

thenavigator

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Source: Tom Janssen / Cagle Cartoons

Cheerio United Kingdom and welcome little Britain!

My heart is broken.

To see the country I grew up in and my grandparents fought two wars to preserve their freedom, reduced to the current mess it is in, is unbearable. The rise of xenophobia, father against daughter, rich versus poor, north versus south... To see the Great British pound tumble like an emerging market currency and watch the country's credit rating being downgraded with perhaps more downgrades to follow. To realize that the Scots are likely to break away followed by the Northern Irish. To have a country that is effectively leaderless with both major political parties in disarray. What for?

Purely for the selfish ambitions of two politicians! David Cameron's ambition to quiet

Bring me my Bow of burning gold;
Bring me my Arrows of desire:
Bring me my Spear: O clouds unfold!
Bring me my Chariot of fire!

I will not cease from Mental Fight,
Nor shall my Sword sleep in my hand:
Till we have built Jerusalem,
In England's green & pleasant Land.

William Blake, "Jerusalem"

the hard core Eurosceptic faction of the Conservative party by allowing a referendum on the membership of the European Union, followed by Boris Johnson's naked ambition to become prime minister at any cost, which just this minute has failed.

It is telling that, when the leave victory was announced, both Boris Johnson and Michael Gove looked like two children, who had their toys taken away. They were, no doubt, hoping for a narrow remain victory, whereby the prime minister would be severely undermined, while they could make their grab for power.

The promises made during the referendum seem to have vanished in a puff of smoke just like the plans on what comes next. The promise of a stronger, more prosperous country was just fool's gold sold to the people by charlatans. The UK is now facing the possibility of becoming an inward looking country reminiscing about the good old days of the empire. It seems to be forsaking its rightful place in the world. Surely, Great Britain's fitting role was at the head of Europe, balancing out the socialist tendencies of the French against the rigid rule followed by the Germans by adding an Anglo Saxon dose of pragmatism.

The BREXIT hangover is now in full effect, and we will need cool heads and warm hearts to get through it.

Looking at some of the other countries around the world experiencing similarly extreme rise of populism, I urge you to use wisdom instead of emotion, hope instead of hate, diplomacy over aggression, and humanism over nationalism. I know, that we are all upset with our current ineffective governments, but do not sell the future of your children and grandchildren so cheaply. Do not fall for the arguments to become more inward looking, listen to the voices around you even though they may not always agree with yours. Let compromise and mutual benefit lead you like a shining beacon out of this period of darkness.

This fragile planet is the legacy we leave to the generations ahead. Let's all work together in an outward looking way to secure and improve it.

Or was it just a nightmare?

Looking at the facts and taking emotion out of the picture - what has actually happened?

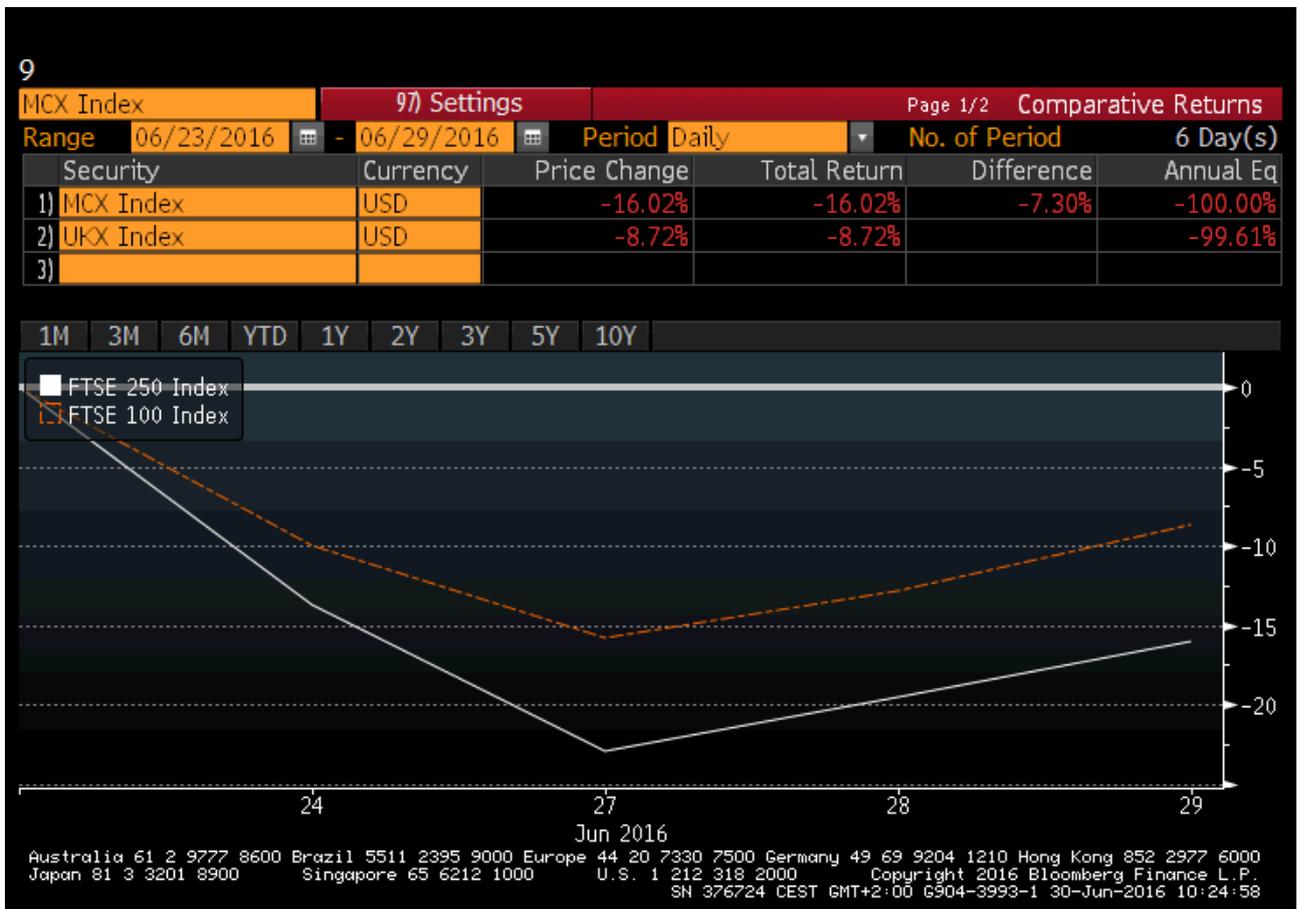
The UK has announced its intention to leave the European Union but has not activated article 50 of the Lisbon treaty, which formally confirms this decision and starts the two year clock ticking for it to leave. If all remaining countries (27) agree, then the two year time frame can be extended. Therefore, effectively at this point in time, the UK is still a member of the European Union. There seems to be no rush to trigger article 50, and the current British prime minister has made it clear that this will be up to his successor, who will not be appointed until 9th September at the earliest. Some of the possible candidates for this job have made it clear, that they are in no rush to trigger article 50. Maybe, just maybe, it will never be triggered!

It is important to note, that in the UK a referendum is advisory and not legally binding. Thus, before the final act of leaving the EU is formalized, it has to be approved by the parliament, where 75 percent of MPs are in favor of staying in the EU. It would be a political suicide to ignore the will of the people. Yet, the opinions of many no-voters have changed since. Adding the fact that Scotland and Northern Ireland are likely to withhold their support for an exit, poses somewhat of a dilemma. There is even the possibility of a second referendum, if the terms of UK's relationships change significantly, and perhaps even a general election, which could null and void the referendum result, depending upon what the winning political party has in their manifesto.

There is a new verb about to enter the German language - "Merkeln", which means to do nothing or failing to make decisions. Perhaps the best English equivalent is dithering. In the environment we are in at the moment, perhaps a long pause for breath is what is needed for emotions to cool somewhat.

The sharp knee jerk reaction of markets following the referendum results suggests that many market participants assumed a wrong position and were effectively caught with their pants down.

Performance of FTSE 100 compared to broader FTSE 250 after BREXIT vote



Source: Bloomberg L.P.

The recovery in the FTSE100 share index hides the pain that is already impacting British businesses, as a large proportion of the index consists of large caps, whose profits are generated overseas and, therefore, profit when GBP falls. Perhaps a fairer reflection is the FTSE250 index, which shows the extent of the pain already suffered.

It seems pretty obvious that the uncertainty will most likely slow down consumer spending, increase job losses, and postpone investments by businesses until the situation becomes clearer. The overall impact will probably be not as bad as the stay-in camp predicted, but also worse than the Brexiteers claimed.

A new hope?

At the moment we are in a political crisis, which has not migrated into an economic one yet. Earlier this year markets fell by more, yet economies did not go into a recession. Looking at exports into the UK, in the Eurozone they account for only 3.3% of GDP, whilst in the USA they account for 0.5%. Assuming a downward revision of 0.3% of Eurozone GDP growth over the next 18 months, it would put the expected GDP growth at 1.8% in 2016 and 2% in 2017 – hardly a disaster, but European markets, especially, seem to be pricing in a much worse scenario.

As a result of this turbulence, central banks are likely to keep monetary policy easy for the foreseeable future. It now seems highly unlikely that the FOMC will raise rates this year. The BOE is likely to cut interest rates and unleash QE, while the ECB will probably expand its current QE program.

Performance of S&P 500, FTSE 100 and EuroStoxx 50 indices in 2016



Source: Bloomberg L.P.

We do not expect a disintegration of the Eurozone, as some commentators have predicted. Despite unhappiness with the Brussels' bureaucracy and the open door immigration policy, most Europeans are still positively disposed towards the Union. Stepping back from the headlines, 440mn consumers are just not going to disappear off the face of the earth. Some kind of equivalent structure would also be needed to facilitate free trade and deal with global issues such as climate change. It would also leave a large gap in the geopolitical world, where currently Europe acts as a buffer between Chinese and American self-interests.

Whilst the current structure of the European Union was appropriate after the Second World War, it had become glaringly obvious that urgent reforms were needed. The BREXIT result has, in our opinion, provided a much needed wake-up call and is likely to result in a European Union that is less bureaucratic, more accountable to voters, takes account of immigration concerns, and has better PR.

One could also easily imagine a Eurozone of concentric circles with Germany, France, Italy, Spain and Holland moving towards fiscal and political union. This core would be optional. In the circles that orbit around it, there would be countries that either were not in the correct shape to join or those that just wouldn't want such a close union.

Let's assume for a moment that BREXIT goes ahead. Then, we are effectively looking at what is probably the world's most complicated divorce (and perhaps the most lengthy) likely to develop into a relation of 'friends with benefits'. The UK could possibly adopt a Norway-style deal with perks, which would grant it an access to the free markets.

None of the scenarios we see are a death blow to global growth. Yes, it may slow down a bit, but we have become used to this stop-start phenomenon for almost a decade.

As I started with some poetry, I might as well finish with, perhaps appropriate for the times we live, in an excerpt from Rudyard Kipling's "If".

*If you can dream - and not make dreams your master;
If you can think - and not make thoughts your aim;
If you can meet with Triumph and Disaster
And treat those two impostors just the same;
If you can bear to hear the truth you've spoken
Twisted by knaves to make a trap for fools,
Or watch the things you gave your life to, broken,
And stoop and build 'em up with worn-out tools;*



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