Trade Idea – Foreign Exchange

Brexit: First impressions

29 July 2016

Central banks hold fire

- Following the UK’s EU referendum, both the Bank of England (BoE) and the European Central Bank (ECB) have chosen to hold off on implementing pre-emptive easing measures, waiting instead for data to confirm the initial economic impact of the vote. However, the reality is that relevant data for the UK and Eurozone will take months to come available, which creates a period of heightened volatility for currency markets. Participants and central bankers alike will study upcoming reports for indications of whether Brexit concerns have materialised, making markets subject to pronounced moves. Below, we examine how upcoming data releases and political events in Europe could reinforce mainstream Brexit fears and the potential impact on key exchange rates.

The economic angle

- From an economic perspective, apart from the obvious worry over the future of UK-EU trade relations, fears arose that the uncertainty associated with a Brexit outcome would inhibit European enterprises from making investment and staffing decisions. Worries grew that this would trickle down to the consumer and result in lower expenditure and economic growth. Early survey data of business activity and economic sentiment have been mixed. On the one hand, the widely observed ZEW survey of Eurozone Economic Sentiment (Source: [www.zew.de/en/](http://www.zew.de/en/)) experienced the sharpest drop on record, while preliminary Eurozone manufacturing data for July was healthy. More concrete data on the strength of UK and Eurozone economic activity will come in the form of preliminary GDP numbers and industrial production due from middle of August to September (see Figure 1). Should these releases beat analyst expectations then positive sentiment towards Europe will likely lend broad based support to the EUR and GBP. However, if these surprise considerably to the downside then the opposite will likely be true.

**Figure 1: Economic calendar - 2016**

<table>
<thead>
<tr>
<th>Month</th>
<th>Date</th>
<th>UK</th>
<th>EU</th>
</tr>
</thead>
<tbody>
<tr>
<td>July</td>
<td>28</td>
<td>Consumer Confidence</td>
<td>Inflation data (July Prelim)</td>
</tr>
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<td></td>
<td>29</td>
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<tr>
<td>August</td>
<td>1</td>
<td>Markit Manufacturing PMI</td>
<td>Markit Manufacturing PMI</td>
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<td></td>
<td>3</td>
<td>Markit Services PMI</td>
<td>Markit Services PMI</td>
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<tr>
<td></td>
<td>4</td>
<td>BoE Meeting/Minutes/Inflation Report</td>
<td>Markit Composite PMI</td>
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<td>9</td>
<td>Markit Composite PMI</td>
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<tr>
<td></td>
<td>10</td>
<td>NIESR Jul GDP estimate</td>
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<tr>
<td></td>
<td>11</td>
<td>RICS Housing Price Balance</td>
<td></td>
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<tr>
<td></td>
<td>16</td>
<td>CB Leading Economic Index</td>
<td></td>
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<tr>
<td></td>
<td>18</td>
<td>Inflation data</td>
<td>Inflation data (July Revised)</td>
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<tr>
<td></td>
<td>31</td>
<td>Retail Sales</td>
<td>Preliminary Q3 GDP Estimate</td>
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<tr>
<td></td>
<td></td>
<td></td>
<td>Unemployment Rate</td>
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<tr>
<td>September</td>
<td>5</td>
<td>Industrial Production</td>
<td>Retail Sales</td>
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<tr>
<td></td>
<td>7</td>
<td></td>
<td>ECB Meeting &amp; Press conference</td>
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<tr>
<td></td>
<td>8</td>
<td></td>
<td>Industrial Production</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td>Consumer Inflation Expectations - N12M</td>
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<tr>
<td></td>
<td>14</td>
<td>ILO Unemployment</td>
<td></td>
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<tr>
<td></td>
<td>15</td>
<td>Average Earnings</td>
<td></td>
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<tr>
<td></td>
<td>20</td>
<td>BoE Meeting/Minutes</td>
<td>ECB Meeting &amp; Press conference</td>
</tr>
<tr>
<td></td>
<td>27</td>
<td>Preliminary Q3 GDP Estimate</td>
<td></td>
</tr>
</tbody>
</table>

Source: Bloomberg, ETF Securities, PMI = Purchasing Managers Index, NIESR=National Institute of Economic and Social Research, RICS=Royal Institute of Chartered Surveyors, CB=Conference Board, N12M = Next 12 months, ILO=International Labour Organisation.

*All figures quoted are sourced from Bloomberg unless stated otherwise.
• Inflation is another key area likely to be impacted by the Brexit. In the UK, a weaker GBP suggests greater imported price pressure, but this could well be offset by weaker domestic activity. In the Eurozone, Brexit presents further downside risks to an inflation rate which has been below target for almost four years. In mid-August, should UK and Eurozone inflation data disappoint then both the BoE and ECB will have scope to implement greater monetary stimulus, especially if lower inflation starts to embed itself in expectations. Weak inflation data should therefore place the GBP and EUR under pressure as market expectations for further easing rise.

**Political risks**

• For mainland Europe, a major concern was that a UK vote to leave the EU would garner momentum for right wing nationalist movements on the continent. In Italy, Germany and France upcoming referendums and elections threaten the rule of incumbent administrations and a loss at either could trigger a period of political instability. Italian president, Matteo Renzi, has set the date for a constitutional referendum in October and has vowed to resign should his reform agenda fail. While polls show a Renzi victory as marginally more likely, the Brexit has shown that tight elections can produce surprise results. Recent mayoral elections in Rome and Turin have shown that the Italian nationalist Five-Star Movement has gained real public support and a loss for Renzi in October could see calls for an election. The outcome of the Italian referendum carries considerable weight and poses a threat to the future of the Eurozone and in turn the EUR. A loss could build momentum for right wing protectionist parties all over Europe during a time when a series of terrorist attacks have increased public discontent with established political parties.

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- ETFS Long EUR Short GBP (GBUR)
- ETFS Short EUR Long GBP (URGB)
- ETFS Long USD Short GBP (GBUS)
- ETFS Short USD Long GBP (USGB)

**USD Base**
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- ETFS Short GBP Long USD (SGBP)
- ETFS Long EUR Short USD (LEUR)
- ETFS Short EUR Long USD (SEUR)

**EUR Base**
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- ETFS Short USD Long EUR (XBJQ)
- ETFS Long GBP Short EUR (EUGB)
- ETFS Short GBP Long EUR (GBEU)

**3x**
- ETFS 3x Long USD Short EUR (EUS3)
- ETFS 3x Short USD Long EUR (USE3)
- ETFS 3x Long GBP Short EUR (EGB3)
- ETFS 3x Short GBP Long EUR (GBE3)
- ETFS 3x Long GBP Short USD (LGB3)
- ETFS 3x Short GBP Long USD (SGB3)
- ETFS 3x Long EUR Short USD (LEU3)
- ETFS 3x Short EUR Long USD (SEU3)
- ETFS 3x Long USD Short GBP (USP3)
- ETFS 3x Short USD Long GBP (PUS3)
- ETFS 3x Long EUR Short GBP (EUP3)
- ETFS 3x Short EUR Long GBP (SUP3)
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5x

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- ETFS 5x Short USD Long EUR (5CH6)
- ETFS 5x Long USD Short GBP (USP5)
- ETFS 5x Short USD Long GBP (PUS5)

Basket

- ETFS Bullish GBP vs G10 Currency Basket Securities (LGBB)
- ETFS Bearish GBP vs G10 Currency Basket Securities (SGBB)
- ETFS Bullish USD vs G10 Currency Basket Securities (LUSB)
- ETFS Bearish USD vs G10 Currency Basket Securities (SUSB)
- ETFS Bullish EUR vs G10 Currency Basket Securities (LEUB)
- ETFS Bearish EUR vs G10 Currency Basket Securities (SEUB)

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