOV Brazil	83 680	3.4 %	↑	9.1 %	9.5 %	27.1 %
MICEX Russia *	2 320	1.0 %	↑	13.2 %	10.0 %	6.6 %
MSCI EM	1 263	2.9 %	↑	13.8 %	9.2 %	42.0 %
SENSEX 30 India	36 050	2.3 %	↑	9.3 %	6.6 %	31.8 %
Hang Seng (H-K)	32 654	1.7 %	↑	15.5 %	9.1 %	47.2 %
Shanghaï Composite	3 548	2.1 %	↑	4.5 %	7.3 %	12.7 %

Commodities

Commodities	Last	1wk		3mth	YTD	12mth
Brent	$71	2.0 %	↑	21.2 %	6.3 %	27.4 %
Gold	$1 359	2.3 %	↑	6.5 %	4.3 %	13.5 %
Silver	$17.6	3.2 %	↑	3.8 %	3.3 %	3.4 %

Source: Datastream, on 1 February 2018. 1wk = 1-week change, 3mth = 3-month change, 12mth = 12-month change, YTD = year-to-date change, YoY = year-on-year change, BAML = Bank of America Merrill Lynch, JPM = JP Morgan, IG = Investment Grade, EM = emerging markets.
* Price return for MICEX equity index. Equities; total return in local currency. Government bonds = 3-7 year returns. Figures are rounded.

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