



CIPFA Pensions Network
CFO Briefing

The Economy and the Referendum

23 June 2016

The Referendum Campaign

The plebiscite problem



Read my lips

- Economic Armageddon
- Fiscal Flogging
- Her Majesty's Loyal Opposition
- Immigration
- Strange Bedfellows
- Egregious Mendacity

The Big Picture

Three Things

1. The Polls

2. The World

3. The Aftermath

The Polls

Campaign polling

Referendum intention in 2016

EU referendum voting intention in 2016

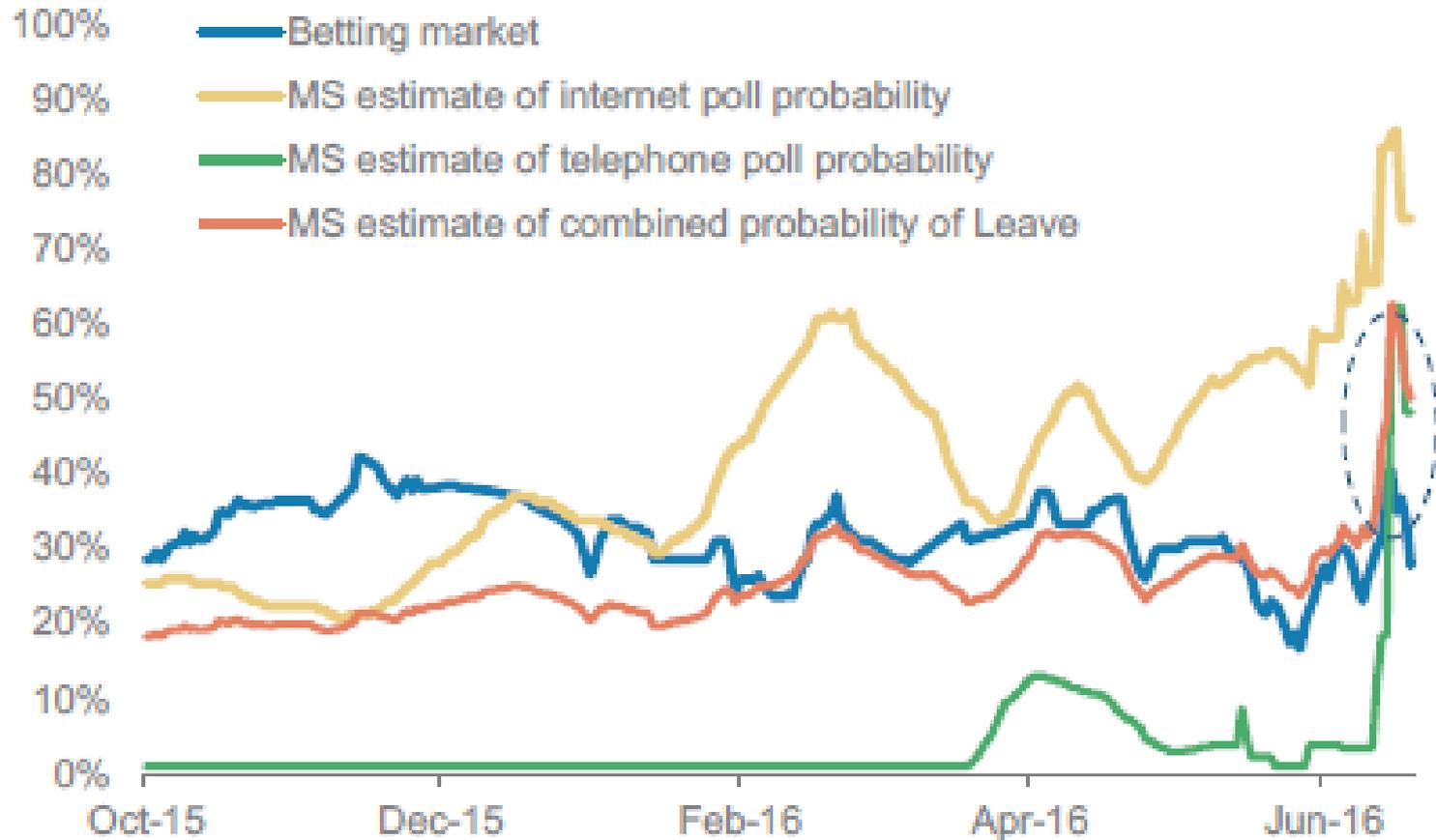
Remain Leave



YouGov | yougov.com

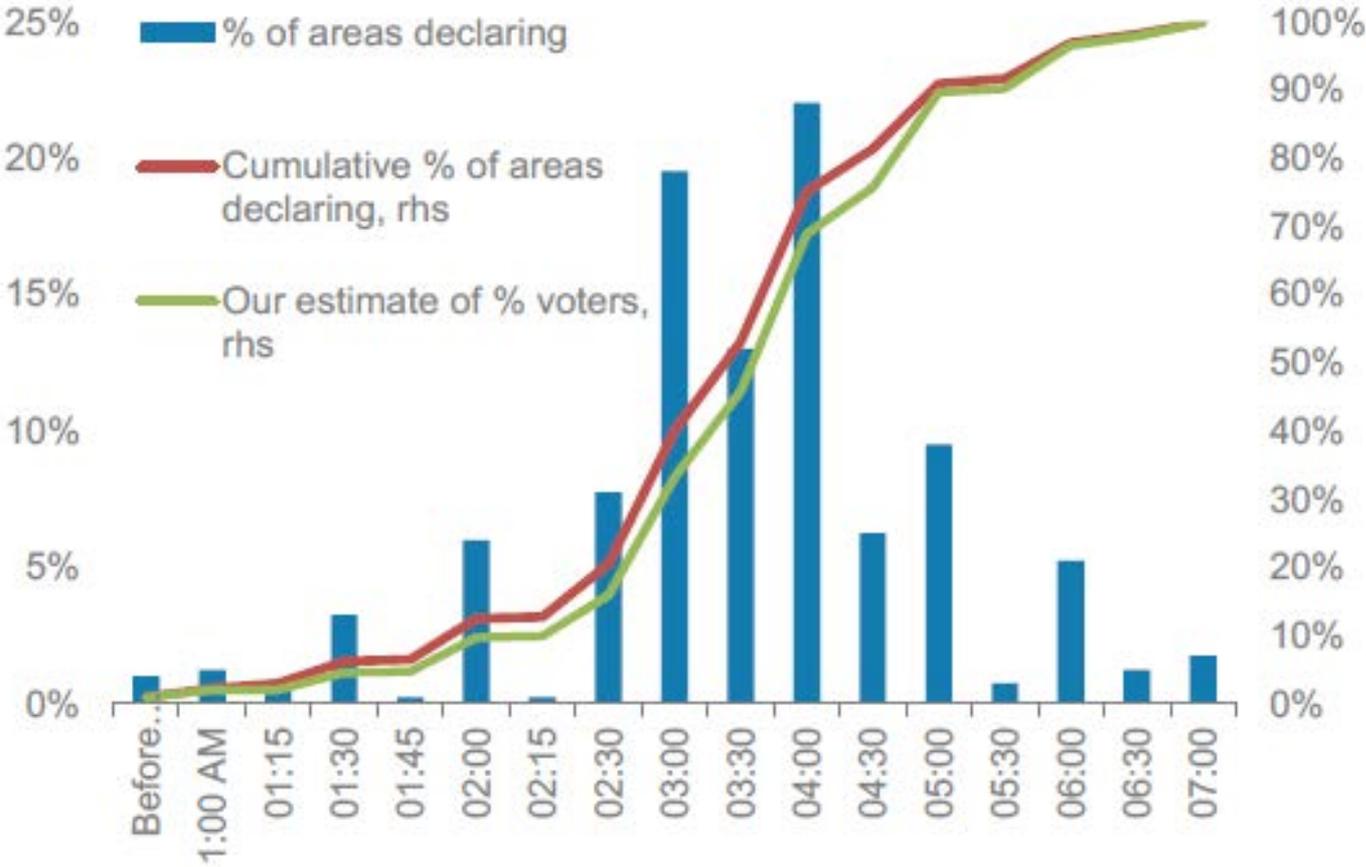
Latest update: June 17-19, 2016

The Polls



Source: whatukthinks.org, Betfair, Morgan Stanley Research

Expected Results



Source: Electoral Commission, Morgan Stanley Research

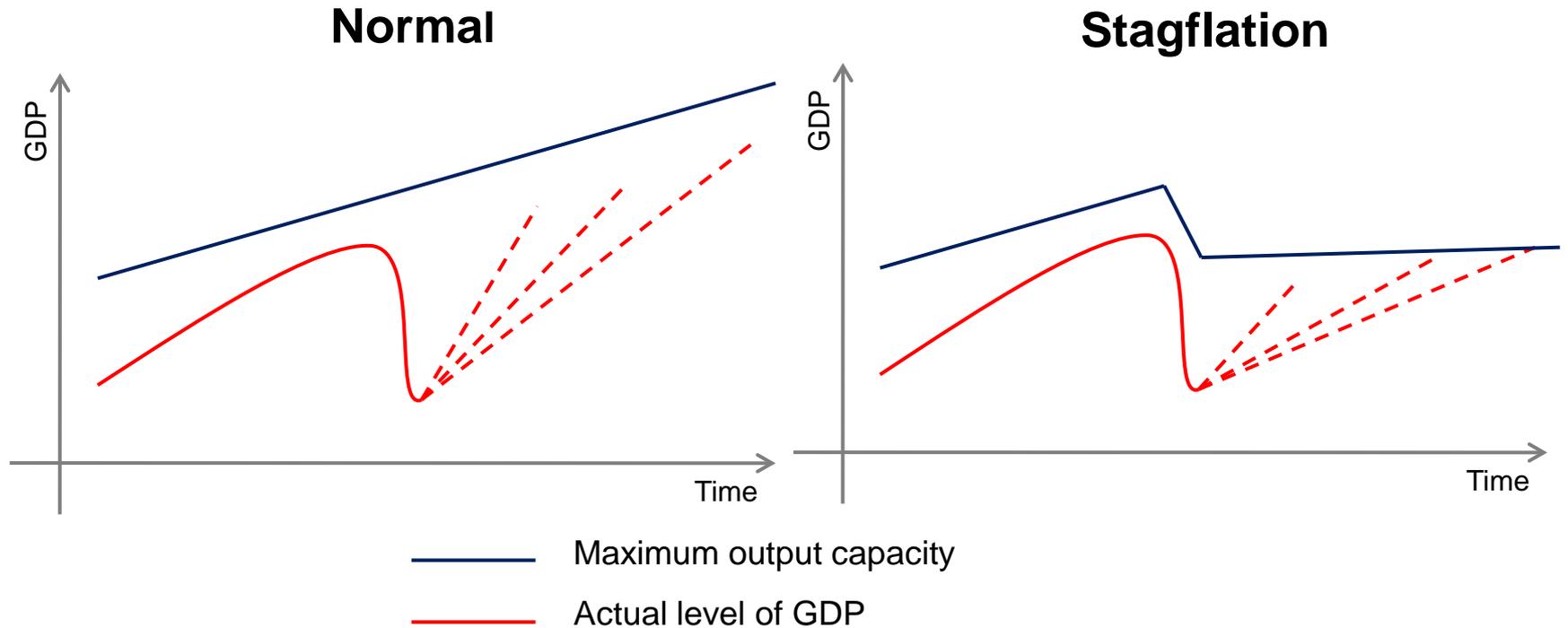


The World

Investment Themes

- The Productivity Crisis
- Sputtering economic growth
- Central bank monetary policy: Europe, Japan, China
- US interest rate expectations
- US presidential election
- China: deceleration and transition
- Corporate profits cycle
- Debt market disruption

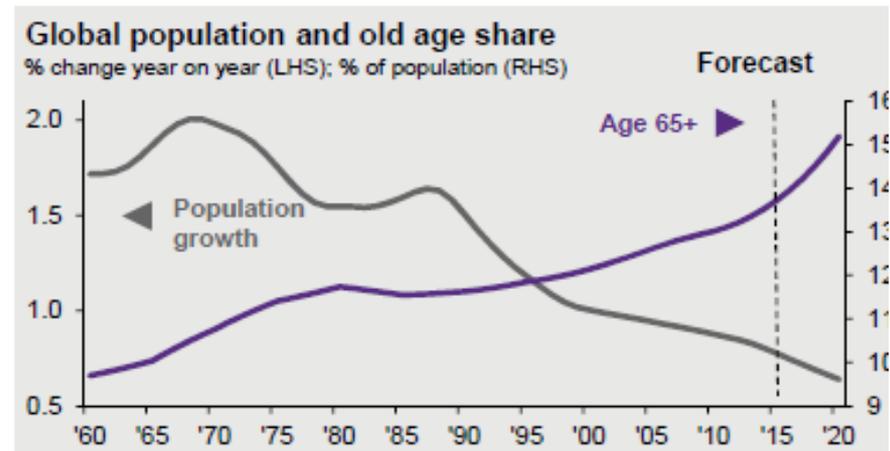
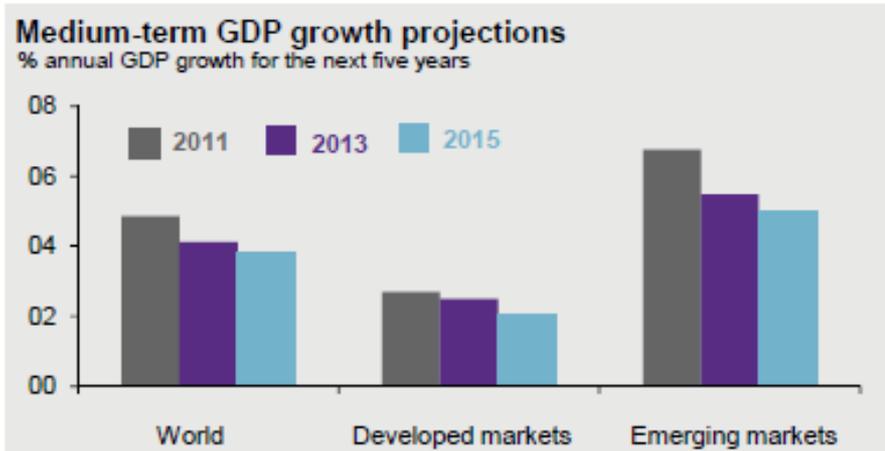
Shock Recovery Scenarios



- Typical cyclical pattern
- No loss in productive capacity
- Medium term potential for rapid growth to return to long-term path

- The worst of both worlds
 - Impaired long-term growth capacity
 - risk of higher endemic inflation
- Cyclical and structural deficits

Productivity and growth



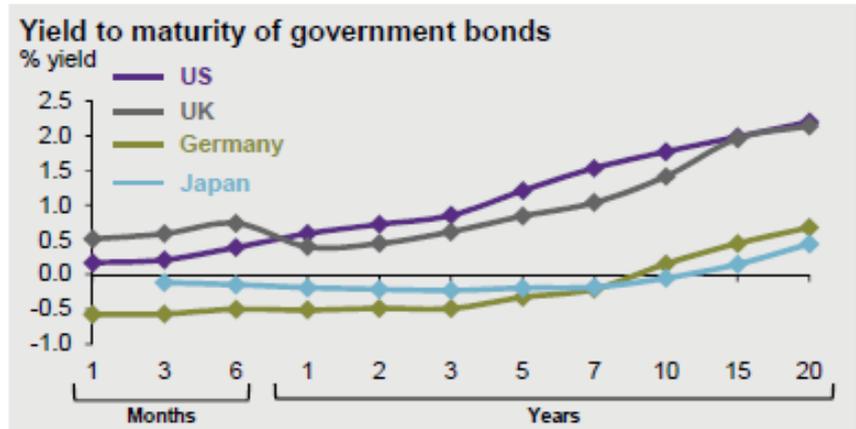
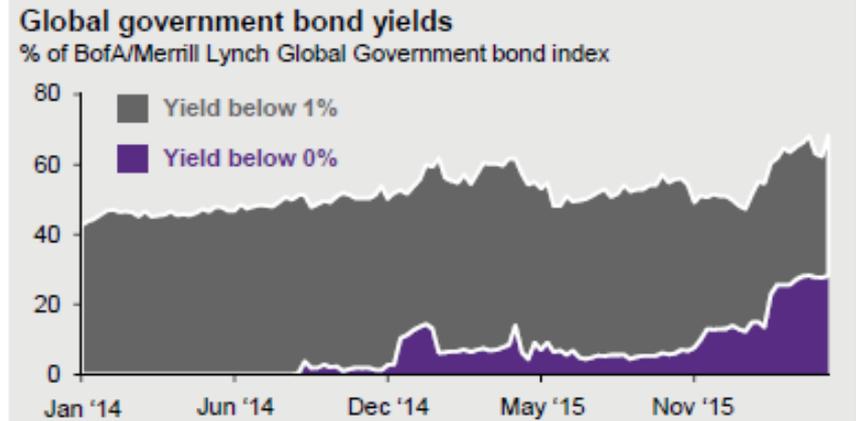
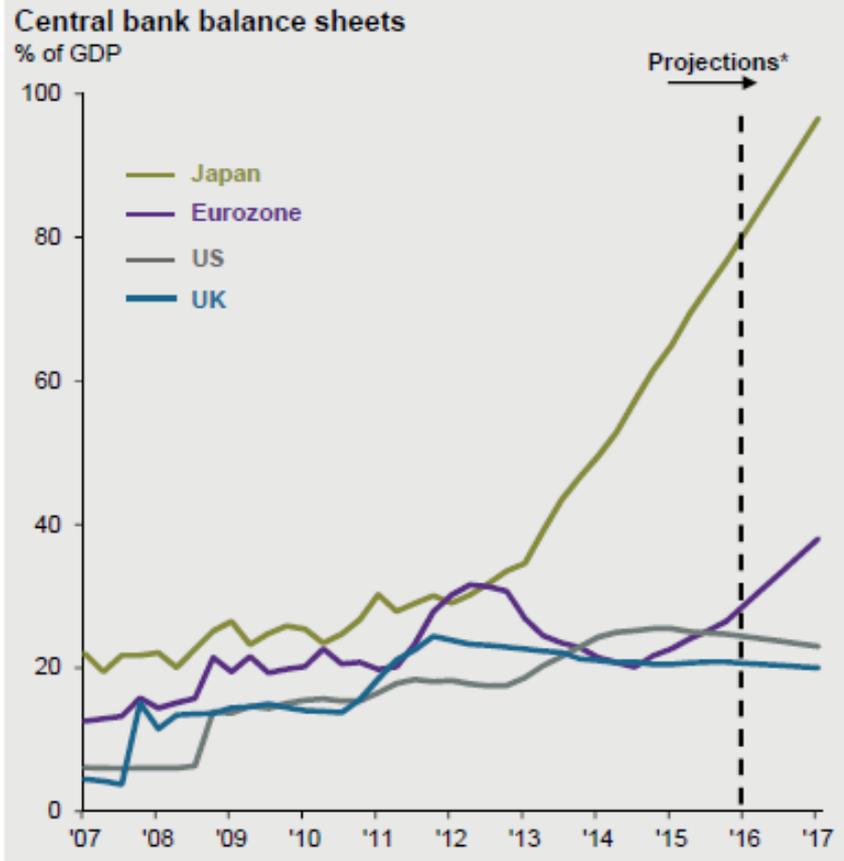
Source: (Top) J.P. Morgan Economic Research, J.P. Morgan Asset Management. *Emerging markets productivity data excludes China and India due to data availability. (Bottom left) IMF, J.P. Morgan Asset Management. (Bottom right) J.P. Morgan Economic Research, United Nations, J.P. Morgan Asset Management. Guide to the Markets - UK. Data as of 31 March 2016.

Global inflation



Source: JP Morgan

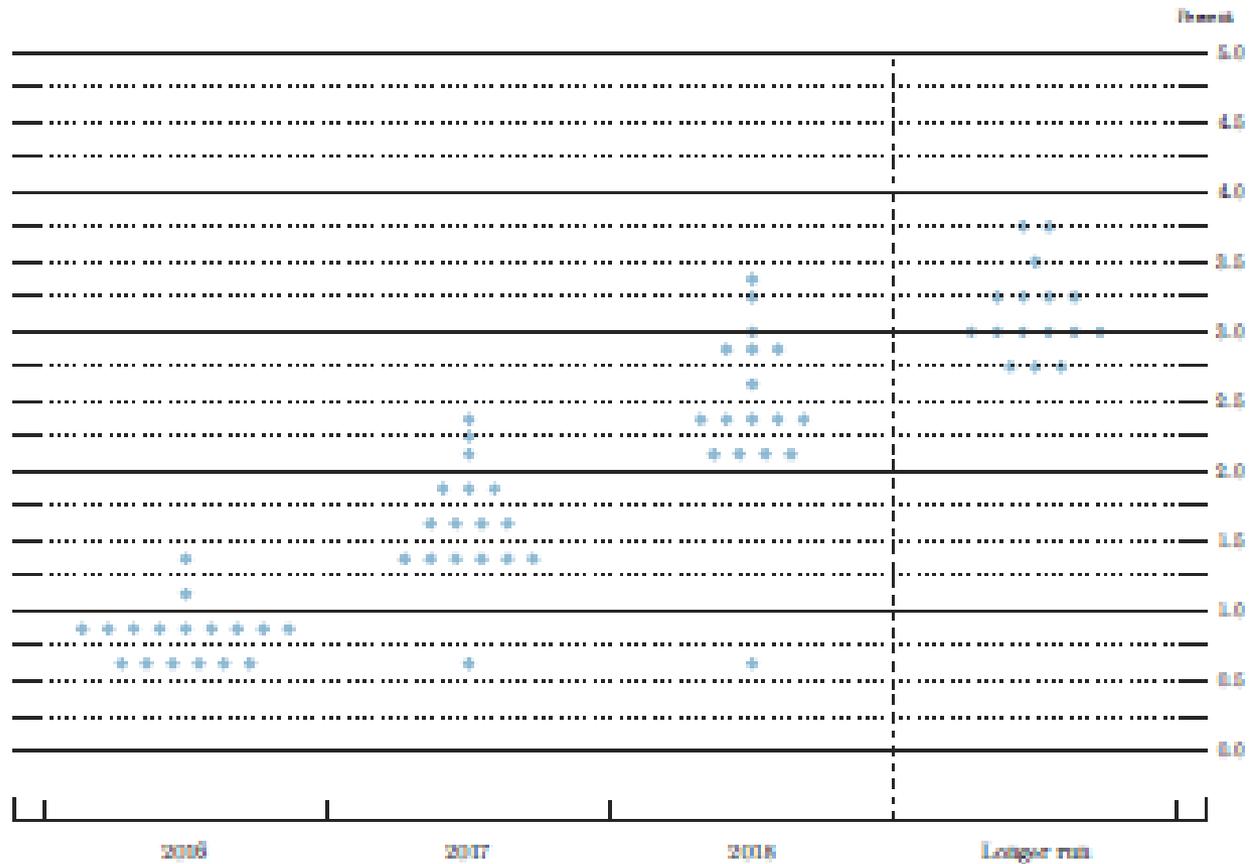
Global monetary policy



Source: (Left) Bank of England, Bank of Japan, ECB, US Federal Reserve, J.P. Morgan Economic Research, J.P. Morgan Asset Management. *Central bank assets as percentage of nominal GDP is forecasted from Q4'15 to Q2'16 using J.P. Morgan Global Economics Research nominal GDP forecasts and assumptions for central bank balance sheet size based on statements released by each respective central bank and its governors. (Top right) Bloomberg, BofA/Merrill Lynch.

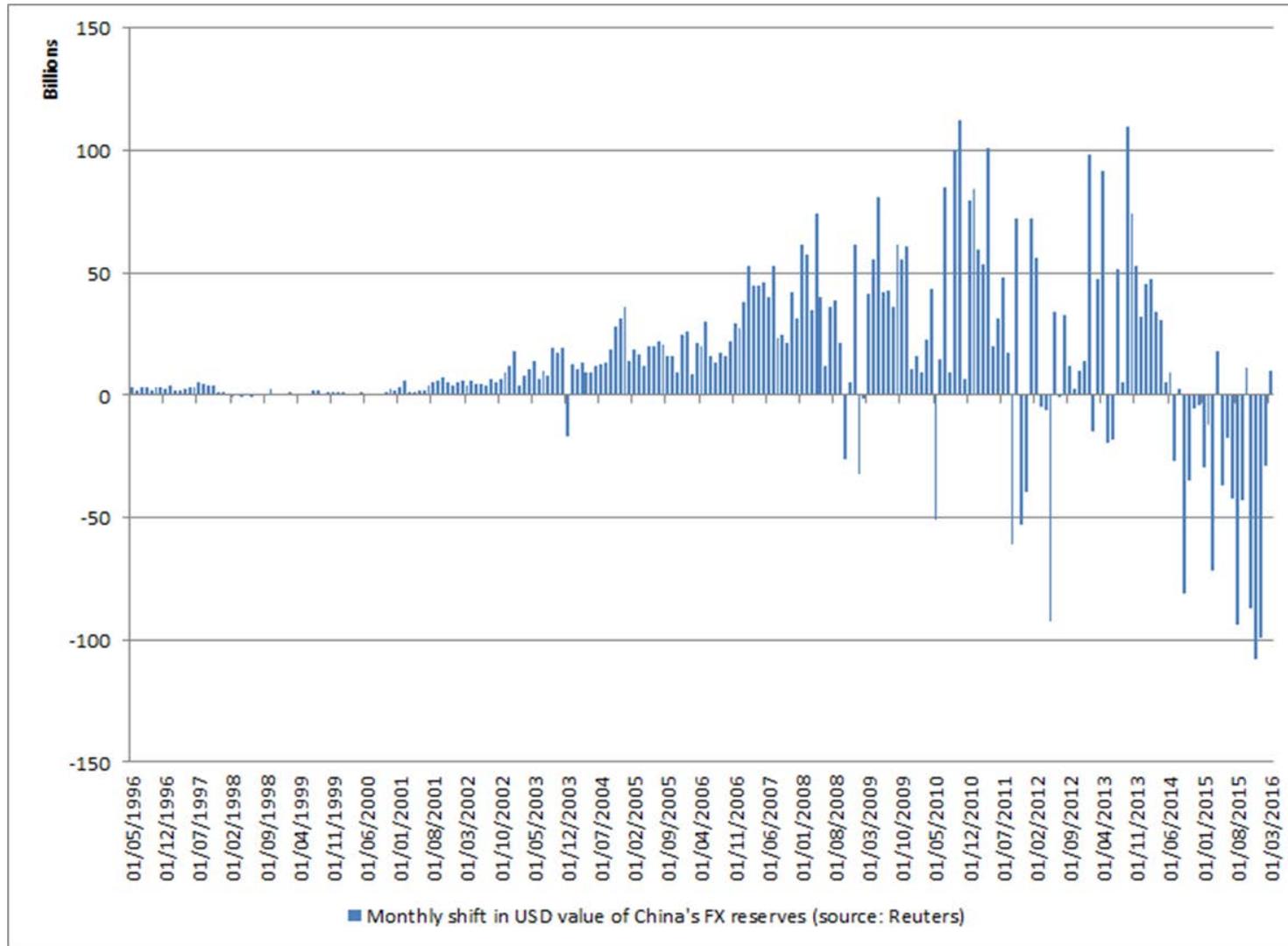
US interest rate forecasts

Figure 2. FOMC participants' assessments of appropriate monetary policy: Midpoint of target range or target level for the federal funds rate



Source: US Federal Reserve

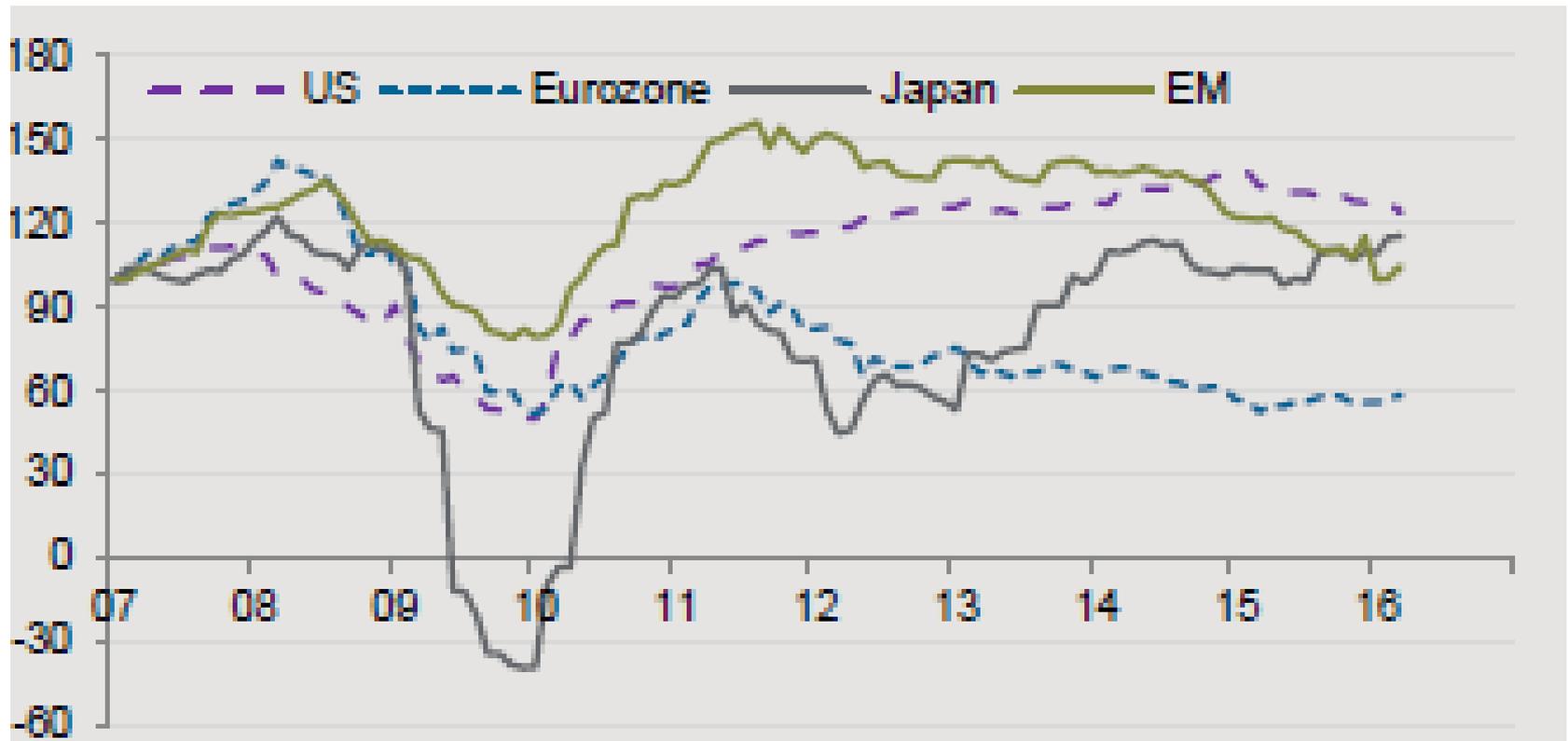
China FX Reserves



Source: BNY Mellon

Corporate earnings

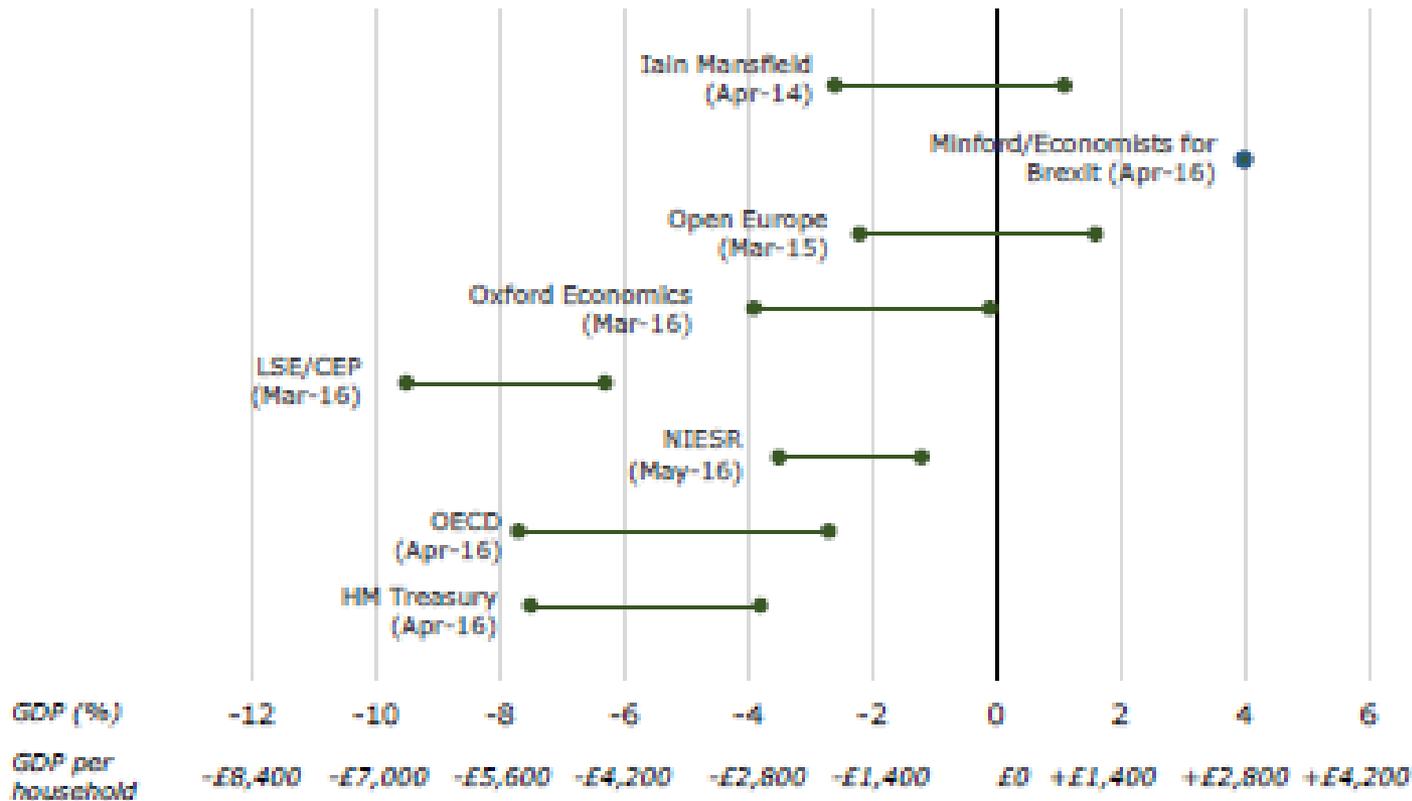
Trailing 12-month MSCI EPS (index, 2007=100)



Source: Datastream, Haver Analytics, MSCI, IBES, OECD, Hibiscus. Data up to 04 April 2016

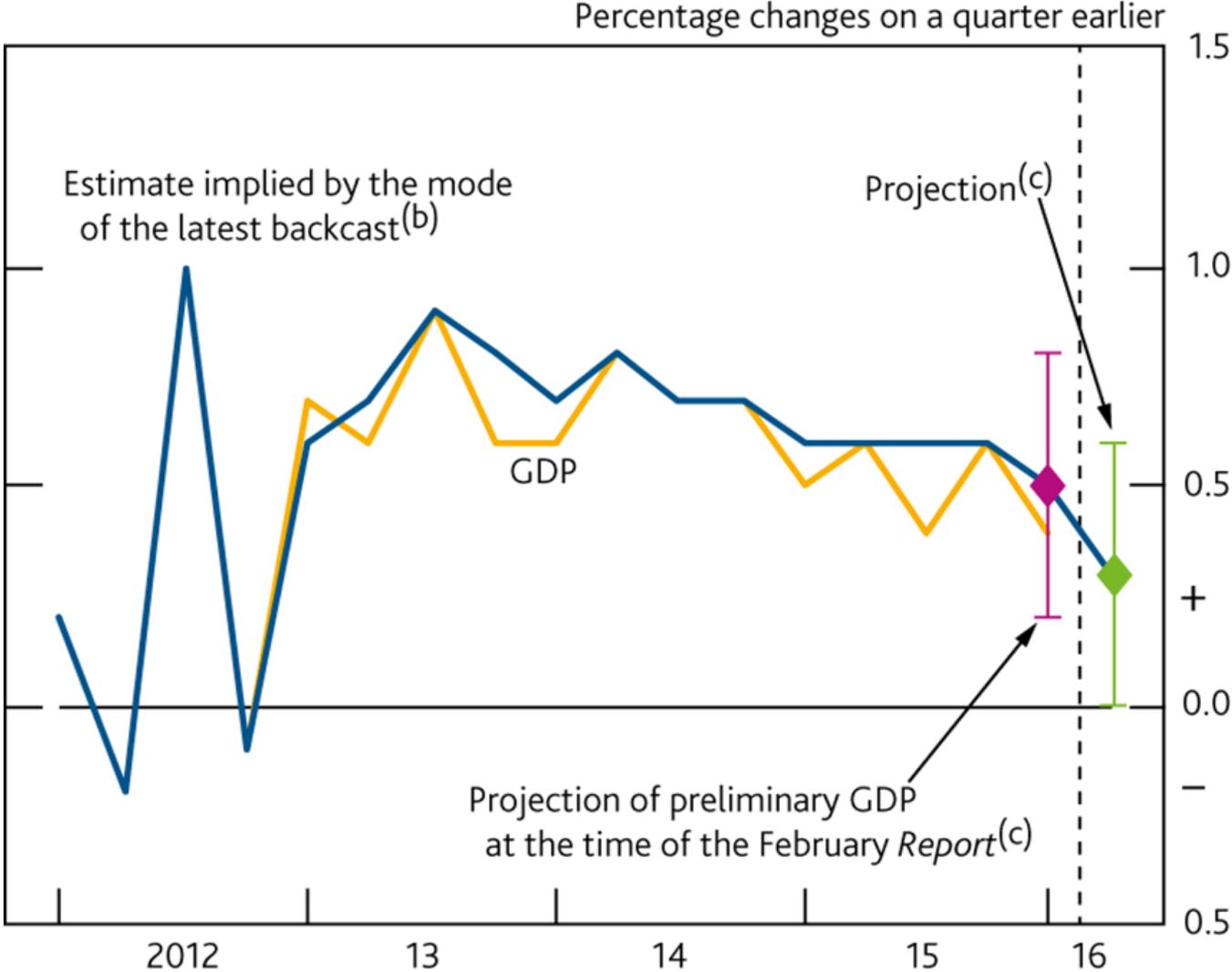
The Aftermath

Long term impact estimates



Source: Treasury Select Committee

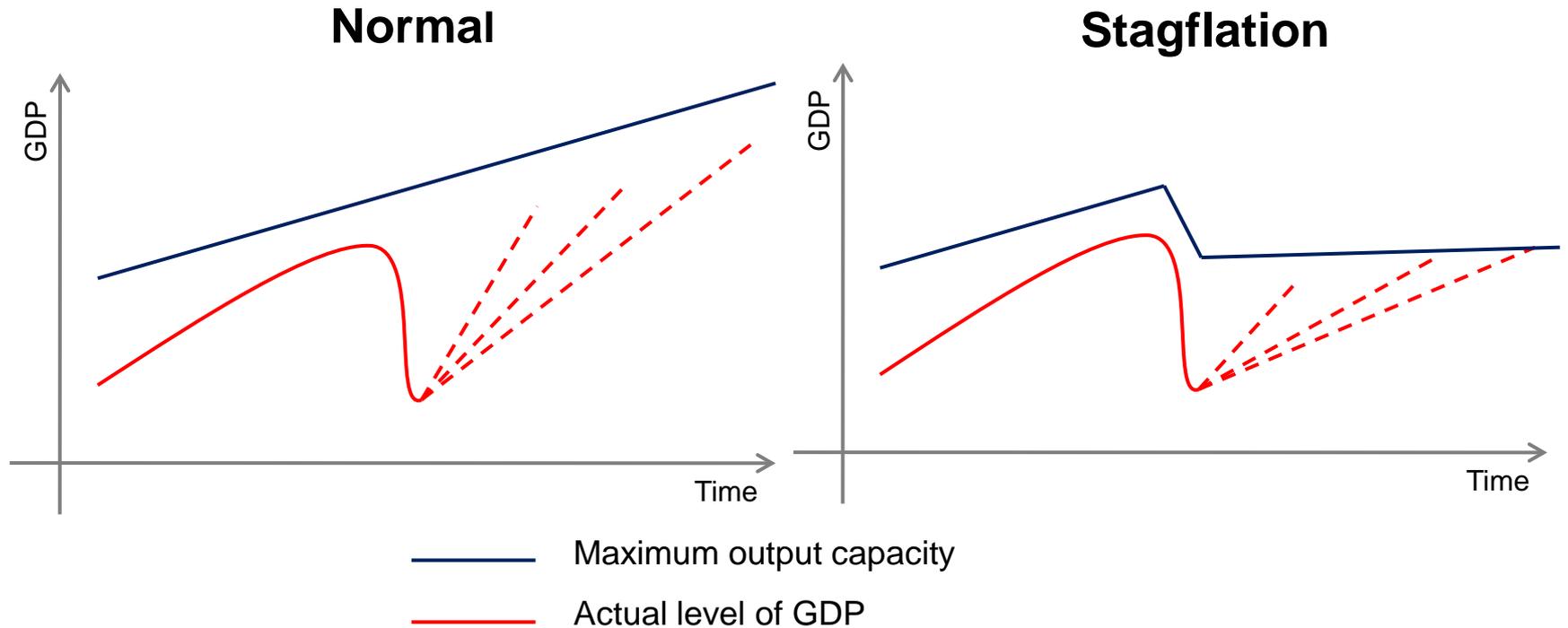
UK GDP Growth



Source: Bank of England



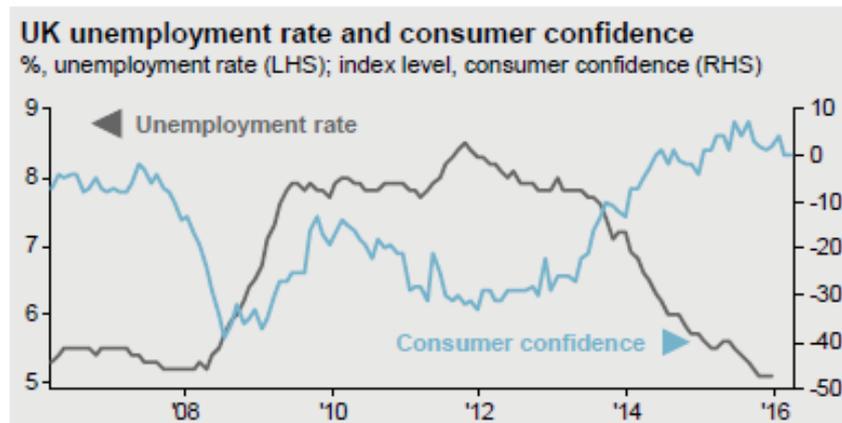
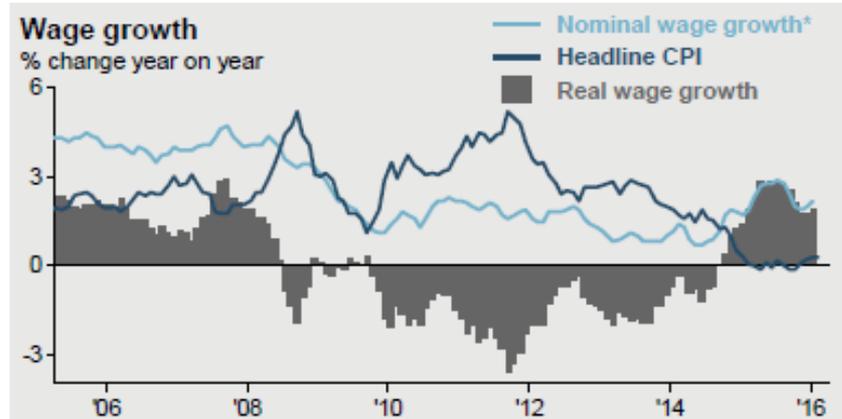
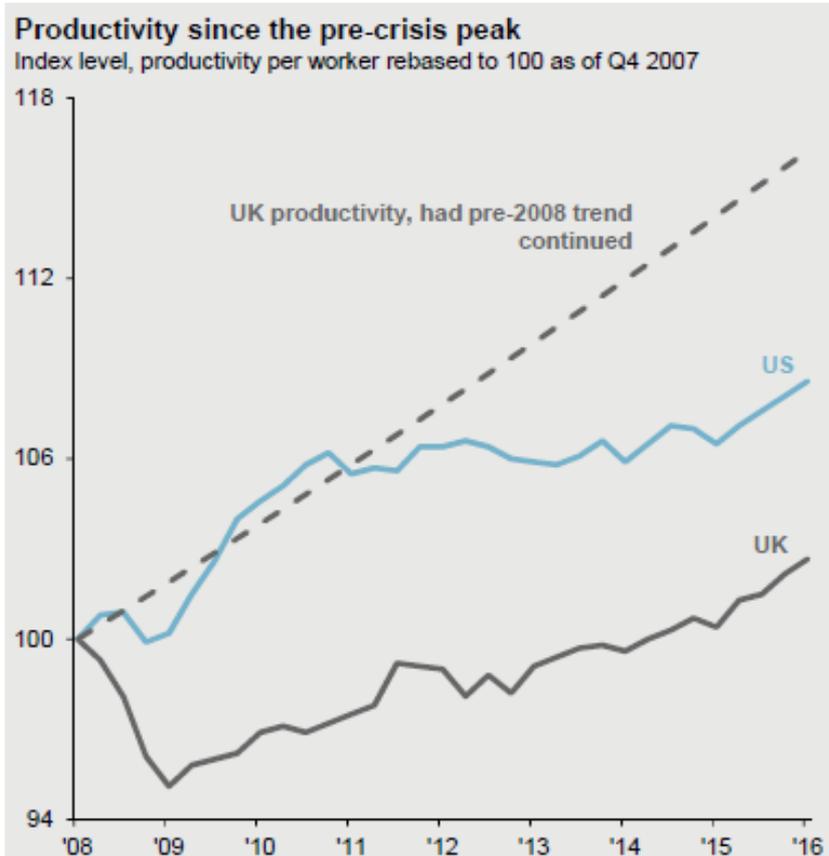
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UK Economy



Source: (Left) BEA, BLS, ONS, J.P. Morgan Asset Management. (Top right) FactSet, ONS, J.P. Morgan Asset Management. *Nominal wages include bonuses. (Bottom right) FactSet, GFK, ONS, J.P. Morgan Asset Management. *Guide to the Markets - UK*. Data as of 31 March 2016.

Source: JP Morgan

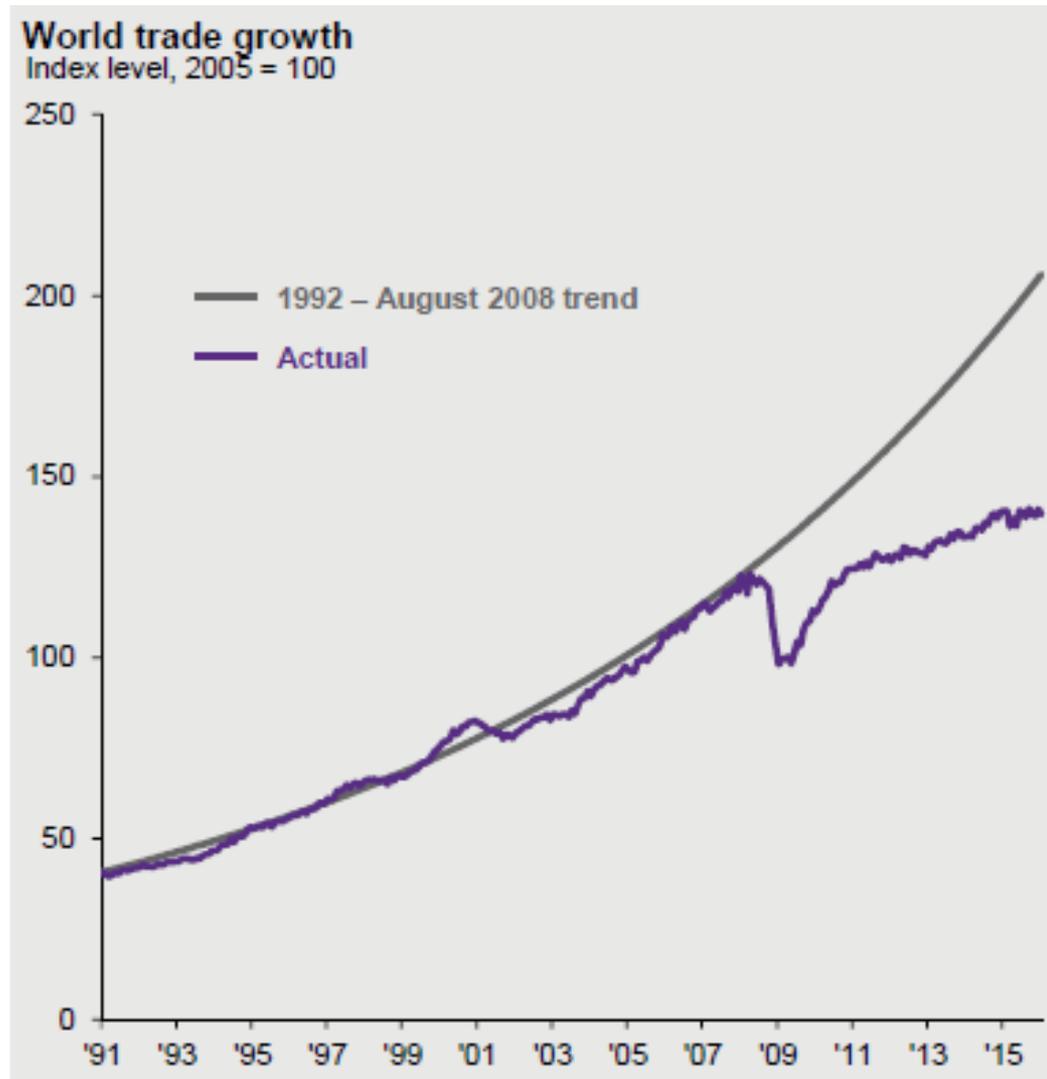
UK Budget

On course to meet the mandate in 2019–20?

- Osborne on course to achieve surplus of £10bn in 2019–20
- Only true because
 - Changed timing of revenues/spending: reduces borrowing by £8bn
 - Pencilled in unspecified spending cuts: reduce borrowing by £3.5bn
- Without these actions, he would have been on course to break the fiscal mandate
- There is considerable uncertainty surrounding borrowing in four years' time
 - OBR: 'margin [£10 billion] is small in comparison with the uncertainty that surrounds our fiscal forecast at that horizon'
 - Further policy adjustments (either tightening or loosening) likely to be needed/possible

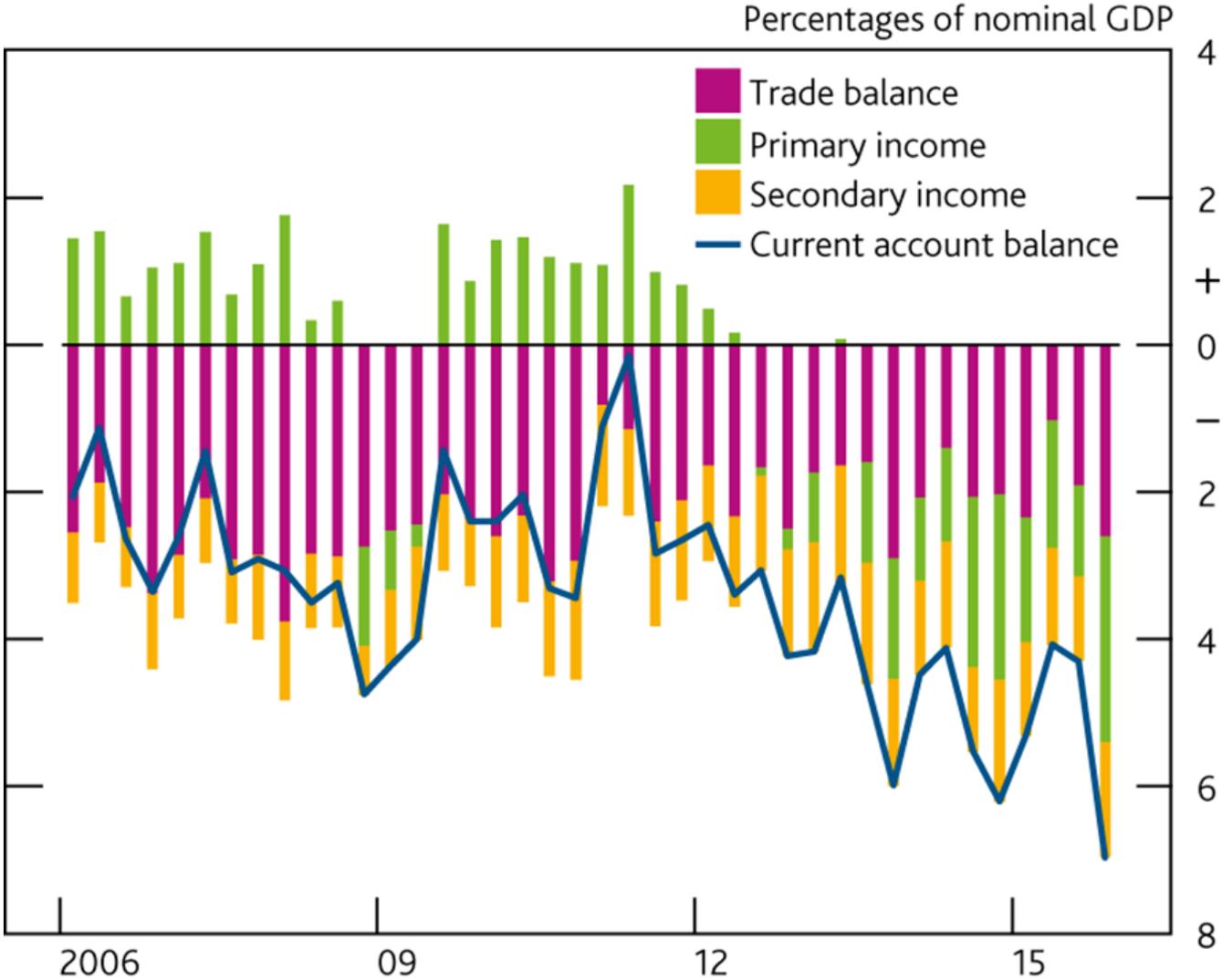


World trade



Source: JP Morgan

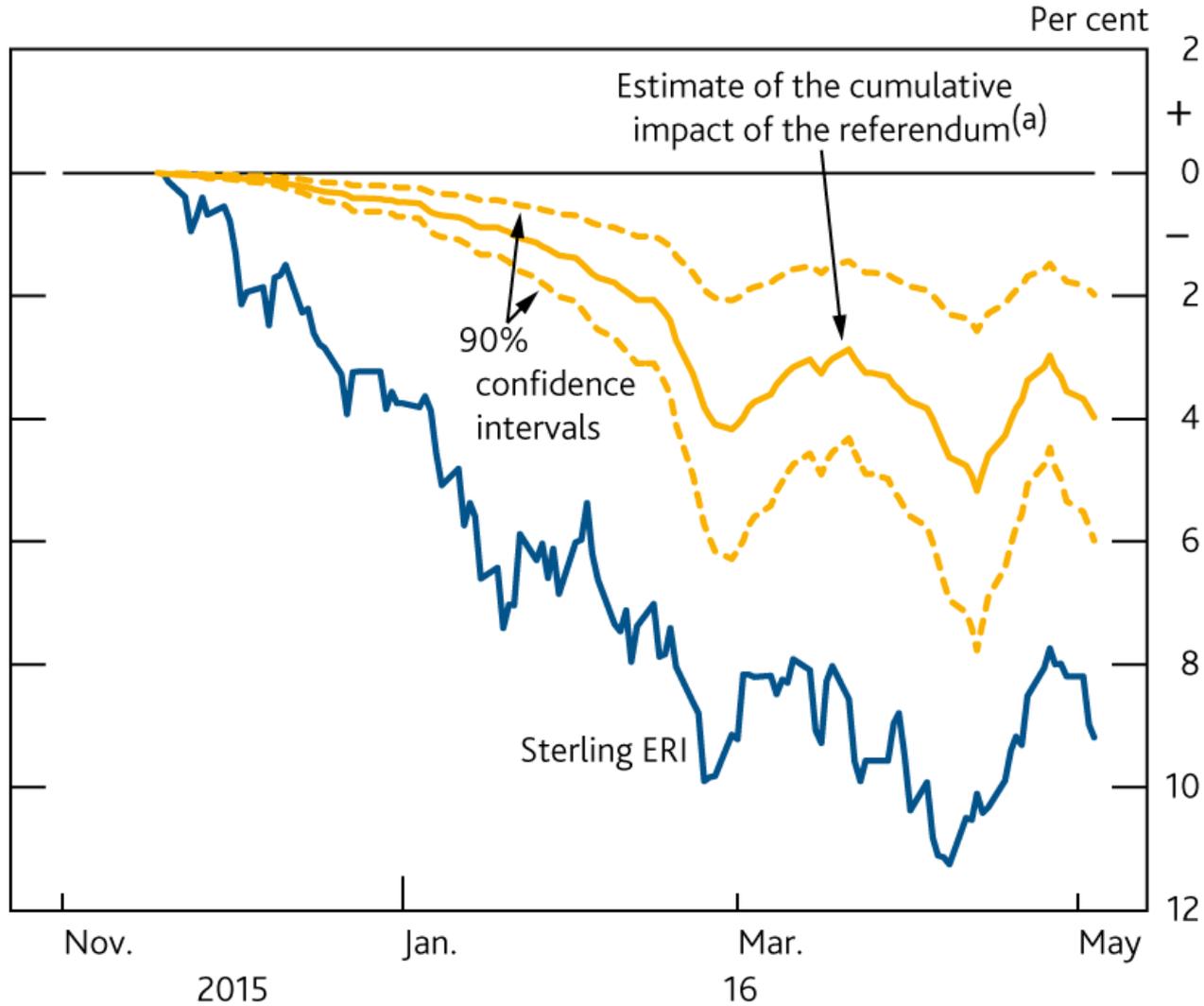
UK Current Account



Source: Bank of England



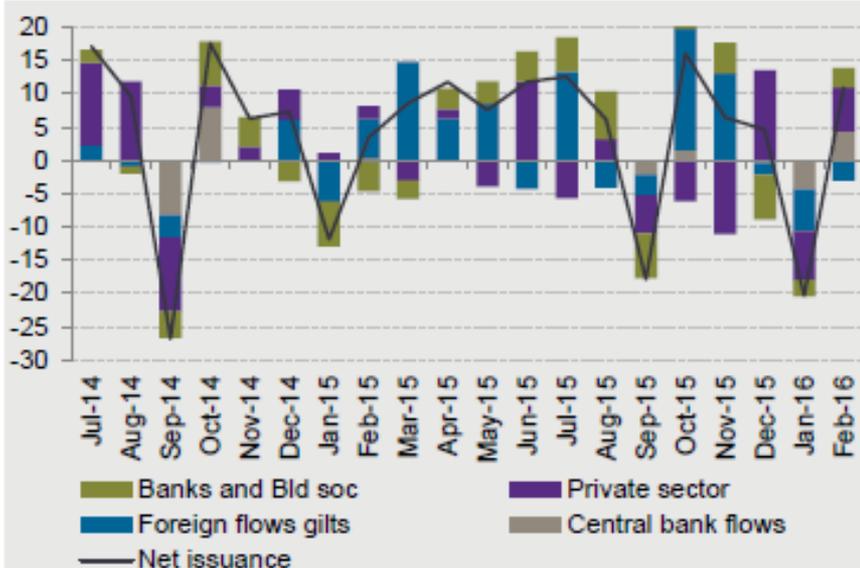
Sterling



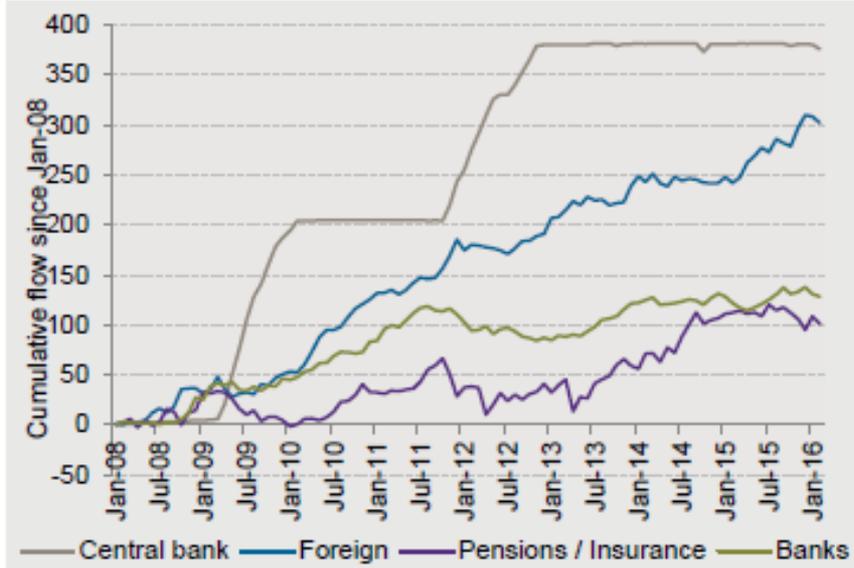
Source: Bank of England

UK Gilt Market

Monthly flows into UK gilts, signs of non-domestic selling



Overseas buyers now hold around 25% of UK Gilts



Source: JP Morgan

Investment markets

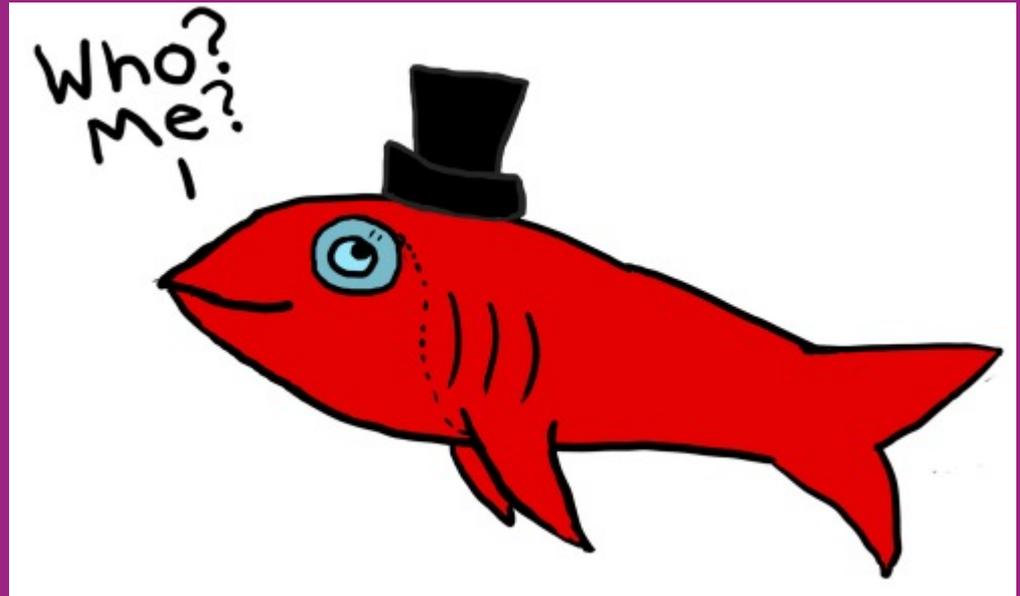
Immediate aftermath

Asset	Remain	Leave
Global Equities	European equities, in particular rebound. Limited by global events, corporate earnings cycle and US political developments.	European equities fall on the back of potential negative implications/uncertainty. Emerging markets least negatively affected.
UK Equities	Likely to rebound on relief sentiment and as risk premia unwind. Relief will be constrained by the closeness of the result, longer term economic developments and political repercussions from a divisive campaign.	Political and diplomatic upheaval will likely lead to sentiment - driven falls. Large cap outperform smaller companies, though impacts very much sector and stock specific, and related to exposure to sterling.
UK Property	Pricing infrequency means little immediate impact.	Pricing frequency means little immediate impact, but some erosion of value possible.
Sterling Corporate Bonds	Risk premia unwind. Credit spreads may tighten.	Credit spreads widen as risk premia increase. Long term issuance and liquidity impairment may hinder investors.
Fixed Interest Gilts	Uncertain – nominal yields likely to correct at least part of pre-Referendum moves. Markets quickly return to being driven by UK interest rate expectations and global macro themes.	Term premia increase. Change in shape of curve potentially as long-end may remain supported by demand though short-end yields fall. Middle part of curve may be affected by negative international sentiment with risk of significant yield rises.
Index-Linked Gilts	Uncertain – real yields may fall.	Term premia increase. Change in shape of curve possible as above. Inflation expectations likely to rise (subject to global factors), though real yields may fall.
Sterling	Risk-premium unwinds. Sterling rebounds but not all pre-Referendum weakness may be recouped.	Severe sterling weakness.

Leave impact: medium term

Asset	Best Estimation
Global Equities	European equities suffer as potential contagion (both political and financial) from the UK vote spreads to Europe. Driven primarily by global macro and political factors.
UK Equities	Uncertain, but probably negative – Financials could struggle in aftermath of vote. Lower economic growth could impact consumer stocks. Exporters could benefit from weaker sterling. Larger companies may outperform smaller, possibly value outperform growth, but will depend on global equity market trends.
UK Property	Foreign investors may reduce UK property holdings. Commercial property weakens on falling demand especially in London and the South-East. Yields rise. May accelerate cyclical downturn.
Sterling Corporate Bonds	Sterling issuance falls, yields widen. Liquidity falls.
Fixed Interest Gilts	Short-end yields suppressed. Potential of UK recession leads the BoE to reduce rate rise expectations and potentially launch a new further monetary policy easing (subject to currency pressures). International credit rating agencies may downgrade, and fiscal projections adversely affected, leading to steepening of curve, possibly particularly pronounced in middle part of the curve.
Index-Linked Gilts	Inflation expectations potentially pick up on sterling weakness. Real yields may remain suppressed.
Sterling	Sterling continues to weaken increasing the risk of a currency crisis. Possible interest rate policy dilemma for Bank of England on whether to increase interest rates if economic growth is still anaemic.

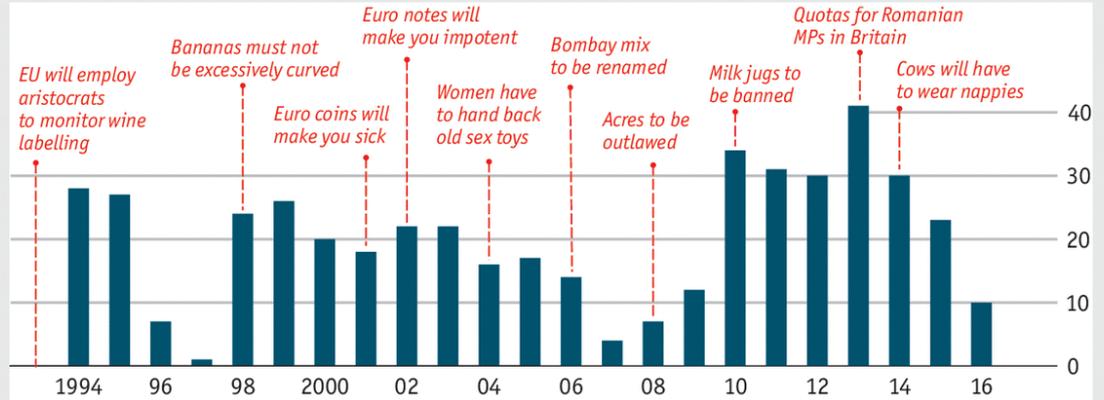
Red Herrings



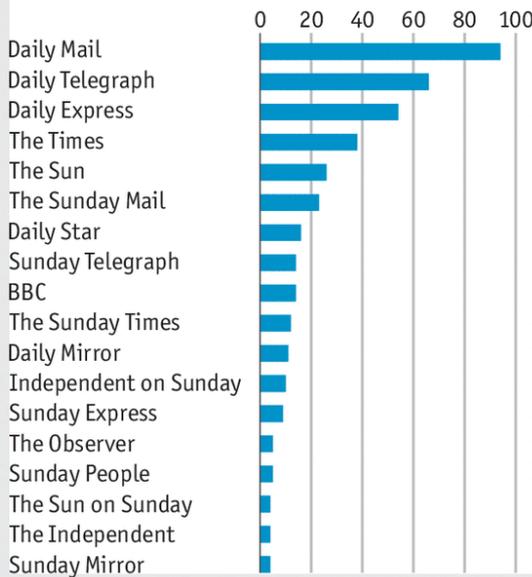
EU myths

Lies, damned lies and directives

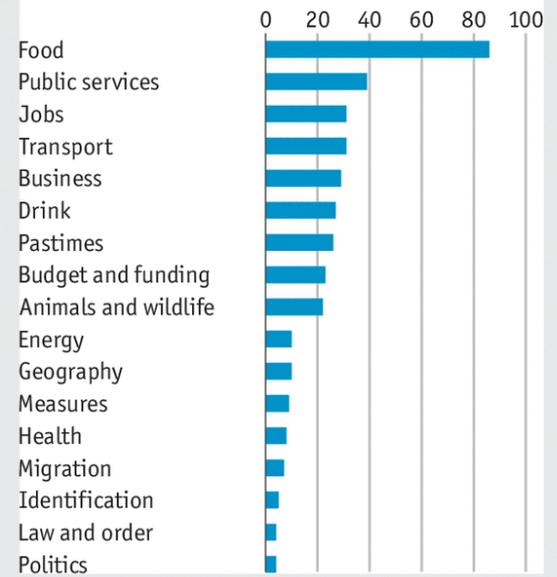
Number of EU myths debunked by the European Commission



By publication



By myth category



Source: European Commission

Economist.com

Simon Hill

Chief Investment Officer

Xerox HR Services
160 Queen Victoria Street
London
EC4V 4AN

T: 020 7429 1261
Email: simon.hill@xerox.com

www.xerox.co.uk/hrconsulting

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