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## Brexit-Referendum - a Non-Event?

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Was the decision by the UK to leave the EU a non-event? Globally speaking, share prices have increased, the spreads for default risk have narrowed on many markets, and the UK central bank, i.e. the Bank of England, did not cut its key-lending rate.

### Good growth rate

The economic indicators continue to suggest real economic growth of 2 to 2.5% globally. While, from a historic perspective, the growth rate is below average, in view of the disadvantageous developments such as falling productivity growth, an ageing population, weak world trade, and the pressure to deleverage, this bandwidth can actually be regarded as good.

### Positive data surprises

The preliminary global purchasing managers indices for the service sector decreased in July, but the one for the manufacturing sector increased. Also, the data surprises are remarkably positive in most developed economies. This means that the actual growth rates of indicators such as retail sales, industrial production, and employment have exceeded estimates. The economic indicators in China suggest that the stimulus measures have been sufficient to facilitate the stabilisation of economic growth at 6.5%. While the economic growth rate in the Eurozone weakened from 2.4% in Q1 to 1.2%, it was still above potential growth (i.e. long-term expected average). The low yet still existing credit growth of about 2% y/y indicates the stabilisation of growth towards its potential. At a growth rate of +1.2% in Q2, the US economy failed to recover significantly from the subdued growth rate in Q1 (0.8%). The solid growth of private consumption in combination with the early drawing-down of inventories suggests a slightly higher growth rate for Q3. The limited investment activity admittedly remains a weak spot.

### Brexit effects regionally limited

The immediate economic effects are regionally limited. In the UK, some survey indicators incurred a drastic fall in July. This suggests a significant decline of real economic growth of 2.4% in Q2 to zero growth in the current, third quarter. But even in the UK, not all indicators are heading South. In July, the Lloyds Bank Business Barometer bounced back from a drastic slump

in June and is now only slightly below the long-term average. In the EU, worries that the sentiment in the EU might deteriorate, have not materialised. In fact, the July values for business confidence in the EU have largely increased.

## **End of austerity**

The [Brexit](#) vote is part of the surging global anti-establishment movement. Basically, this is about isolation vs. openness. In the EU, this means an increase in centrifugal forces. With regard to EU politics, this shifts the balance from moral hazard concerns to measures taken in support of the economy. The European Commission has already announced not to fine Portugal or Spain, although their budget deficits are excessive. Almost the same is true for fiscal policy in general. The closer monetary policy gets to the frontier of its effectiveness, the more likely austerity policies will come to an end.

## **Defaulted loans in Italy**

At the moment investors are looking at the high volume of defaulted loans and the low capital ratio in Italy. Public subsidies are only permitted when, prior to them being effected, the public sector also shoulders a part of the losses. While this sounds reasonable, one has to bear in mind that the Italian bank bonds are not only held by institutional investors such as pension funds and insurance companies, but also by “small” (retail) investors. The likelihood of a pragmatic solution has increased.

## **Monetary policy still effective**

The effectiveness of the monetary policy has decreased, but it still exists. In reaction to the increased uncertainty in the wake of the Brexit vote, many important central banks have sent out signals that they would loosen their monetary strategy if need be. As a result, the future money market rates priced into the bonds decreased. This means that the markets were supported by a mere statement, not by an actual measure. So the [central banks](#) still have some powder, which has not been wasted prematurely.

## **Rate cut in the UK**

The Bank of England has fuelled expectations about an actual loosening for the next monetary policy committee meeting on 4 August. At the very least, a rate cut from the current 0.5% is priced in as we speak.

## **Step towards helicopter money in Japan**

On 29 July the Japanese central bank pointed to a, what it called, significant level of uncertainty with regard to the development of inflation. Until the next meeting of the monetary committee in September, the status quo is to be comprehensively assessed. Indeed, the rate of inflation in Japan is moving farther away from the inflation target of 2% as we speak. In June inflation (excluding food and energy, i.e. the core inflation rate) amounted to only 0.4% y/y. The probability of a further loosening with regard to quality and quantity of the bond purchases has increased. At the same time, a fiscal package will be announced shortly in Japan. This would basically mean another step towards helicopter money (i.e. the central bank permanently finances the budget deficit).

## **Fed in wait-and-see mode**

The US Fed has assumed a wait-and-see stance and thus supported the markets. But on 27 July officials declared that the short-term risks for the economic outlook had decreased. The tendency towards, or prospect of, a rate hike this year remains in place. This step is currently priced in.

## **Elevated political risks**

The political and geopolitical risk remains elevated: the increasing tensions in the South China Sea; the referendum on a constitutional amendment in Italy in autumn; US presidential elections in November – the political uncertainty will remain an important influencing factor for the markets and the economic policy.

## **Summary and conclusion:**

1. The leading indicators suggest continued real global growth of 2 to 2.5%.
2. The central banks have reacted to the elevated uncertainty triggered by the Brexit by assuming a wait-and-see stance and issuing expansive signals.
3. The financial markets have digested the increased uncertainty well.
4. This combination is (still) positive for risk assets in the short run, especially with regard to default risk (company, government, emerging markets).
5. Investors should not become careless with regard to risk. To mention but two: commodity prices, especially oil, have been

falling since the beginning of July, and the expectations of rate hikes in the USA might rise.

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