

Market Bulletin

24 June 2016

Brexit - a shock for markets, or a crisis?

Investors have been seriously wrong-footed by the result of the EU referendum. But the shock of City traders this morning is nothing compared with the stunned response of the people who thought they ran the country. The economic and political questions raised by this vote will not be answered for years, possibly decades. But the immediate questions for investors are how long the "risk-off" mood in markets will continue and how much damage it will do in the process.

Our first assessment is that this is a large shock but, ultimately, a local one.

- The UK economy will slow sharply. Our best estimate is that growth will slow from an annualised pace of 1.6% to around 0.6% in the second half of 2016, with a similar growth rate achieved in 2017. We can expect inflation to jump to 3% or 4% by the second half of 2017, as a direct result of the decline in sterling. That compares with a previous forecast of around 1.7%.
- We expect the Bank of England (BoE) to look through the rise in inflation. Policy will surely be looser than it would have been under Breinain. The BoE will make clear its willingness to offer emergency liquidity to the market, but it may well wait to gauge its response to the slowdown in economic activity. We also expect it will think hard before intervening to defend the pound. The fall so far today has been dramatic, by any standard, with the pound at one point falling to its lowest level against the dollar in 30 years. But the scale of the fall has been exaggerated by the rally preceding the vote. Arguably, a double digit decline in the currency is not an over-reaction to a policy change of this magnitude.
- The interplay of domestic and global factors is highlighted by the UK Gilt market, where long-term government bond yields barely moved in early trading. This may have been because domestic "risk-off" flows into bonds were being offset by foreign sales of Gilts. But Gilt yields moved sharply lower after the prime minister, David Cameron, announced his resignation. We would expect Gilt yields to be lower, over time, than if voters had opted to remain in the EU, given the "lower for longer" view on short-term rates outlined above. Put another way, we do not think question marks about sterling will turn into questions about the creditworthiness of the UK government.



Stephanie Flanders
*Chief Market Strategist
for UK & EMEA*

- Further afield, growth in the eurozone will be dented, possibly strengthening the case for the European Central Bank to expand its quantitative easing - bond purchases - in the autumn. If there is a prolonged decline in global market confidence, the US central bank could find it more difficult to move forward with higher interest rates in the second half of 2017. Central banks in countries with "safe haven" currencies, notably the Japanese yen and the Swiss franc, may also come under pressure to ease policy to prevent these currencies rising a lot further.

These are significant consequences. But right now we do not think the Brexit shock poses an immediate threat to the global recovery. Over time, we would expect this reality to be reflected in asset markets outside the UK, particularly in the US, where the stock market has reacted sharply to a result which would be expected to have only modest direct consequences for the US economy. However, it could take some time before the dust settles and investors should expect plenty of volatility, as UK policymakers and the wider world come to grips with the consequences of this historic vote.

This immense shock for the UK will have an economic and financial impact on the rest of the world, but we believe that the fallout should be manageable, if policymakers respond appropriately and investors keep their heads. Whether the political implications will also be containable, particularly in Europe, is another matter.

The views contained herein are not to be taken as an advice or a recommendation to buy or sell any investment in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own professional advisers, if any investment mentioned herein is believed to be suitable to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yield may not be a reliable guide to future performance.

J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. This communication is issued by the following entities: in the United Kingdom by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other EU jurisdictions by JPMorgan Asset Management (Europe) S.à r.l.; in Hong Kong by JF Asset Management Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited; in India by JPMorgan Asset Management India Private Limited; in Singapore by JPMorgan Asset Management (Singapore) Limited, or JPMorgan Asset Management Real Assets (Singapore) Pte Ltd; in Taiwan by JPMorgan Asset Management (Taiwan) Limited; in Japan by JPMorgan Asset Management (Japan) Limited which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Korea by JPMorgan Asset Management (Korea) Company Limited; in Australia to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Cth) by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919); in Brazil by Banco J.P. Morgan S.A.; in Canada for institutional clients' use only by JPMorgan Asset Management (Canada) Inc., and in the United States by JPMorgan Distribution Services Inc. and J.P. Morgan Institutional Investments, Inc., both members of FINRA/SIPC.; and J.P. Morgan Investment Management Inc.

In APAC, distribution is for Hong Kong, Taiwan, Japan and Singapore. For all other countries in APAC, to intended recipients only.

Copyright 2016 JPMorgan Chase & Co. All rights reserved

Compliance ID: 0903c02a814c29c8