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ECONOMIC SPOTLIGHT

WEEK 16 2018



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THE **HUNT** FOR **U.K. ASSETS** BEGINS

In the midst of the Chinese and American verbal war on trade, the most important European economic event for years, the Brexit, has been pushed in the background.

The time for divorce between the EU and Britain is approaching. After all, it is Europe's second largest economy (the same size as France) that shall exit the EU and the single market. There are still unbelievably many unknowns in play, even the overall result for the British economy is uncertain. Personally, I'm still in doubt about many outcomes, though many others are in doubt too, which in turn opens-up opportunities.

The schedule for the separation seems to have been agreed after the EU-U.K. summit last month. When the Article 50 agreement has been fulfilled by March next year, a further transition period has been agreed until December 2020. This means that Britain is finally out of the European Union on January 1st 2021. A condition for the transition period to come into force is that the Article 50 process is finalized by March 2019. Since this roadmap has been established, there has been some discussions in Britain about how fast the legal framework, rules, etc. can be re-established. An open and critical question remains how to handle the current open border towards Ireland. The agreement about a fairly long transition period and the arguments about the complicated legal issues concerning the divorce has led to an ongoing debate- a new Brexit vote.

My main scenario is that there won't be any new Brexit vote and the reality is that Britain is out of the EU in about 2½ years. The million-dollar question remains - which trade agreement can Britain and the EU agree on?

It still can be everything from an EFTA or EEA deal like Norway has to no agreement, and only regulated by the WTO agreement.

Several factors speak against an EFTA / EEA membership because some of the heavy EU countries like France and Spain want to punish Britain as much as possible. In addition, the broadest trade agreements between the EU and U.K. will require the free movement of labour into Britain. This was what most Britons voted against at the Brexit.

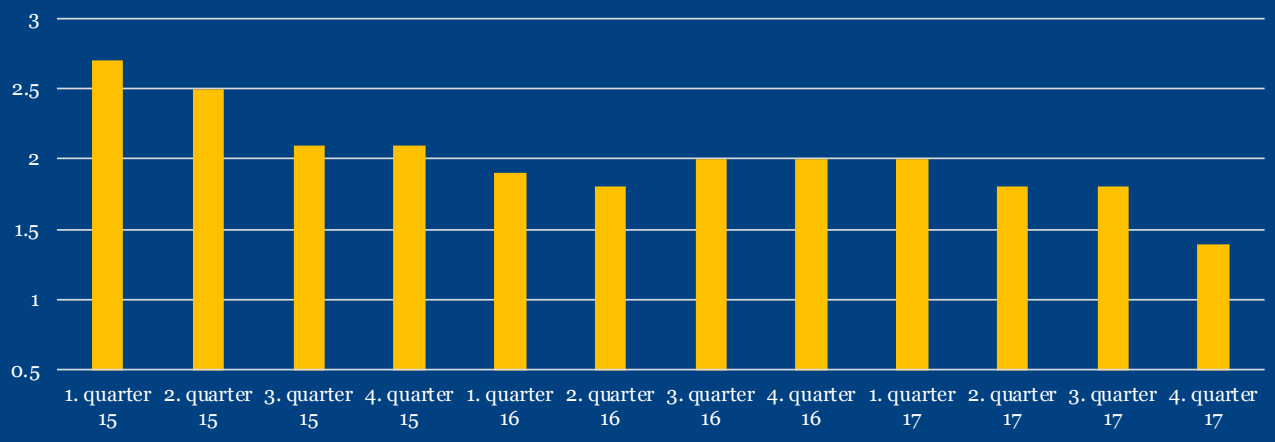
Conversely, the various member countries in the EU are pragmatic enough to let life to go on with the loss of as few jobs as possible. This suggests that, as a minimum, a free trade agreement for all manufactured goods is found, but without a trade agreement the covers the service sector.

The economically dominant part of the services sector is of course the financial sector. The dream in both Paris, Frankfurt and Amsterdam, since the Brexit vote has been to take over London's role as Europe's leading financial centre. But one should not forget that London had a leading position in the financial industry long before the EU was conceived. Also involving my own more than 10 years of professional work in Germany's financial metropolis Frankfurt, my assessment is that the continent cannot offer an alternative to London as a new European financial centre.

Some operations will be moved from Lon-

***Graphic 1*:**

GDP-GROWTH PER QUARTER ANNUALISED IN PCT.



Source: Office for National Statistics, United Kingdom

don to locations within the Eurozone. However, if one looks at the plans so far, the impact is relatively limited and primarily concerning support jobs.

This situation, or reality, could also be apparent for the negotiators and therefore, my expectation is that the service sector won't weigh so much in the negotiations in the future. It speaks for an agreement between the EU and the UK, which also partially includes the service sector and therefore is broader than the financial market's current fear - this outcome is my main scenario at the moment.

Although Britain's new life formally starts on January 1st 2021, my focus is on the developments/negotiations from now until March next year. My expectation is that during this period, everything finally will be negotiated, which affects the financial market's pricing of financial assets, exchange rates, etc. Since much about the Brexit remains unknown, then 11 months won't be long for investors that are considering new investments in the U.K.

For investors, the very basic question of course, is whether the UK economy is moving down the drain towards a black hole of uncertainty and dropping domestic demand? Or whether the next 11 months' clarity (hopefully) about agreements with the EU as well as free trade agreements with other countries, results in prosperity for the UK economy?

After the Brexit vote, it was inevitable that the sudden uncertainty would affect the economic growth negatively. As graphic one shows the GDP growth rate has been under pressure for some years. Though one should remember that the GDP growth for a number of years was high after the financial crisis and significantly higher than in most other EU countries.

Some important figures have recently surprised positively where graphic two is an example. House prices show surprising strength again where not only the low interest rates but also the strong labour market are important reasons. Based on the same developments, the consumer confidence also surprised positively in March which showed the highest level since May last year.

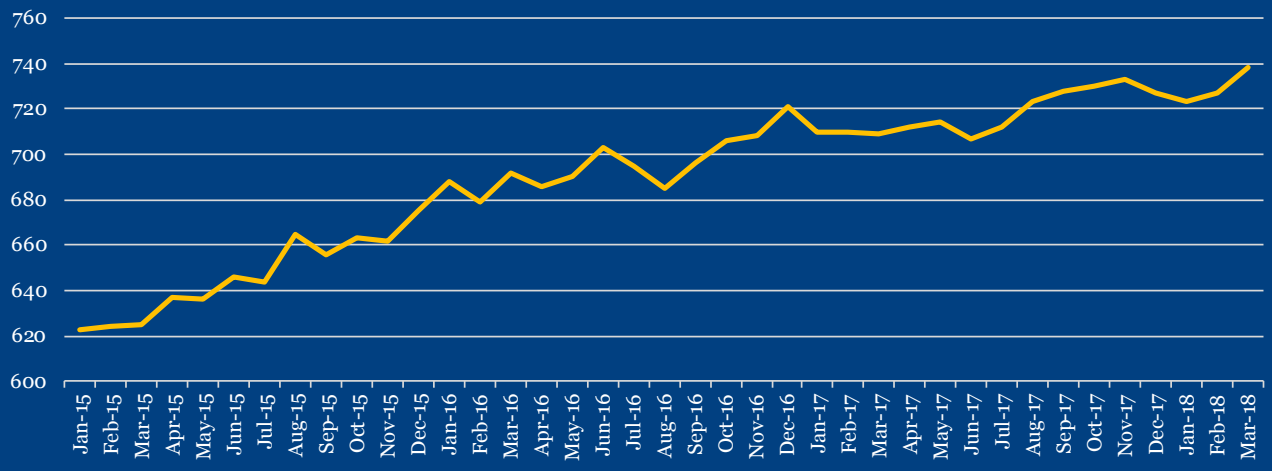
Investors with risk appetite and interest in a larger allocation to Britain will without no doubt soon be on the hunt for new investments in the country. I can imagine that some might consider how much London's real estate market really should be hit.

Naturally, companies that benefit from an increasing consumer confidence are already under the loupe.

Personally, I have been waiting for the negotiations between the EU and Britain to enter into a constructive phase like it now has entered. My assessment is that it will comfort the financial markets – therefore another main scenario is that the British pound will rises by 10 pct. against the euro until March next year.

Graphic 2 **:**

HOUSING PRICES INDEX



Source: FRED, Fed St. Louis

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