

IAPF Conference 2016

Macro view

Keith Wade, Economist, Schroders

Macro overview

2016: storm warning

Key questions

- China: heading for recession?
- US: heading for recession?
- UK: heading for Brexit?



China and oil are driving the markets

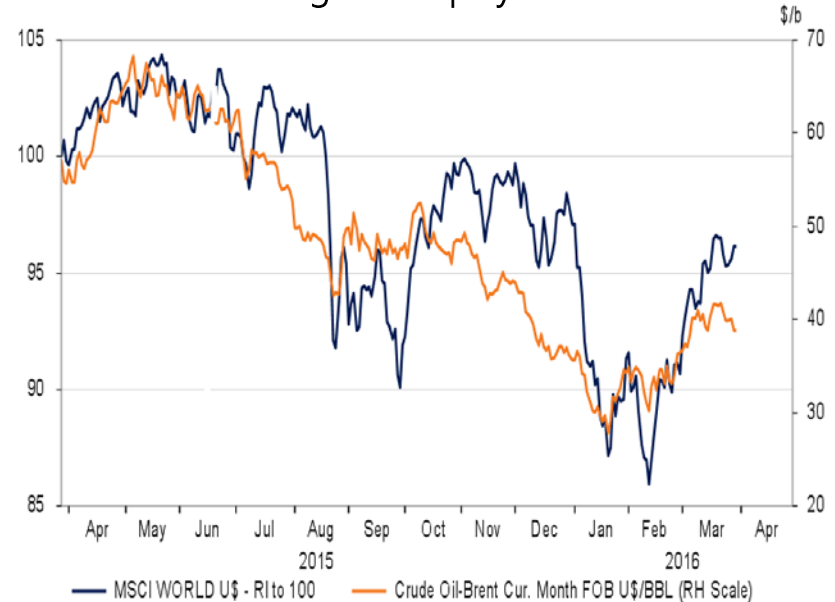
High correlations at times of stress

CNY vs global equity market



Source: Thomson Reuters Datastream, Schroders, Updated 30/03/2016

Oil vs global equity market

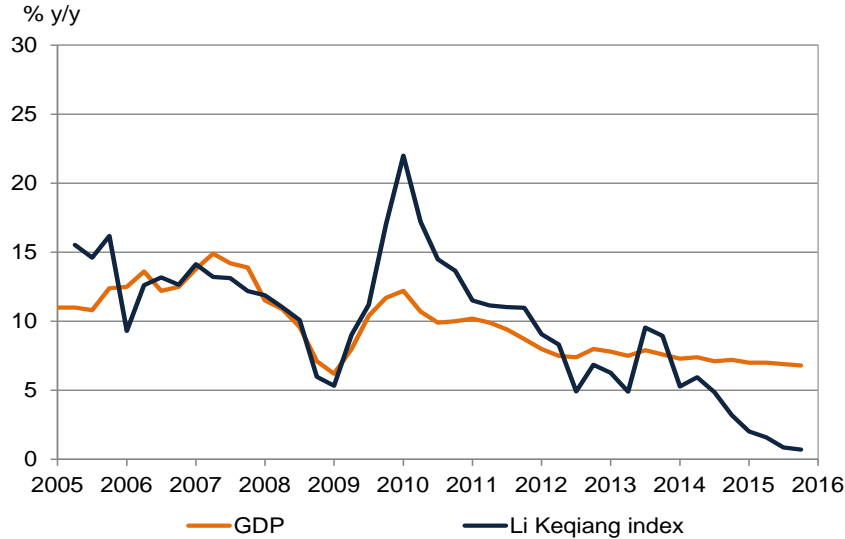


Source: Thomson Reuters Datastream, Schroders, Updated 30/03/2016

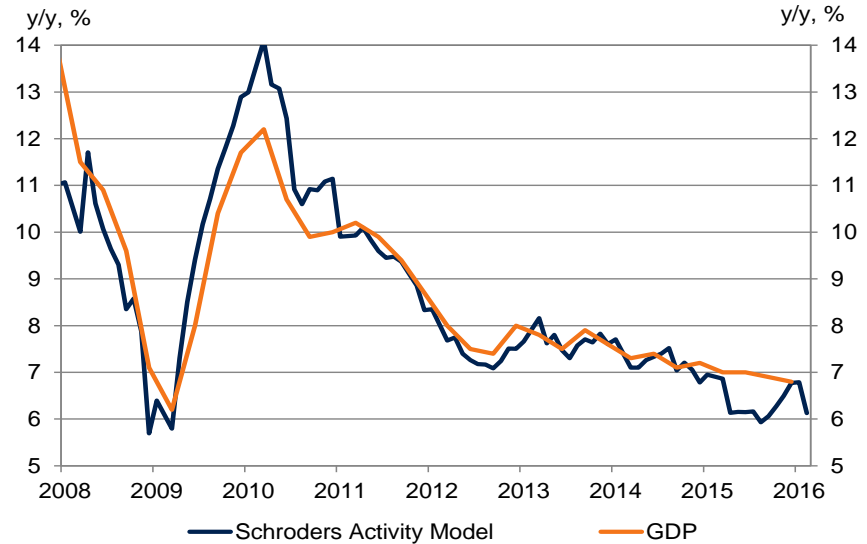
China: heading for recession?

Will the real China please stand up?

Has growth collapsed?

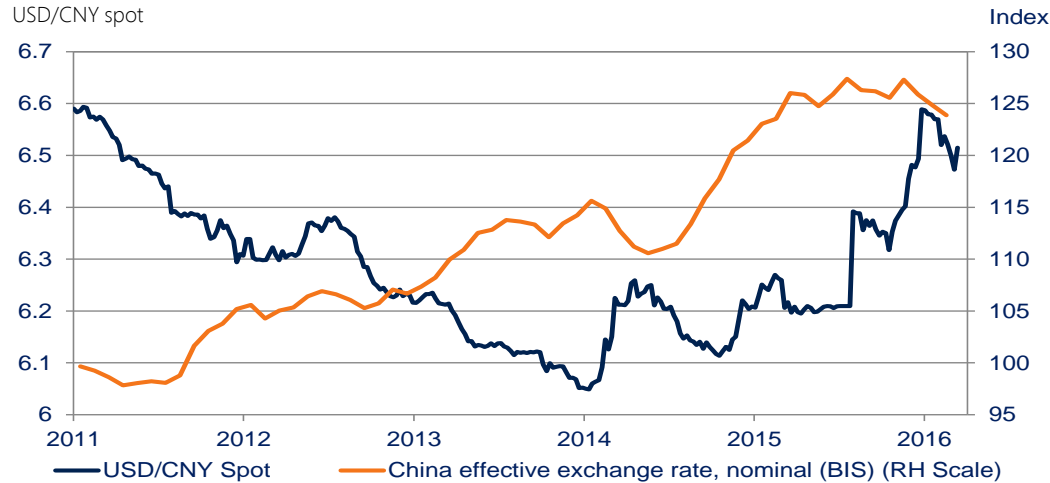


Or just slowed?



China: now tracking the trade weighted exchange rate

CNY policy will impact dollar strength

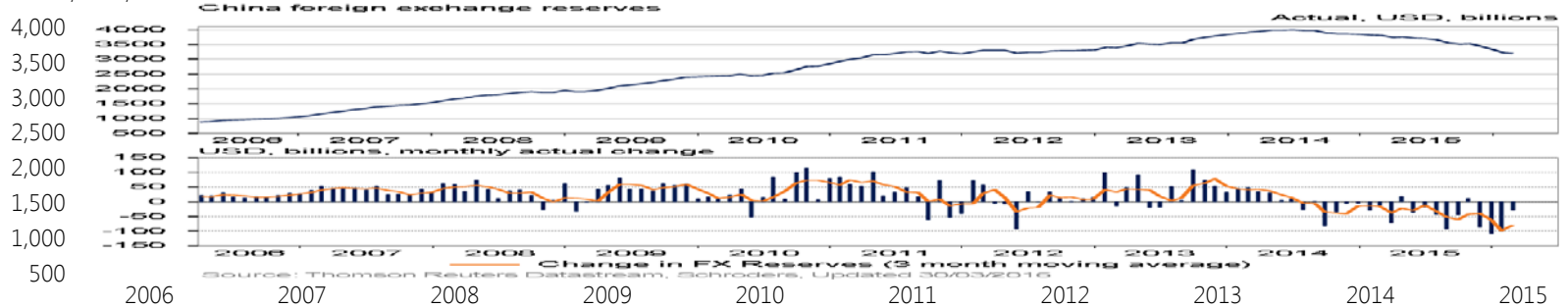


CNY: how much control do the authorities have?

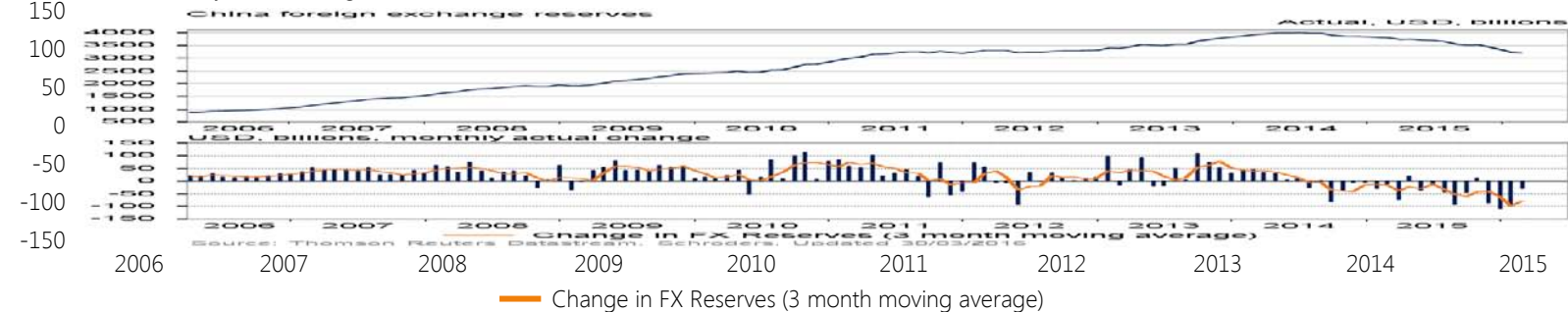
FX reserves are declining sharply

China foreign exchange reserves

Actual, USD, billions



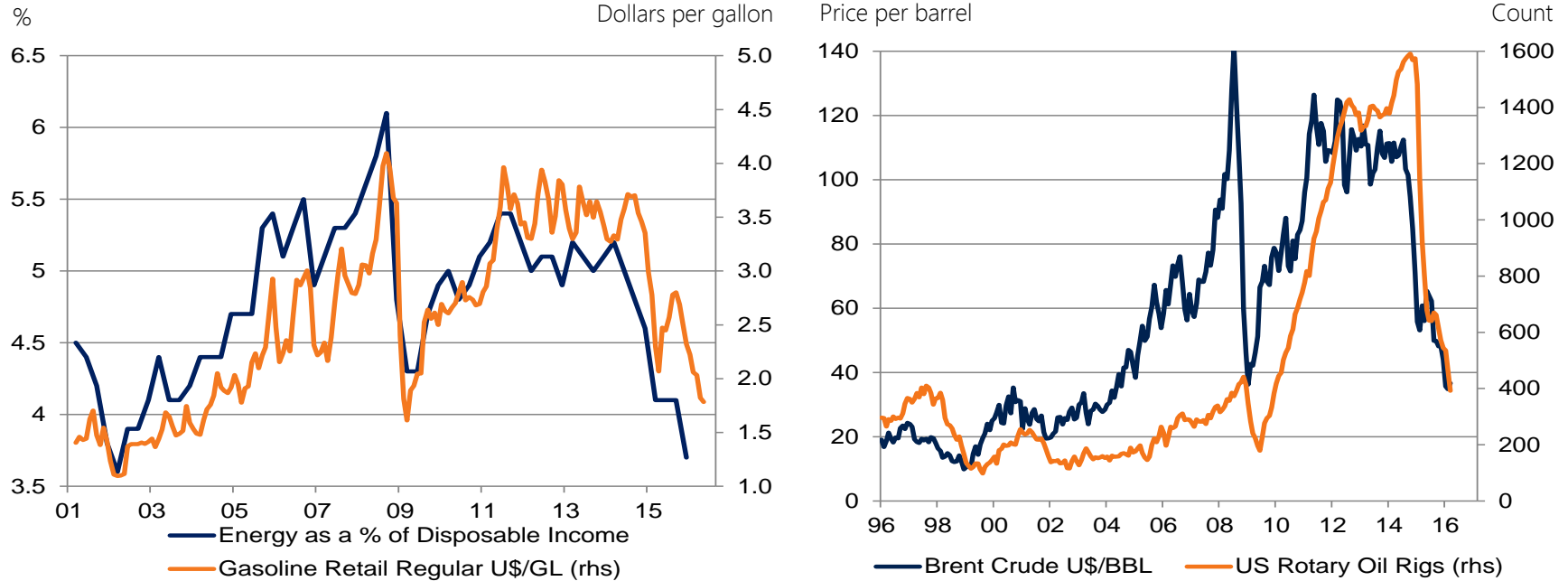
USD, billions, monthly actual change



Source: Thomson Datastream, Schrodgers, 30 March 2016

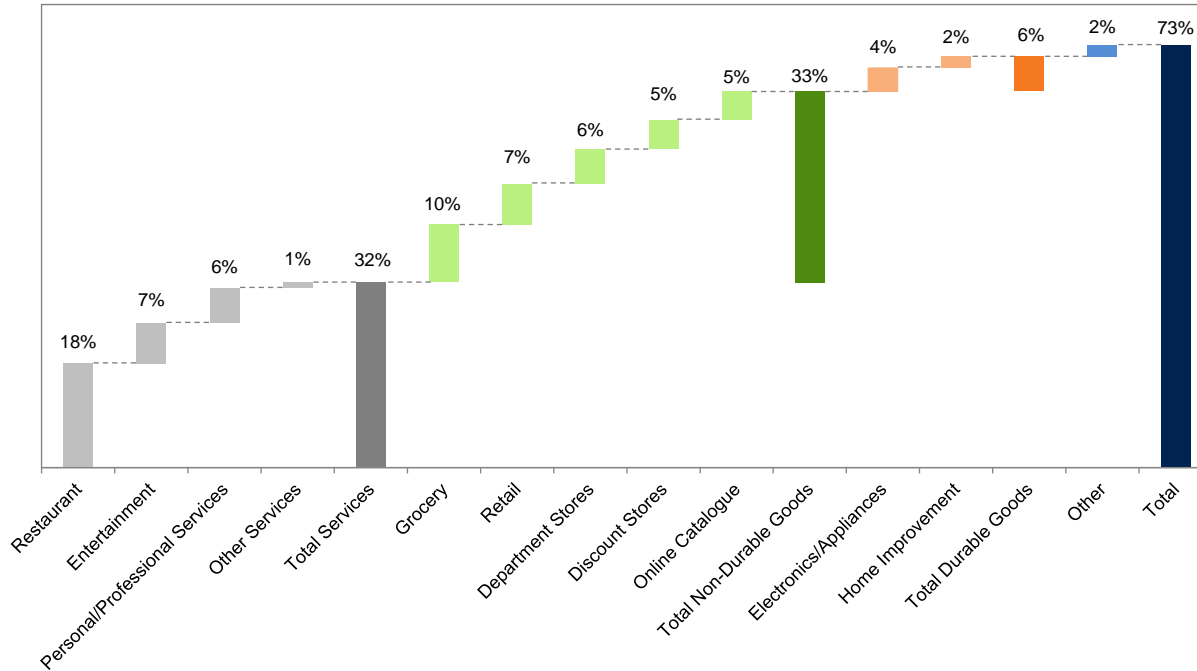
Oil price winners and losers

The energy tax cut in the US vs the hit to oil and gas capex



US consumers eat much of their gas savings

Percent of savings from lower gas prices spent on non-gas categories



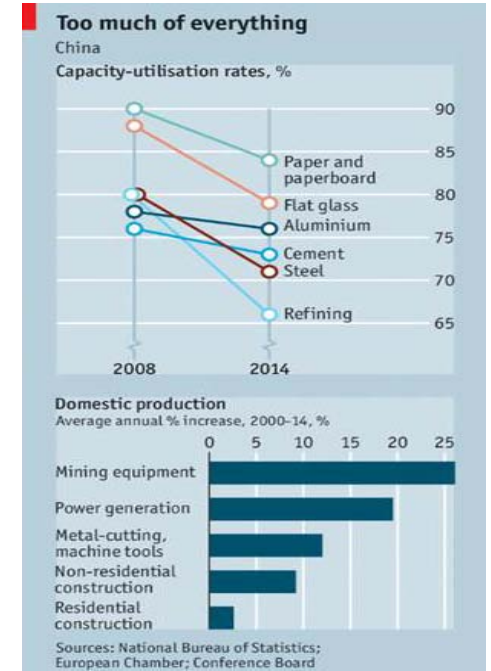
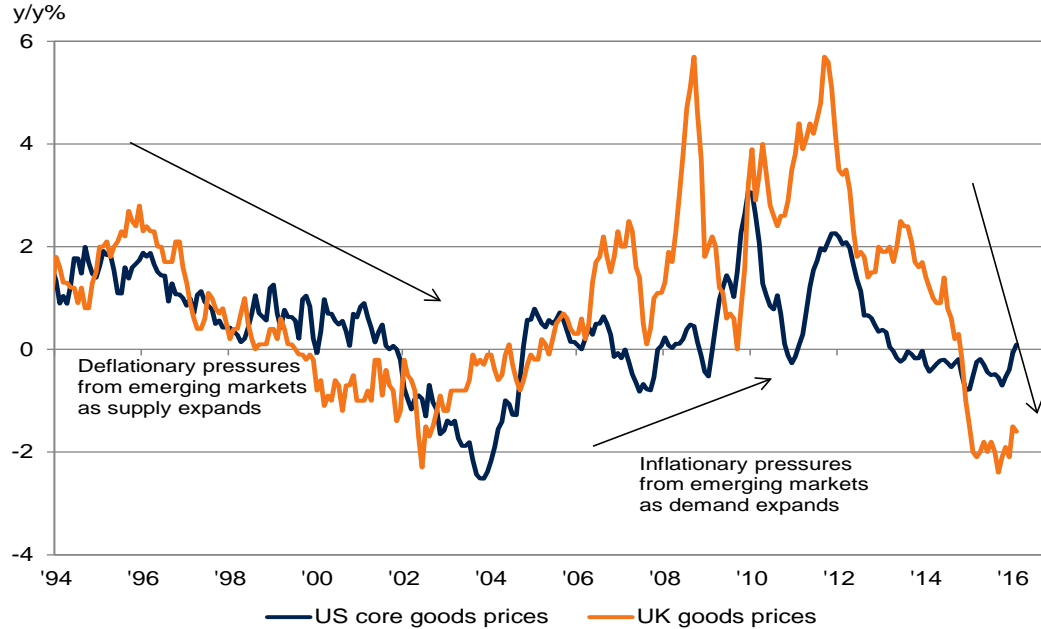
Global trade growth stalls

EM exports not responding to DM recovery



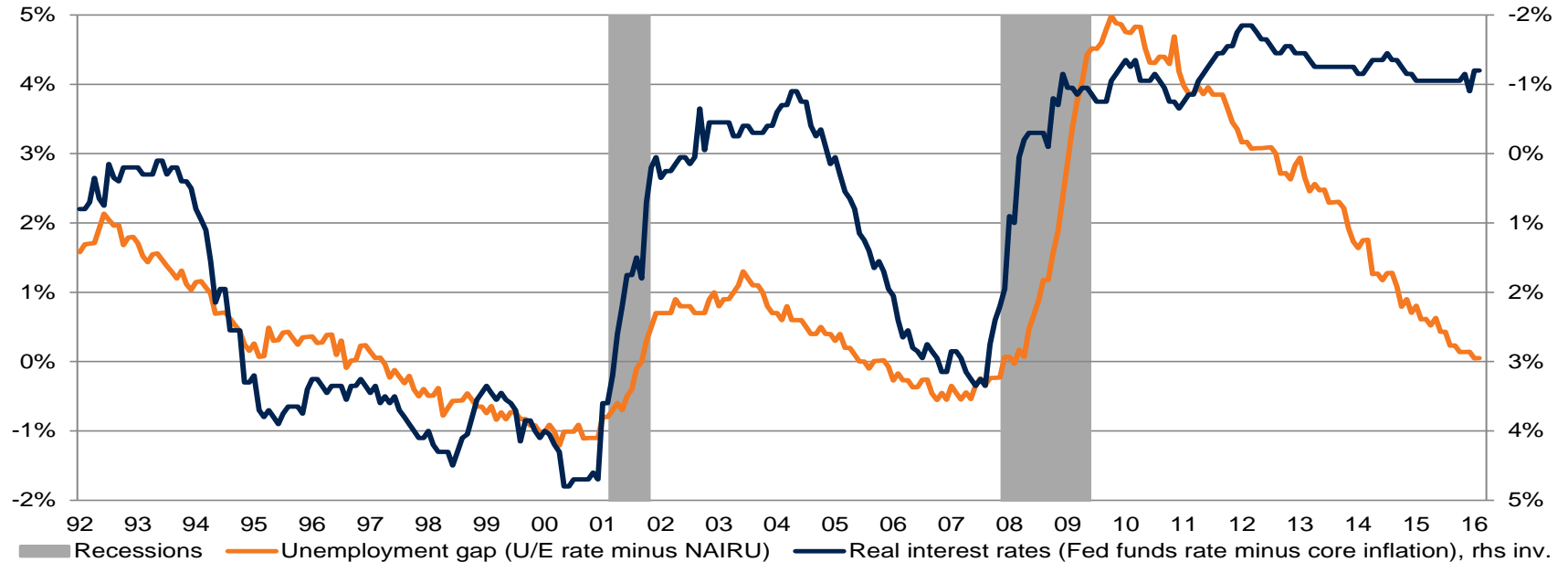
China shakes the world?

No hard landing, but watch for a wave of deflationary pressure from EM



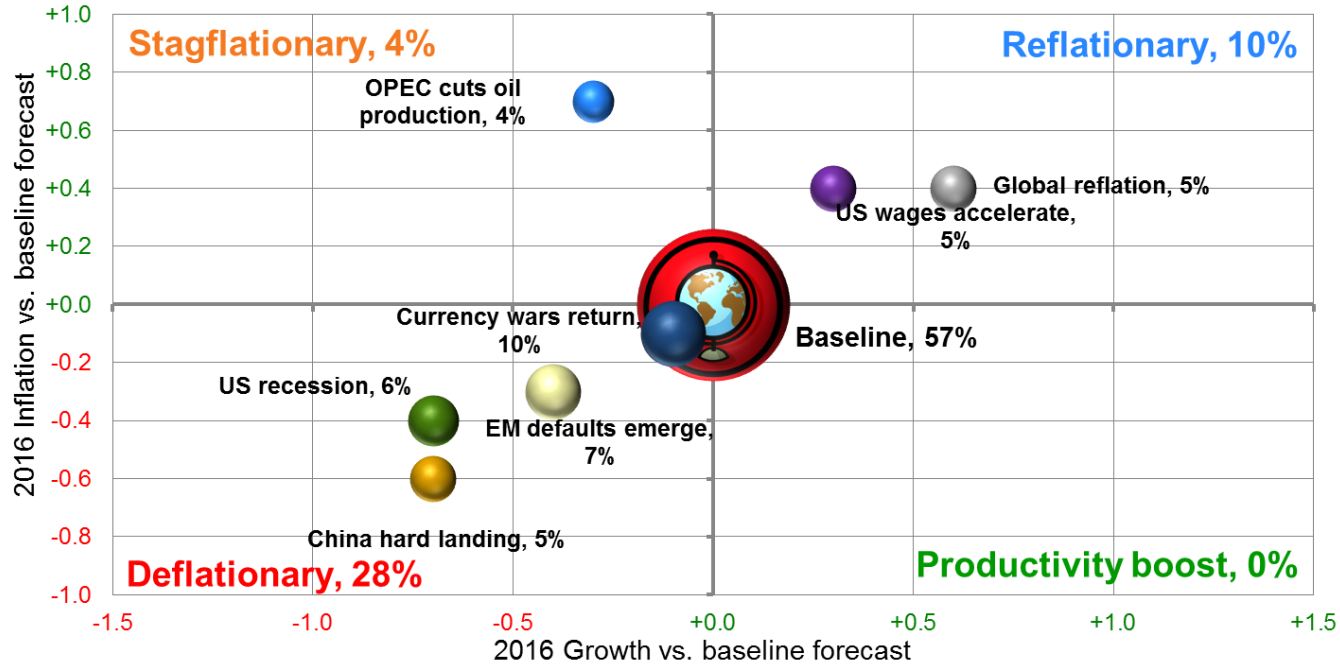
Fed tightening delayed, not dodged

US unemployment cycles and real Fed funds rate



The risk universe

Scenarios versus baseline



Brexit

Understanding the risks and implications

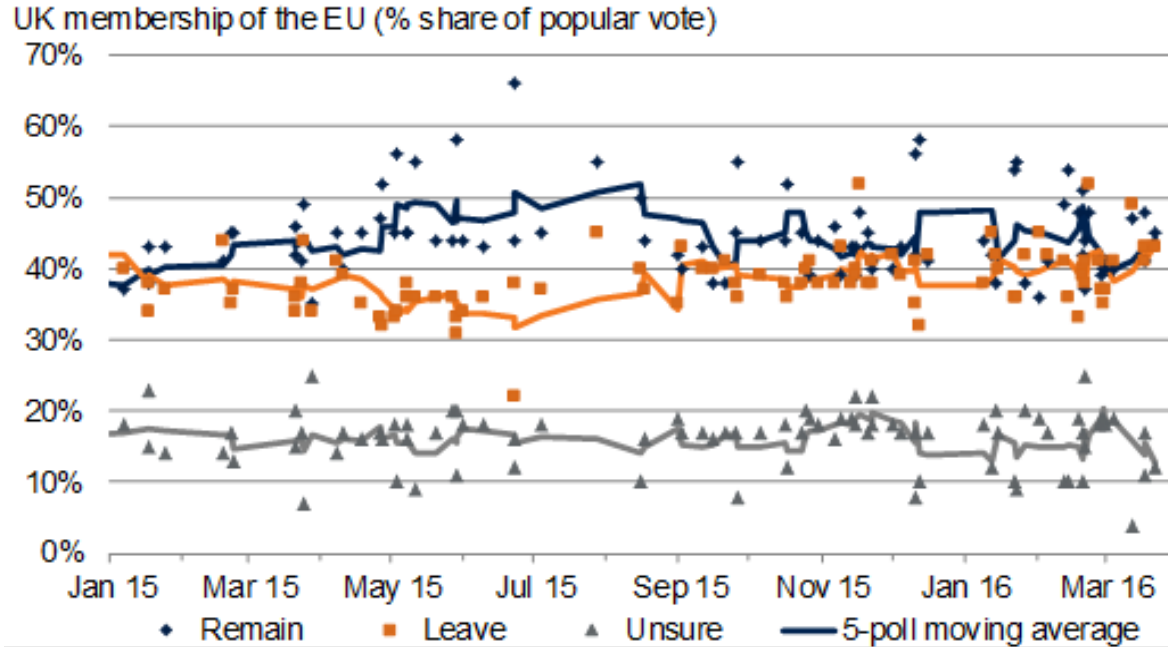
Poor reaction to Cameron's draft deal with EU

Snap polls suggest deal makes voters more likely to vote to leave



What are the polls saying?

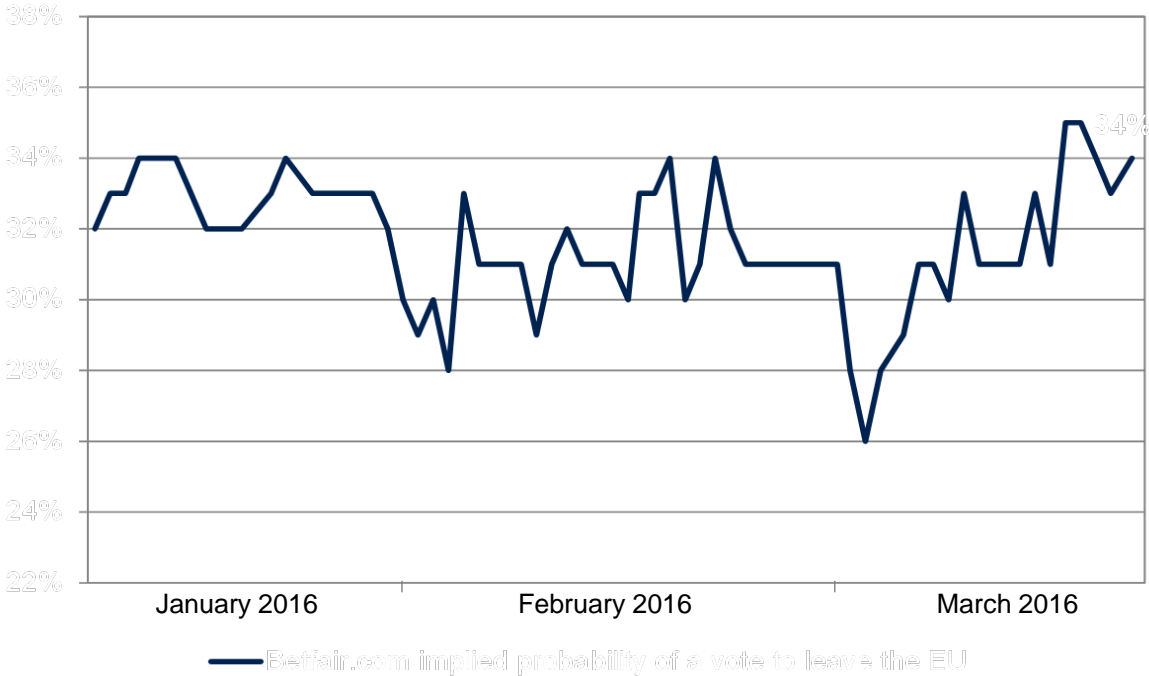
Voting intentions on an EU exit neck and neck



Source: ComRes, ICM, ORB, YouGov, BMG Research, Survation, Ipsos MORI Panelbase, Pew Research Centre, Norstat, Populus, TNS-BMRB. Schrodgers Economics Group. Last survey conducted 24 March 2016

Betting markets show lower Brexit risk than opinion polls

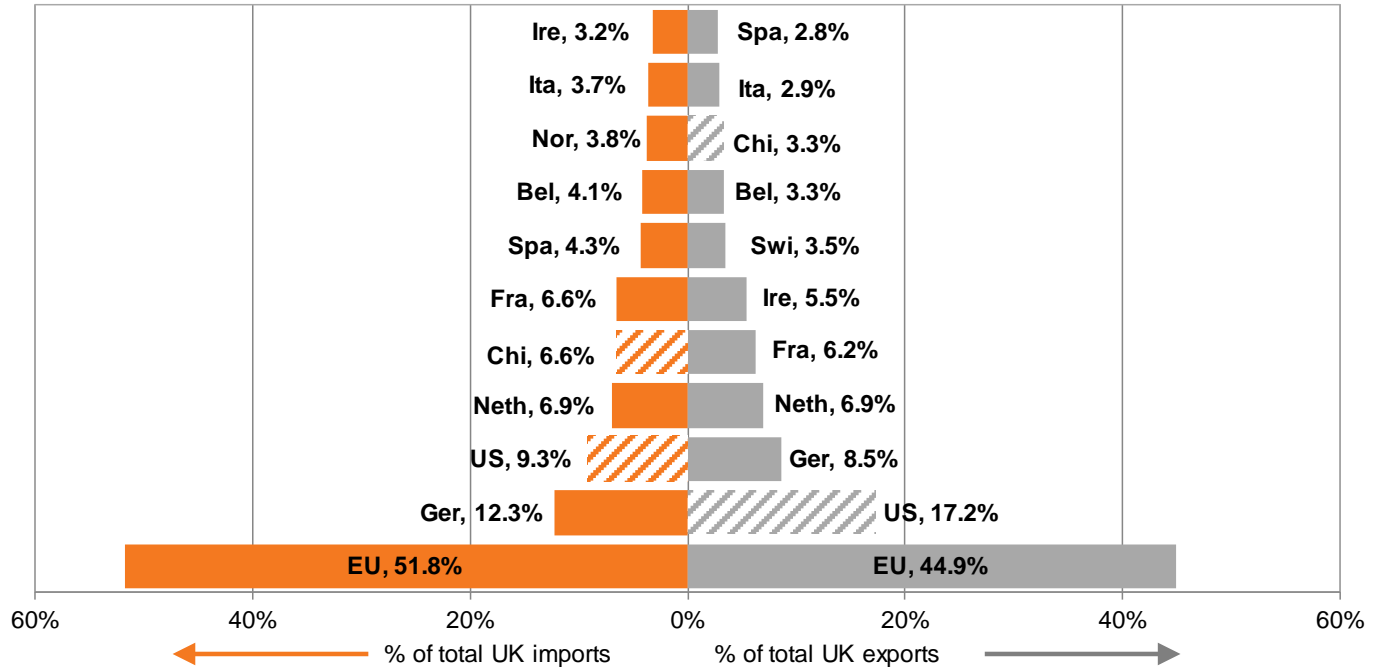
Betfair implied probability shows a 34% chance of voting to leave



Source: Betfair.com, 30 March 2016

UK's top 10 trade partners

UK exports and imports as share of total (2012-2014 average)



The UK's relationship with the EU

Trade, investment and migration

Trade:

- 45% of UK exports go to the EU28 (£23bn, 13% of GDP)
- 52% of imports are from the EU (£29bn, 16% of UK GDP)

Investment:

- The EU owns £1.6tn worth of UK assets (FDI £0.6tn, Portfolio £1.0tn)
- The UK received £9.4bn (0.6% of GDP) worth of inward FDI per annum from the EU (2011-14 average)
- The UK invested £21.8bn (1.6% of GDP) in outward FDI per annum in the EU (2011-14 average)

Migration:

- Since 2005, there has been 1.2m net inward migrants from the EU23
- Since 2005, there has been 2.1m net inward migrants from the non-EU countries
- 64% of EU inward migrants are arriving for work and 22% for study

Life after Europe

What would the UK's future look like?

Life after Europe

Options for Brexit

After leaving the EU, these are some of the models the UK could follow:

- European Economic Area membership (Norway, Iceland Lichtenstein)
 - Full access to EU markets
 - Still pay 90% of fees, and bound by EU rules on employment, health & safety, transport and the environment
 - However, no political influence on rules, and must implement any new regulations
 - Free movement of labour and capital
- European Free Trade Area (EFTA) Switzerland
 - Partial access to EU markets (goods), almost no access to services markets
 - Pays less in fees (40%), but can be selective on most rules depending on market access
 - Free movement of labour is required, but no free movement of capital
 - Separate bi-lateral trade agreements required, which often become outdated as EU changes regulations
- Customs Union (Turkey)
 - Tariff free access to most goods markets, but some regulation required. Fees are very small
 - No free movement of labour or capital

Conclusions

Highly uncertain outlook in the event of a Brexit vote

- Macro impact likely to be negative
 - Short-term negative as consumers and corporates pause in the face of uncertainty, higher inflation from fall in GBP
 - Long-term depends on renegotiation, but risk of reduced FDI and trade whilst lower immigration will slow trend growth
- Markets
 - GBP likely to be negatively impacted
 - Most stocks with large EU trade would also suffer
 - Some stocks with little to no trade with the EU could benefit from weaker GBP
 - Gilts could rally on uncertainty, but could also suffer from ratings downgrades (S&P will downgrade by 2 notches)
 - Longer-term, possible loss of business due to increased costs of trade with EU
- Scotland?
 - Scotland would almost certainly call for a referendum to leave the UK



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