Brexit: What Next?

24 June 2016, as at 10:00 GMT

Central Banks

- Expect co-ordinated global central bank action to include: swap lines and a commitment to provide sufficient liquidity to markets
- Global interest rates likely lower for longer with positive implications for dollar borrowers
- Possible restart of UK QE within a few weeks
- Dominance of macro risk over inflation in terms of policy goals

Politics

- Expect immediate shuttle diplomacy between the UK and major EU partners (EC, Germany, France). Emergency summits expected across the EU to start shortly
- Article 50 of the Lisbon Treaty potentially to be invoked by Cameron's successor
- Uncertainty over the future of the UK, especially Scotland. Sinn Fein calling for a Northern Ireland referendum
- UK political leadership uncertainty. Cameron to step down by October. Early UK General Election likely
- Calls for referendums in other EU countries (Netherlands, France and Italy). Rising political uncertainty
- Potential catalyst for broader renegotiation of certain features of the EU project e.g. Schengen, labour laws, justice, trade barriers etc.

Markets

- Markets hate uncertainty – volatility likely to persist for the next few months
- Weak sterling and weak euro likely (on rising prospect of other countries becoming embroiled in similar situations)
- We expect the main market impact to be on rates and rate expectations i.e. rates lower for longer
- Expect UK and European corporate spreads to widen however this may be offset to some extent by ECB and BOE intervention
- Hit to UK financial services. Centre of gravity of European financial services will not shift overnight away from London but at the margin financial services firms will be incentivised to locate operations and services within the EU
- Market positioning was cautious ahead of the referendum: (i) record mutual fund outflows (ii) high cash holdings (iii) weak investor sentiment surveys

Economics

- The UK economy will not collapse – life will go on
- Treasury estimates of short term hit: GDP lower by 3.6% after 2 years, 520,000 more people unemployed. Under the severe shock scenario the impact on GDP rises to 6.0% over 2 years and unemployment is 820,000 higher
- Deferral of UK domestic investment and hiring whilst uncertainty persists. Firms reluctant to commit to spending and jobs until they have more clarity regarding Britain's future place in the world
- Foreign companies also defer plans to hire and invest in the UK. Some relocation to the EU to hedge risk for practical reasons and also for some regulatory and market access reasons
- Bank of England and other central banks likely to remain accommodative for longer, regardless of inflation pressures
- Weaker sterling will eventually support exports (though UK manufacturing is only a small part of the economy It will also increase inflationary pressures
- There is a real risk of a UK recession in H2 2016 through to H1 2017
- However, the direct impact of that on the rest of the world will be relatively small
- If this ushers in a period of global protectionism and more inward looking politics, that carries longer term risks to the global economy

Note: Past performance is not necessarily a guide to the future. Returns may increase or decrease as a result of currency fluctuations.