UK: Brexit certainty (temporarily) lifts sentiment

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The UK went from being an overachiever in the G7 group to being an underperformer after the Brexit vote. What lies ahead?

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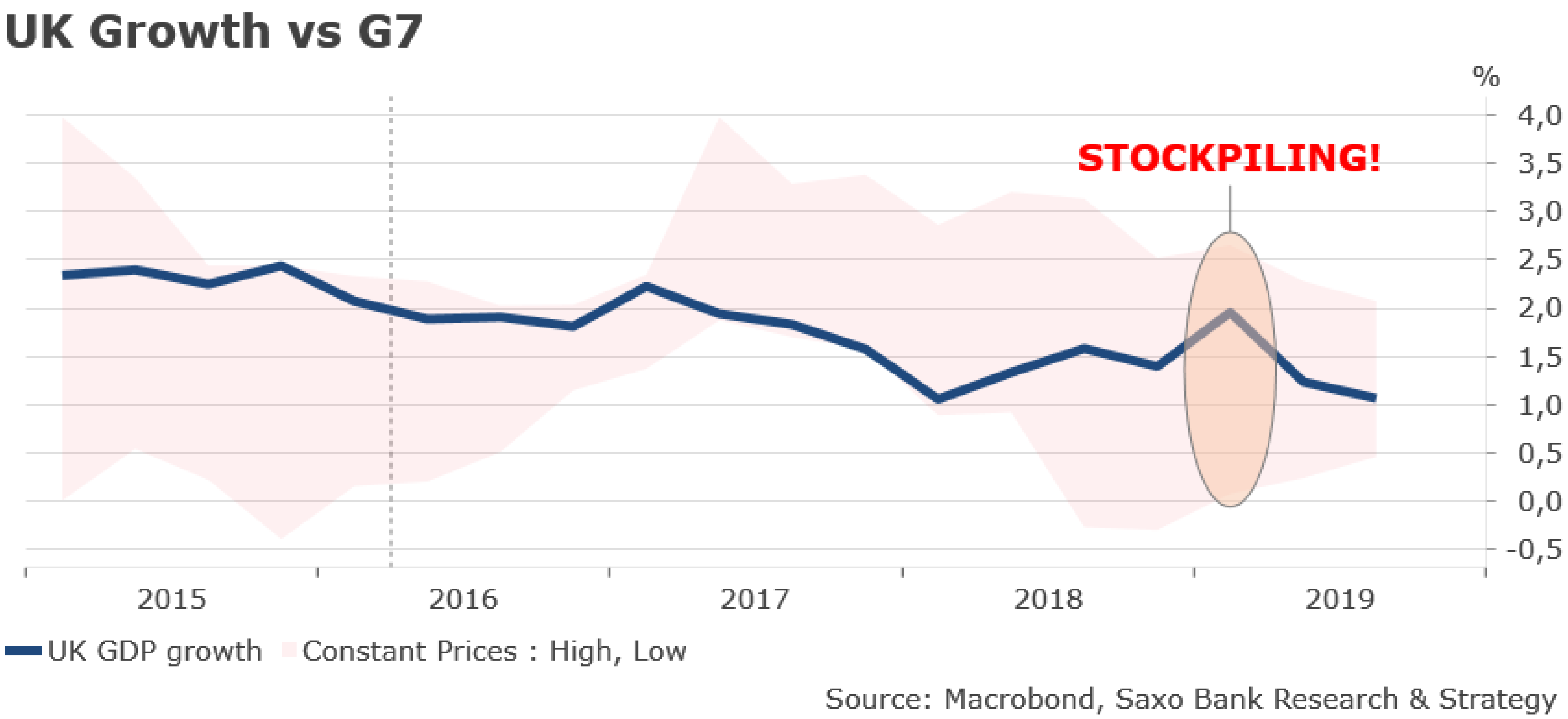

The revival of animal spirits in early 2020

January Flash PMIs are rebounding due to Brexit certainty and lower political risk.

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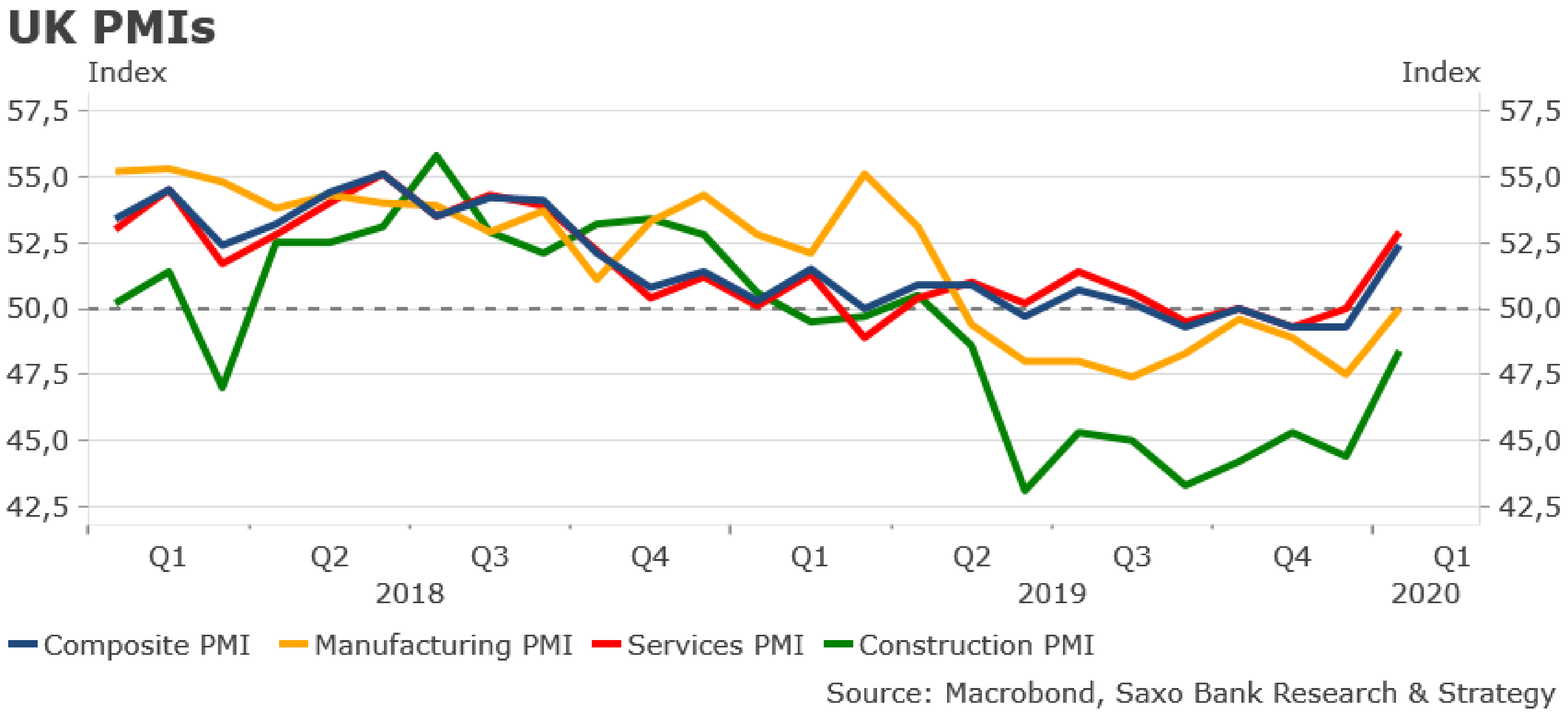

The gap is closing

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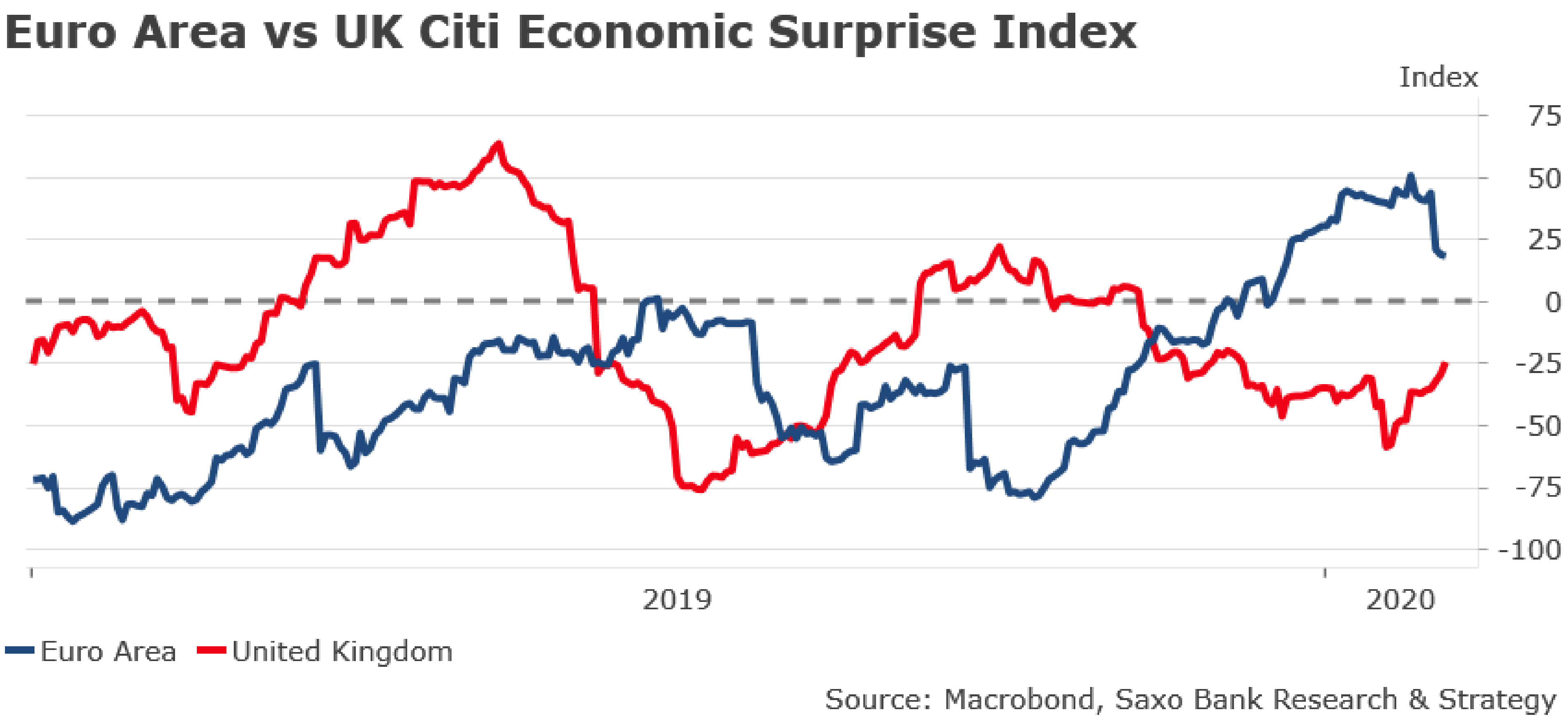
UK Citi Economic Surprise index is improving at minus 24.4 while the Euro Area Citi Economic Surprise Index is down at 18.9.



Leading indicators confirm the economy is stabilizing

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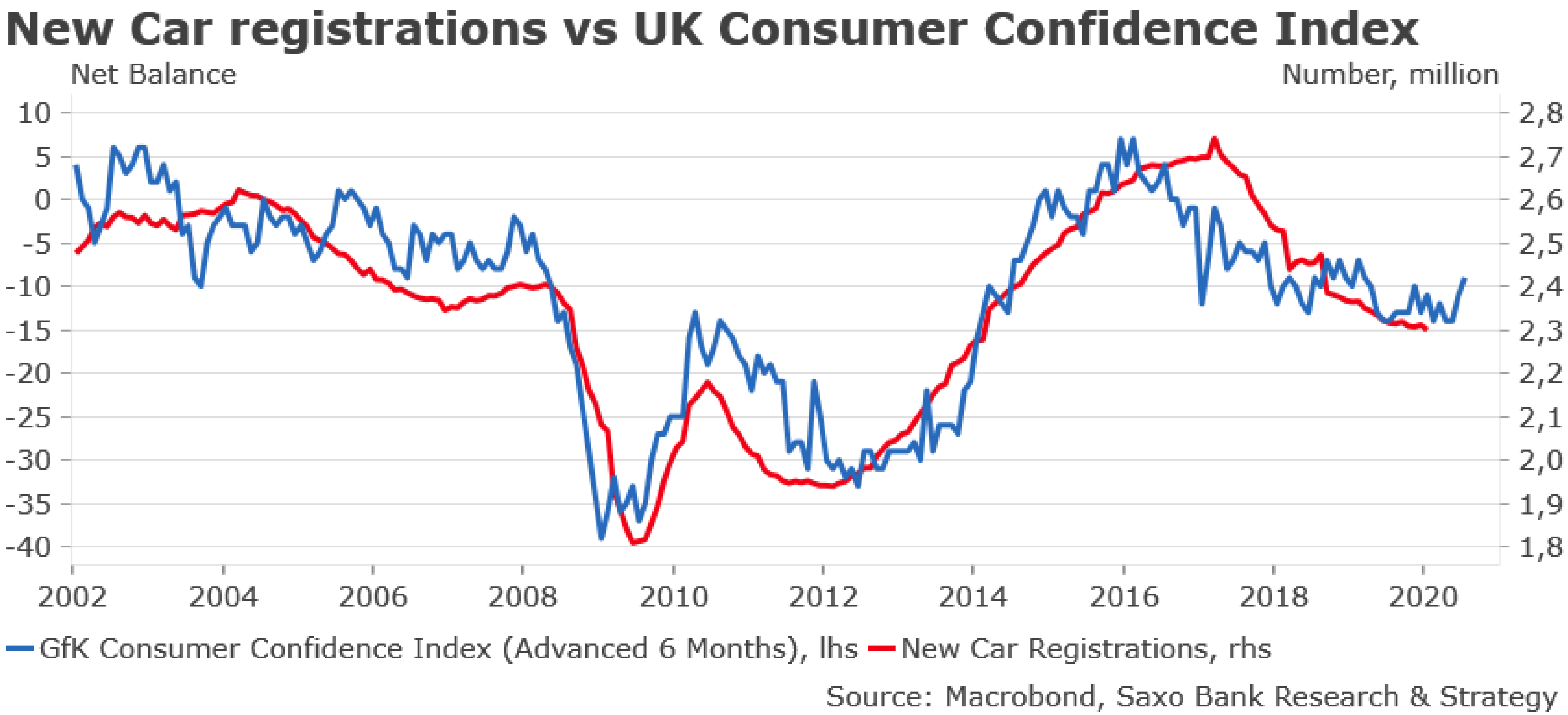
New car registrations, which are often viewed as a leading indicator of the wider economy in the UK, have recently stabilized.



Change of heart ? Market sentiment is positive on the GBP

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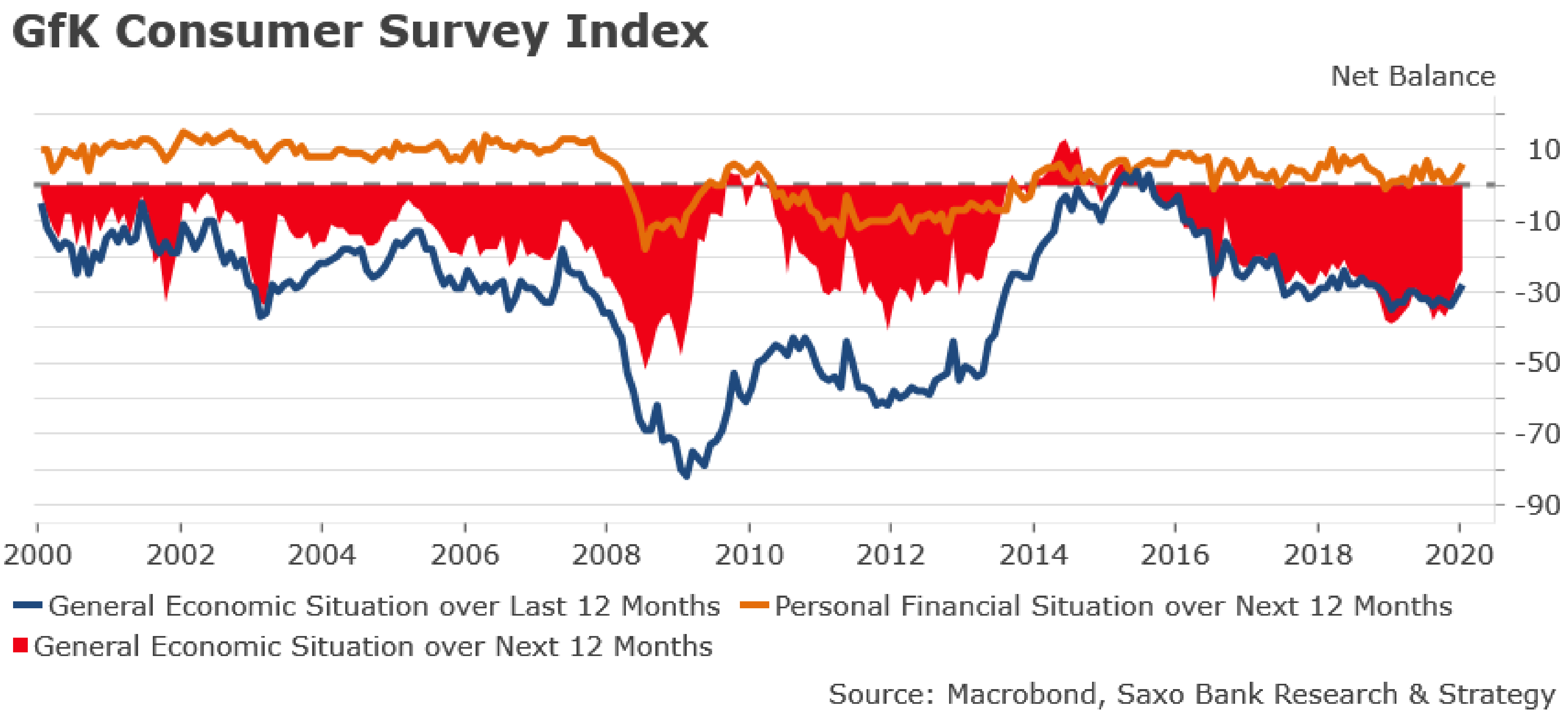
Net longs in the sterling are close to their highest level since Spring 2018 on the back of optimism regarding post-Brexit era and improved data.

Household sentiment is improving

Consumer surveys are rebounding due to higher wages (+2.7% YoY 2019 – OECD), healthy job market and Brexit visibility.



Credit boom is over !

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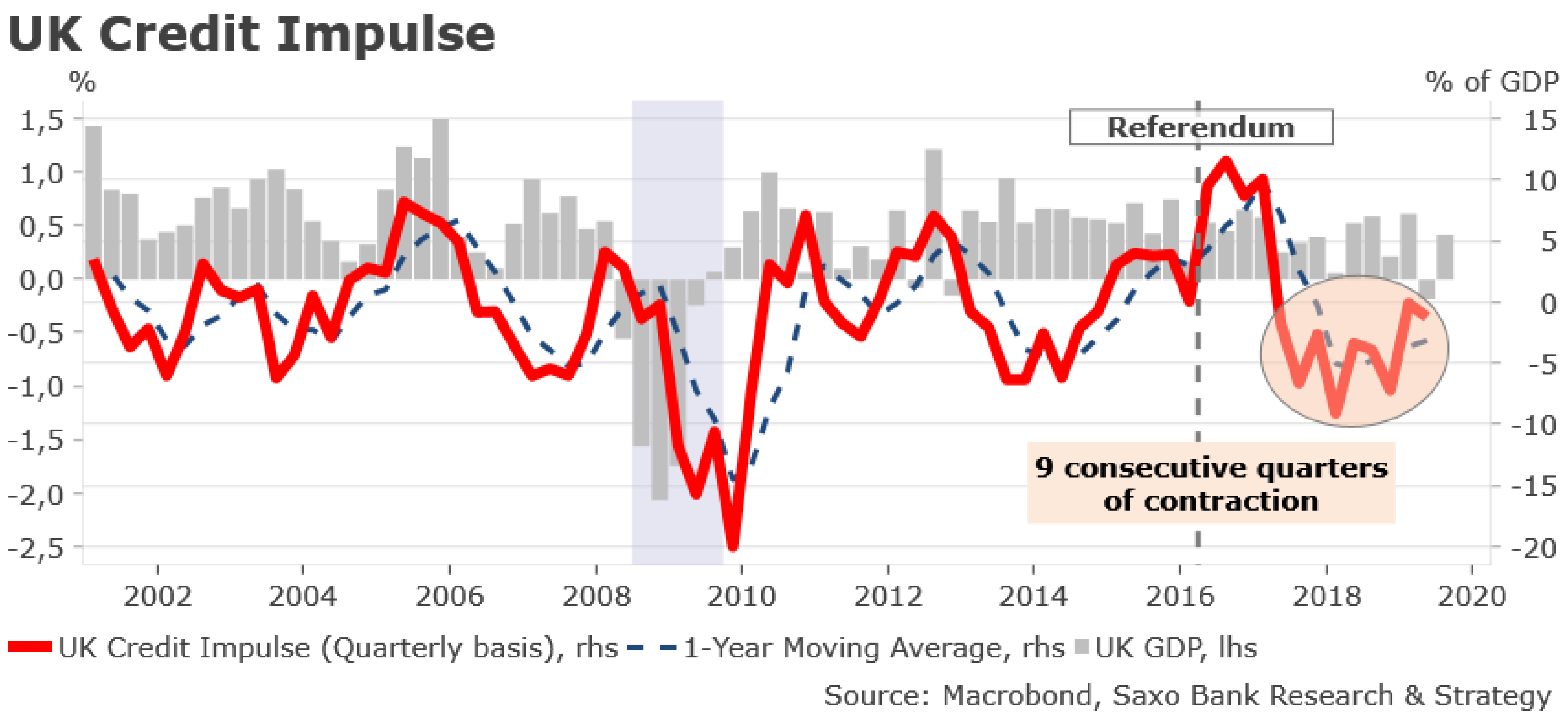
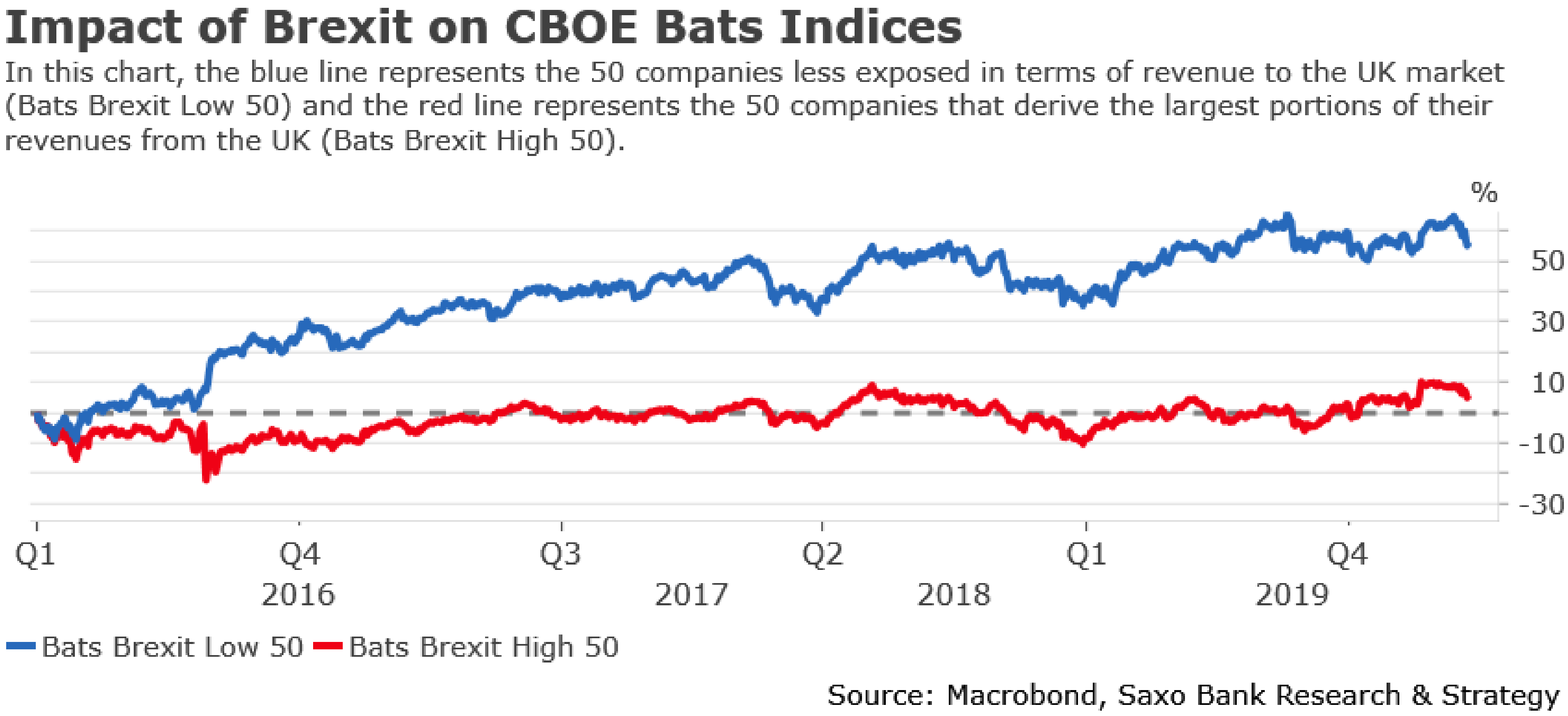
The UK's top macro problem is the lack of new credit growth. Credit push has been in contraction for 9 consecutive quarters. The length of the contraction is similar to that of the GFC, but with a smaller amplitude.



Brexit market impact

Companies most exposed to the UK are lagging their counterparts that are the least exposed (**+7% vs +54%** since the referendum).



Brexit domestic impact

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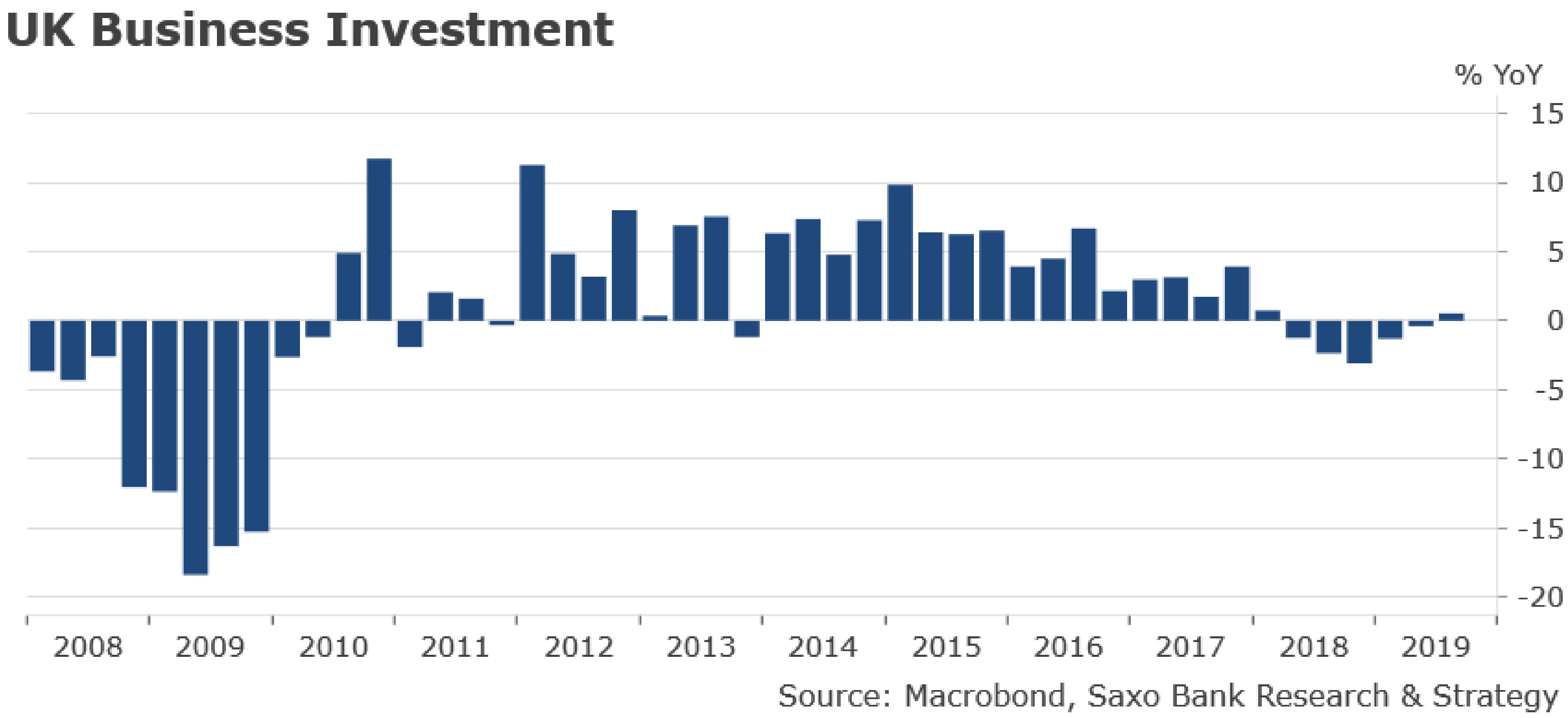
Productivity-enhancing business investment went through five consecutive quarters of contraction.
We expect a modest recovery in the short-term due to Brexit visibility, but risks remain on the upside.



Monetary conditions (based on 17 variables such as monetary aggregates, swap rates, FX rate etc.) are supportive to growth

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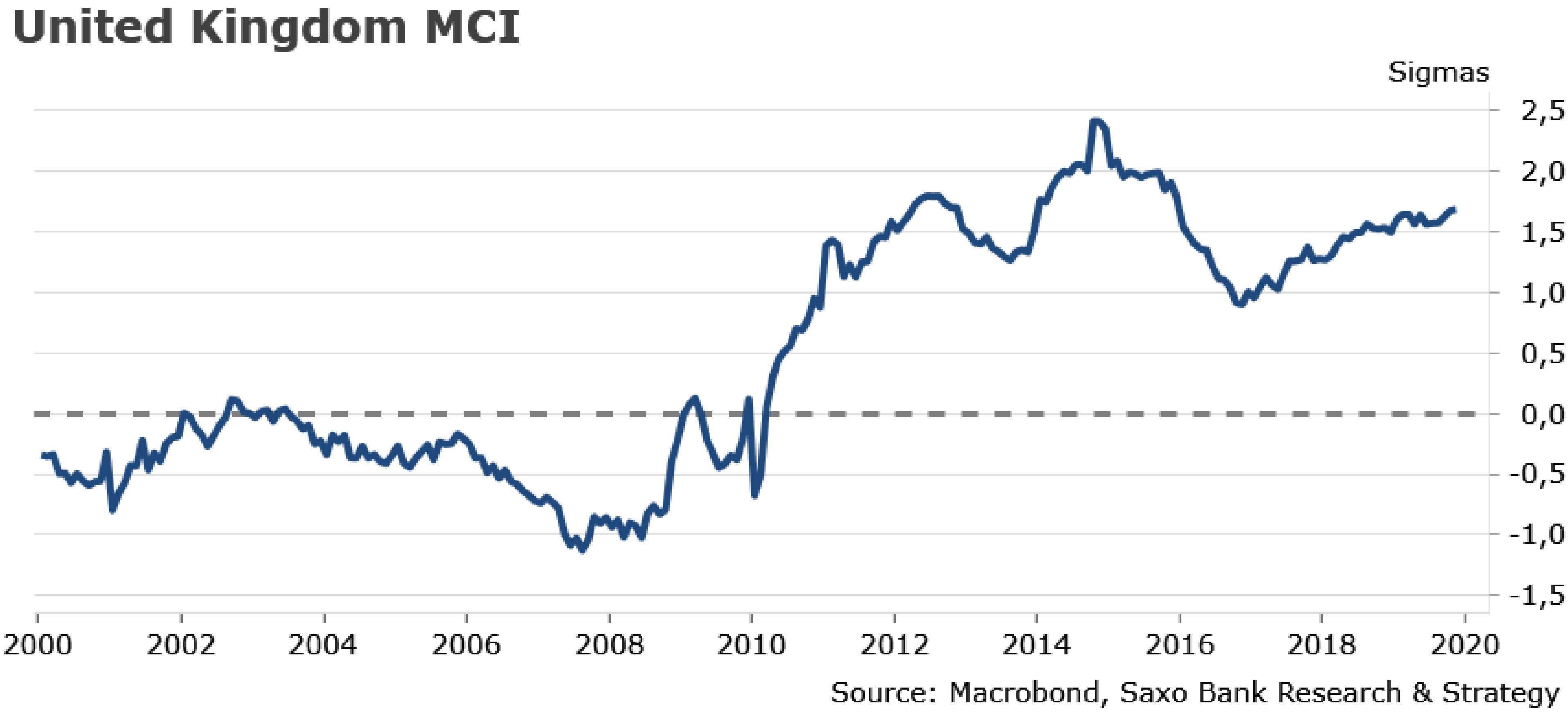
A rate cut by BoE's Bailey in March cannot be ruled out, depending on the state of the UK economy in post-Brexit era. It could help offsetting the prolonged contraction in credit push and the five consecutive quarters of contraction in private investment.



Brexit contagion

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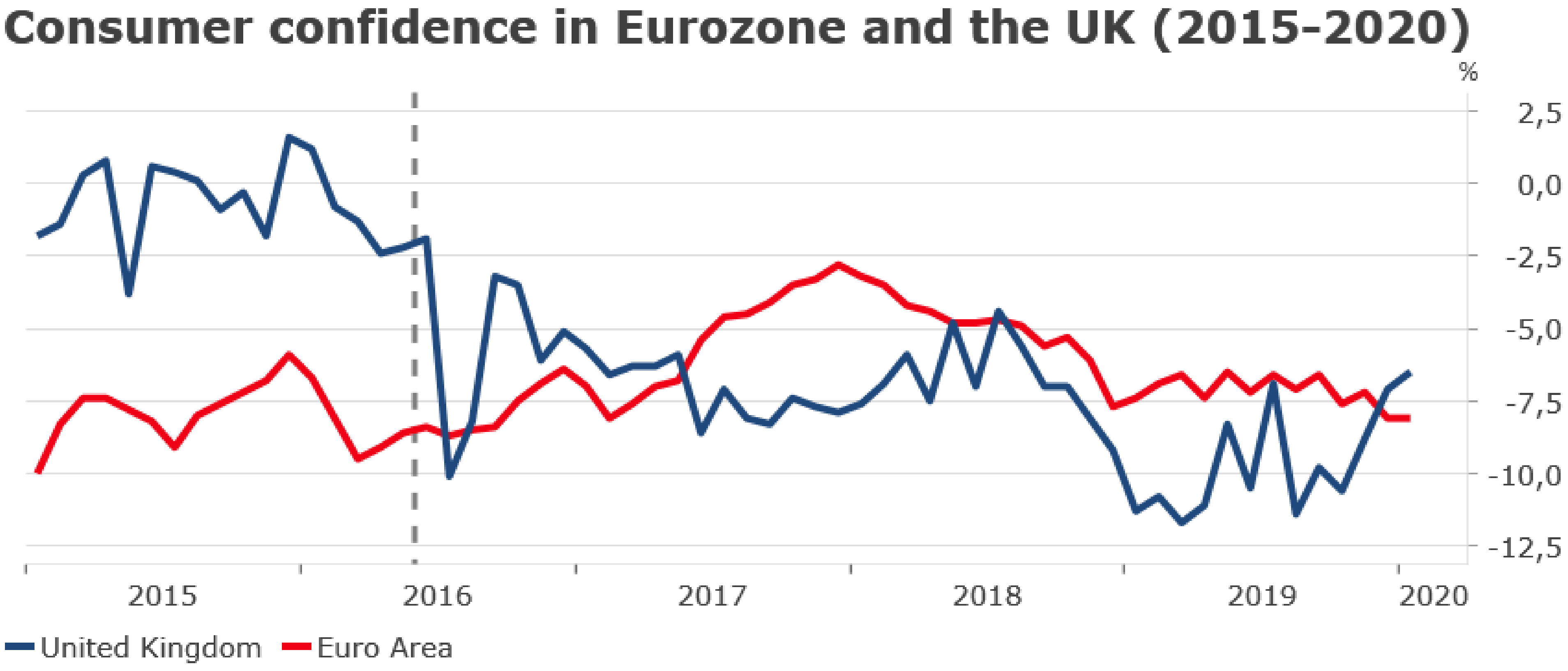
At the EU macroeconomic level, the impact of Brexit is rather limited and manageable…The EU earns around 3% of its exports to the UK.



Source: Macrobond, Saxo Bank Research & Strategy

Brexit contagion

...Except for Ireland which is in uniquely vulnerable position (need for fiscal stimulus).

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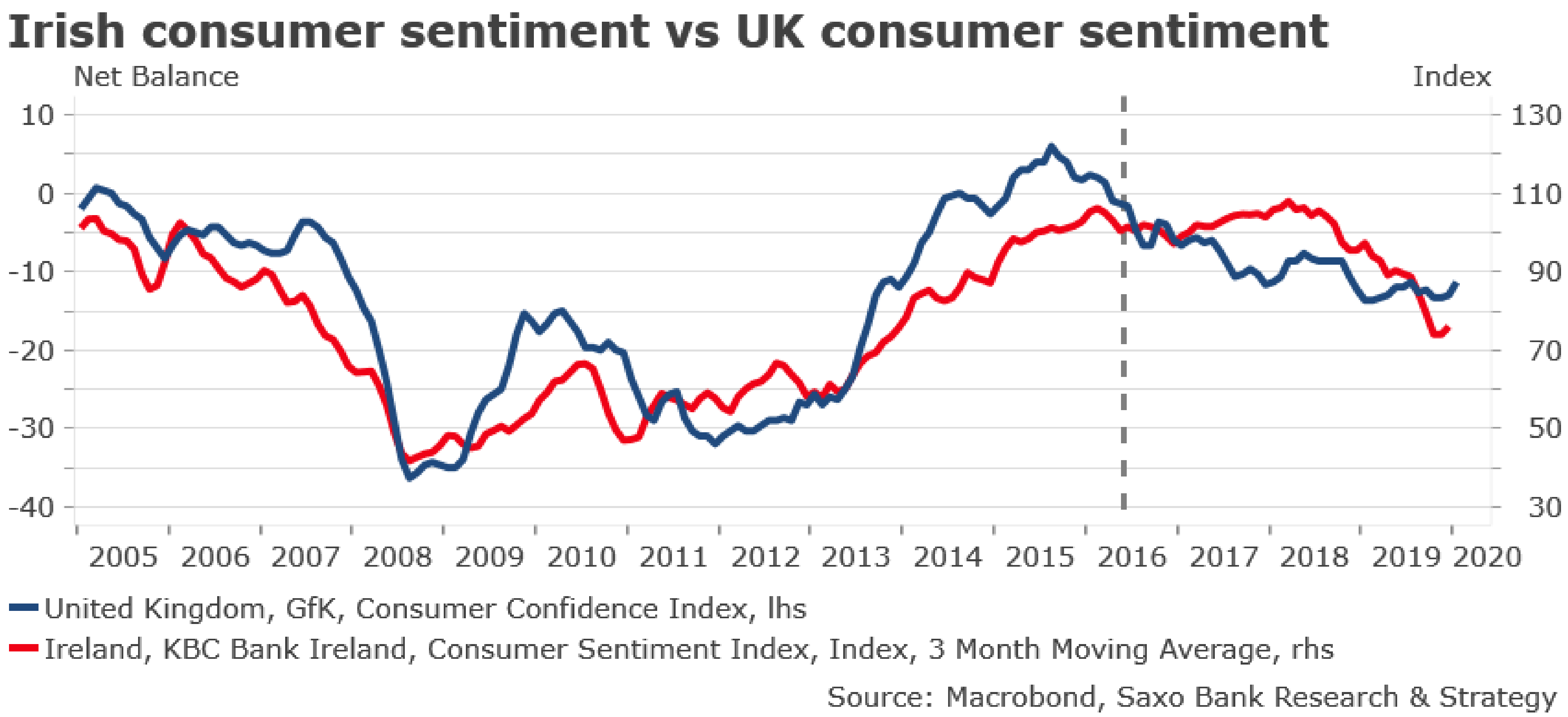

Brexit contagion

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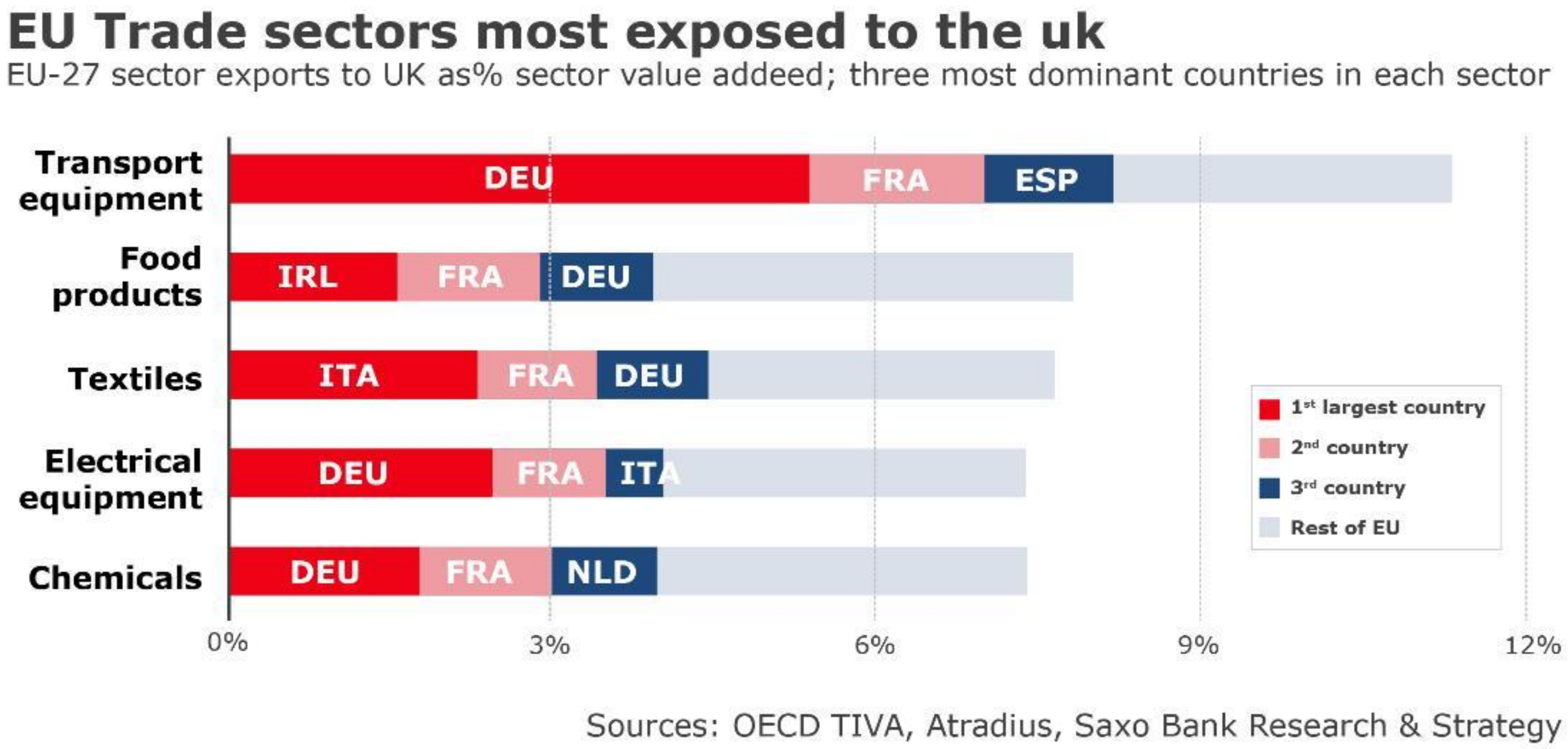
Transport and food industries are the most exposed EU sectors.



Financial services and bank

A brief summary

- **Limited staff relocation in absence of hard Brexit.** Paris (front office activities), Poland and Ireland (back office activities), Frankfurt (administrative departments) and Luxembourg (funds).

  In terms of jobs, the figure officially mentioned for France is 1,500 job transfers to Paris, but it is likely to be lower.

- **The ECB regulator is putting pressure on banks** so that commercial and market activities for continental Europe are no longer processed from London. Ultimately, it is likely that London will remain the financial hub for UK and global (outside Continental Europe) financial operations.

- **Clearing houses are the most important sovereignty issue that has not yet been resolved.** As of today, London is the main euro clearing market. In the context of Brexit, the ECB wishes to relocate these activities to Continental Europe.

  In the interim, the ECB has granted a one-year extension until the end of January 2021 during which it recognizes UK-based clearing houses as “legitimate”, which should help find common ground. Ultimately, the most likely scenario is that UK-based clearing houses will be subject to “dual regulation”, both from the UK regulator and the ECB.

Conclusions:
Brexit Base Case Scenario

- No-deal Brexit at the end of 2020 is unlikely
- Positive market sentiment BUT investors have not priced in yet that negotiations will last longer than expected
- **Trade agreement:** Phase 1, Phase 2 etc…for the next 5/10 years
- **High risk zone:** June/July 2020
- **« Boris boom » is coming:** Fiscal stimulus (March 11 budget) + rate cut by the BoE (March)
- Negative spillovers to the EU are limited (positive sentiment, CB support, solid underlying fundamentals)

Thank you

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