



# WEEKLY ECONOMIC INSIGHTS

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## HIGHLIGHTS OF THE WEEK

**Economist insights: In the United States, the mid-term elections are drawing near and inflation is decelerating, in the eurozone the ECB maintains its course (p.2)**

- › In the US, with the forthcoming mid-terms on 6 November, the latest polls indicate a probability of 74.6% that the Democrats would win the majority in the House of Representatives
- › While US data continues to indicate good momentum, core inflation fell back from 2.4% to 2.2% in August, notably due to a drop in apparel and medical care prices
- › In the eurozone, the ECB maintained its monetary policy unchanged and kept a similar tone in its communication as in June 2018, as we expected

## Focus Brexit: What is the outlook for the UK? (p.5)

- › The risk of a disorderly exit of the UK from the European Union has increased: talks have not made any headway since March 2018 and the disaccord over the Irish border does not appear to have a solution
  - › Furthermore, none of the European Union's existing trade models are able to meet the demands of the two parties, which maintains a high level of uncertainty surrounding the UK's outlook
  - › According to our analysis, even if a deal is made over the Brexit conditions, the UK's economic growth would decelerate in 2019
  - › A no-deal Brexit, on the other hand, would imply a 15% drop in the pound, a sharp rise in Gilt yields and a drop in residential property prices of 25% to 35% over the next three years
  - › However, the impact of a no-deal Brexit on the eurozone would be limited, thanks notably to the relocation of some of the financial services activities that up to now have been domiciled in the UK
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# IN THE UNITED STATES, THE MID-TERM ELECTIONS ARE DRAWING NEAR AND INFLATION IS DECELERATING, IN THE EUROZONE THE ECB MAINTAINS ITS COURSE

## IN THE UNITED STATES, THE MID-TERM ELECTIONS ARE DRAWING NEAR AND INFLATION IS DECELERATING, WHILE ECONOMIC INDICATORS REMAIN STRONG

The United States mid-term elections will take place on 6 November. The Republicans currently have the majority in the two chambers of Congress, with 51 seats in the Senate (vs. 49 for the Democrats) and 235 seats in the House of Representatives (vs. 193 for the Democrats). According to the latest polls, while the Republicans are likely to conserve their majority in the Senate, they would nevertheless probably lose it to the Democrats in the House of Representatives.

In fact, in the Senate, 35 of the 100 seats will come up for re-election on 6 November, 9 of which are currently held by Republicans, 24 by Democrats and 2 by Independents. The Republicans thus start off with an advantage, given that they conserve 42 seats, vs. only 25 for the Democrats. [This is in line with the latest polls carried out by FiveThirtyEight, which indicate a 71.3% probability that the Republicans will conserve their majority in the Senate.](#)

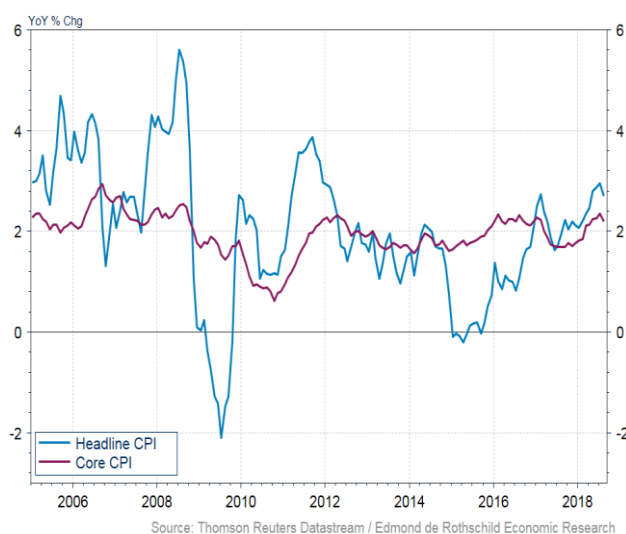
Conversely, in the House of Representatives, the 435 seats are up for election and a change in majority is thus more probable. [Current polls indicate a 74.6% probability that the Democrats will win the majority in House of Representatives, with an average gain of 35 seats](#) (80% chance that the Democrats will win between 14 and 58 seats). These results would be consistent with the mid-term election results observed historically, i.e. which are often unfavourable to the incumbent president (see table 1). In the last 50 years, only George W. Bush and Jimmy Carter won the support of the two chambers in the mid-term elections.

Table 1: In the past 50 years, only George W. Bush and Jimmy Carter won the support of the two chambers in the mid-term elections.

Year of Midterm Election	President	House		Senate	
		Democrats	Republicans	Democrats	Republicans
2018	Trump				
2014	Obama	188	247	44	54
2010	Obama	193	242	51	47
2006	Bush II	233	202	49	49
2002	Bush II	205	229	48	51
1998	Clinton	211	223	45	55
1994	Clinton	204	230	48	52
1990	Bush I	267	167	56	44
1986	Reagan	258	177	55	45
1982	Reagan	269	166	45	55
1978	Carter	278	158	58	41
1974	Nixon	291	144	61	38
1970	Nixon	255	180	54	44
1966	Johnson	248	187	64	36
1962	Kennedy	258	176	66	34
1958	Eisenhower	282	153	65	35
1954	Eisenhower	232	203	48	47
1950	Truman	235	199	49	47
1946	Truman	188	246	45	51
1942	Roosevelt	222	209	57	37
1938	Roosevelt	262	169	69	23
1934	Roosevelt	322	103	69	25
1930	Hoover	216	218	47	48
1926	Coolidge	194	238	48	46
1922	Harding	207	225	42	53
1918	Wilson	192	240	47	49
1914	Wilson	230	196	56	40
1910	Taft	230	162	44	52
1906	T.Roosevelt	167	223	31	61
1902	T.Roosevelt	176	207	33	57

Sources: <http://history.house.gov/Institution/Party-Divisions/Party-Divisions/>  
<https://www.senate.gov/history/partydiv.htm>, Edmond de Rothschild Economic Research

Chart 2: In August, overall inflation was down from 2.9% to 2.7% due to a lower contribution from the energy sector



Source: Thomson Reuters Datastream / Edmond de Rothschild Economic Research

How could the elections change the US President's agenda?

- ▶ Regarding the application of the trade tariffs, Donald Trump could continue to impose them, regardless of the outcome of the November elections. As we have seen over the past few months, the President has cited “national security” (article 232 of the Trade Expansion Act) and “unfair trade practices” (article 301 of Trade Act de 1974) as grounds for raising trade tariffs, there was no need to obtain the approval of Congress. He could thus continue to be active on this front even if the Democrats win the majority in the House of Representatives.
- ▶ The tax reform adopted in December 2017 and implemented from January 2018 is set to remain in place. Any modification of the Tax Cuts and Jobs Act would require the approval of the two chambers, and even if the Democrats

were to win the majority in the House of Representatives, the Senate, which is likely to remain Republican, would not approve the modification or repeal of the law.

- ▶ Conversely, the agenda of the Trump administration in terms of further tax cuts or the repeal of Obamacare could be blocked by Congress if the Democrats were to win the majority in the House of Representatives. The president could then use executive orders.

Beyond the electoral tumult, economic data for the US remains positive. Industrial production notably continued to accelerate, with y-o-y growth of 4.9% in August after 4.0% in July. [Despite this good dynamic, inflation slowed in August, as expected:](#)

- ▶ Overall inflation (measured by the Consumer Price Index - CPI) decelerated to 2.7% in August after 2.9% in July, and core inflation, which excludes food and energy prices, was 2.2% in August after 2.4% in July.
- ▶ A drop of 1.6% in the apparel component of the CPI and of 0.2% in the medical component notably explained the slowdown in the consumer price index.

### Implications

- ▶ The forthcoming mid-term elections could lead to uncertainty over the coming months...
- ▶ ...however, the fiscal stimulus should continue to maintain dynamic growth in the US until the end of 2018, even if its pace is unlikely to accelerate as quickly as in H1.
- ▶ We continue to expect that the acceleration in core inflation will remain limited in 2018 ([see our Weekly of the Economic Research Team of 10 September 2018](#)).

## IN THE EUROZONE, THE EUROPEAN CENTRAL BANK IS MAINTAINING ITS COURSE IN TERMS OF MONETARY POLICY

[Following its meeting on 13 September, the European Central Bank \(ECB\) kept its monetary policy unchanged, as we expected.](#)

Thus, it maintained its key rates, the deposit rate and the refinancing rate, at -0.40% and 0.00%, respectively. Moreover, it reiterated that it intends to continue its net asset purchases up until end-2018 according to the following modalities:

- ▶ it will continue, as it had previously committed to, to make net asset purchases under the asset purchase programme at a monthly pace of EUR30 billion until the end of September 2018;
- ▶ subject to data confirming a return of inflation to its medium-term target, the ECB will reduce the monthly pace of the net asset purchases to EUR15 billion starting in October and until December 2018, and then end them at the end of that month.

Lastly, and especially, the ECB reiterated its forward guidance for its interest rates and the portfolio of assets that it holds, confirming that:

- ▶ the deposit and refinancing rates should remain at their present levels “at least through the summer of 2019 and in any case for as long as necessary”;
- ▶ its policy of reinvesting the principal payments from maturing securities purchased is set to be continued “for an extended period of time after the end of the net asset purchases, and in any case for as long as necessary to maintain favourable liquidity conditions and an ample degree of monetary accommodation”.

[While during his introductory statement Mr. Draghi recognised that the risks for the economic outlook had increased](#), notably citing rising protectionism, vulnerabilities in emerging markets and financial market volatility, [he indicated that the ECB continued to assess the risks surrounding GDP growth as “broadly balanced”](#). Moreover, during the question and answer session, when asked about the trends of emerging countries, Mr Draghi highlighted that so far financial tensions have affected the countries that have the weakest fundamentals, and that there has not been broad contagion of the uncertainty to all emerging markets.

[The new ECB staff projections confirmed that the tensions in certain emerging markets during the summer did not result in a significant change in the eurozone's outlook](#). Thus, while growth forecasts for 2018 and 2019 were revised down from those of June 2018, this revision was minor. Furthermore, the ECB staff inflation forecasts were maintained (see table below).

### New ECB staff Economic forecasts

	2018	2019	2020
<b>GDP growth</b>			
<b>Sept. 18 forecast</b>	<b>2.0%</b>	<b>1.8%</b>	<b>1.7%</b>
<i>June 18 forecast</i>	<i>2.1%</i>	<i>1.9%</i>	<i>1.7%</i>
<b>Inflation</b>			
<b>Sept. 18 forecast</b>	<b>1.7%</b>	<b>1.7%</b>	<b>1.7%</b>
<i>June 18 forecast</i>	<i>1.7%</i>	<i>1.7%</i>	<i>1.7%</i>

Source: ECB / Edmond de Rothschild

#### Implications

- ▶ The ECB maintained its monetary policy stance and did not modify the tone of its communication in September. This supports our scenario according to which the rise in financial tensions over the summer in the emerging countries that have weak economic fundamentals, if there is no contagion to all emerging markets, should not lead to a change in monetary policy.
- ▶ While the ECB confirmed that it intends to end its net asset purchases at the end of 2018, the tone of its communication also continued to show that it does not intend to speed up the normalisation of its monetary policy.
- ▶ We maintain our forecast that the ECB's monetary tightening cycle could be pushed back to 2020. It would be characterised by a very gradual rise in key rates. Conversely, reinvestments would be continued through that date.
- ▶ Thus, we also maintain our forecast according to which, while the prospect of the end of the ECB's net asset purchases could favour a rise in long-term bond yields, its extent would be limited, as the ECB would conserve a significant stock of sovereign bonds on its balance sheet.
- ▶ Key rates maintained at their current level and the relatively low level of bond yields should result in slight downward pressure on the euro against the dollar. We maintain our forecast of an exchange rate of EUR1=USD1.15 at end-2018.

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## BREXIT: WHAT IS THE OUTLOOK FOR THE UK?

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Over the past few months, negotiations of the conditions for the UK's exit from the European Union (EU), or Brexit, have not made notable headway.

The finalisation, in December 2017, of the joint report on progress during phase 1 of the negotiations had nevertheless seemed to indicate that a significant first step had been achieved. This report had confirmed that an agreement had been found on the three issues that would enable a deal to be made for the withdrawal<sup>1</sup> of the UK from the EU and that were unanimously considered by the Europeans to be a pre-requisite to any further negotiations:

- the amount of the financial bill that the UK will have to settle with the EU on its withdrawal,
- the definition of the rights of UK and EU citizens following Brexit,
- lastly, and especially, the question of the Irish border, as Europe is firmly opposed to the return of a border between the Republic of Ireland and Northern Ireland.

Following this report, the European Council of 14 December 2017 had decided that phase 2 of negotiations could commence regarding the future relationship and define the political Declaration<sup>2</sup> on the framework for the future UK/EU relationship.

Moreover, on 19 March 2018, European and UK authorities announced they had agreed to a transition period, which would begin on 29 March 2019 (the official date of the UK's withdrawal from the EU) and continue until 30 December 2020. During this transition phase, which would enable the agreements on the future relationship between the parties to be legally transposed, the UK would no longer participate in the EU's decisions, but would maintain the benefits of the single market and customs union and would continue to apply EU regulation.

However, since March, the discussions between the UK and EU authorities have not shown any signs of significant progress, with the two parties maintaining diverging positions on the definition of their future relationship. The - even vague - definition of the political Declaration between now and March 2019 thus remains uncertain. Moreover, the reversal in the position of the UK authorities with respect to the issue of the Irish border, having rejected in the end the EU's proposal to maintain Ireland in the single market and customs union, but not offering any other alternative deemed satisfactory by Europe (see text insert on p. 6), makes it uncertain whether the Withdrawal Agreement will be able to be ratified by March 2019.

As a result, the risk of a Brexit with no special trade agreement between the UK and the EU in March 2019 has risen in the past months. In the absence of a ratification of the Withdrawal Agreement or decision on the political Declaration, the UK would exit without a bilateral trade agreement with the European Union on 29 March 2019 (there would be no longer any need for a transition period), and their bilateral relationship would be governed by WTO rules. This risk also seems to have increased due to the fact that in the event of an agreement, its signing would be submitted for approval:

- for the EU, between now and 14 March 2019, by a vote in Parliament (a simple majority vote is required) and, between now and 22 March 2019, the European Council (a qualified majority vote is required).
- for the UK, between now and 21 January 2019, by a simple majority vote by the House of Commons.

While there should not be any uncertainties regarding the approval by the EU, adoption of the Withdrawal Agreement by the UK House of Commons is not a given, as not only have the members of parliament shown broad dissent with regard to the guidelines proposed by the UK government up until now, but they have also demanded that the political Declaration be clearly defined (and not only general guidelines).

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<sup>1</sup> Between 29 March 2019, the official date of Brexit, the Withdrawal Agreement (the legally-binding document) must be signed. A Statement of Heads of State or Government, the political Declaration, defining the guidelines for the future UK/EU relationship will be appended (and will not be legally binding).

<sup>2</sup> See note 1

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### Box: The thorny issue of the Irish border

The risk of a failure of the negotiations between the EU and the UK has deepened due to the inability of the two parties to come to an agreement on the issue of the Irish border.

The EU is firmly opposed to the return of a border between the Republic of Ireland and Northern Ireland, and it demands that the UK/EU Withdrawal Agreement specify that, regardless of their future relationship, no hard border will be set up between the Republic of Ireland and Northern Ireland. The European authorities have notably proposed that it be specified in the Withdrawal Agreement that, if no solution is found, Northern Ireland could benefit from a special status and remain in the single market and customs union.

This EU proposal was clearly rejected by the UK authorities, who point out that if Northern Ireland were to remain in the single market and customs union, there would be a break in the continuity of the territory of the United Kingdom, as customs controls could have to be set up between Northern Ireland and the rest of the UK.

The UK government has proposed other alternatives. Notably a “maximum facilitation” arrangement by which, using new border control technology, trade between the EU and the UK could remain fluid, but without preventing new infrastructures from being set up at the border, which was rejected by the EU. Another proposal by the UK is to extend the application of EU customs rules to the UK until 2021. This proposal was also ruled out by the EU, as not only does it include an end-date but because the European offer to stay in the customs union was only for Northern Ireland and not the rest of the UK.

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### Timeline: the upcoming key European institutional and political dates



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### THE MODEL FOR THE FUTURE UK/EU RELATIONSHIP REMAINS UNCERTAIN...

The European authorities have clearly indicated, following the decision by the UK government to trigger Article 50 of the Lisbon Treaty that sets out the procedure for the withdrawal of the UK from the EU, that, regardless of the nature of the trade relationship, the UK will not benefit from the same rights as a member of the European Union if it does not accept the same duties.

As the European Union already has several specific agreements with other countries, the definition of the future relationship between the UK and the EU could have similar outlines as one of these existing models. Three main models thus may serve as a reference framework:

- ▶ **The Norwegian model** (EFTA: The European Free Trade Association) involves compliance with the European rules with respect to the free movement of goods, services, capital and people within the European Economic Area. Three countries have adopted it: Norway, Lichtenstein and Iceland. This model offers the possibility for negotiating international bilateral trade agreements with members outside the EEA (European Economic Area). However, this type of agreement requires a financial contribution to the European budget, compliance with European regulations and jurisdiction, contribution to the European agencies with no voting rights, and participation in strengthening economic and social cohesion.
- ▶ **The Swiss model** provides for a less significant free-trade agreement, but which is reinforced with bilateral agreements by sector, supporting its integration in the European Economic Area. However, Switzerland contributes financially to the European budget, remains subject to European regulations, and there is free movement of people and of certain goods and services (no tariff or non-tariff barriers for agriculture or for industrial products). Several years of























































negotiations were needed to set up these trade agreements (before 1999, Bilateral Agreements 1 in 1999, Bilateral Agreements 2 in 2004).

- ▶ **The Canadian model** (CETA: The Comprehensive Economic and Trade Agreement) is a free trade agreement with the European Union that provides for preferential trade tariffs on goods without the commitment of a financial contribution. Conversely, the services sector does not benefit from the same preferential treatment as for goods. Moreover, the agreement involves maintaining access to the public market for European companies.

However, given the UK and EU's demands, none of these models, in their present form, appear to fit:

- ▶ **More specifically, the Norwegian model** would not meet the UK's demands in terms of the free movement of people, limited contribution to the EU, or independence from the Court of Justice of the European Union (CJEU).
- ▶ **The Swiss model could** offer an alternative, but its complexity makes the European authorities reluctant to opt for this choice. Moreover, a similar model to the Swiss one would involve free movement of people, which the UK is opposed to.
- ▶ **Lastly, the Canadian model** could correspond to the expectations of the UK authorities (control of the movement of people, not participation in the EU budget, independence from the CJEU), but it would involve very strict restrictions for the services sector. Moreover, in order to meet the EU's imperative requirement with respect to the Irish border, the UK would have to accept that Northern Ireland remain in the single market and customs union, which appears to be an unacceptable condition for the UK politically.

On 12 July 2018, Theresa May presented a white paper (the "Chequers plan") outlining the future relationship proposed by the UK government. However, not only was this plan subject to harsh political criticism in the UK (making it uncertain whether it would be approved by parliament), but it was not deemed sufficient by EU authorities either, as while it combines a set of conditions stemming from the current models described above, overall it comes out more favourable to the UK in terms of rights and obligations than each of these models taken separately. [The European Council will give its opinion on this proposal by the UK on 20 September.](#)

	Free movement				Commitments		Rights	
	Goods	Services	Persons	Capital	Budgetary contribution	Regulation and Jurisprudence	Voting rights	Bilateral trade agreements with non-EU countries
 <b>European Union</b>								
 <b>Norway model</b>								
 <b>Swiss model</b>								
 <b>Canadian model</b>								
 <b>WTO</b>								
 <b>United-Kingdom objectives</b>								

### ... AND REGARDLESS OF THE OUTCOME OF THE NEGOTIATIONS, BREXIT WILL ESPECIALLY WEIGH ON THE UK'S ECONOMIC OUTLOOK

According to our analysis, regardless of the outcome of the negotiations, the effective exit of the UK from the European Union (in 2019 or later) would weigh heavily both on the short-term and mid/long-term outlook of the UK economy.

Even in the event of an agreement, given the UK's requirements, it appears impossible that a relationship similar to the Norwegian one could be obtained. This means that, even if an agreement is found concerning the future relationship, the UK would no longer benefit from such favourable conditions for services (which represented 38.5% of UK exports to the EU in 2017). More specifically, and especially, as analysed by Mathilde Lemoine in April 2016<sup>3</sup>, the UK could no longer benefit from a European passport for financial services, which would have major implications for the UK economy, as financial services contributed 6.5% to GDP in 2017.

<sup>3</sup> "Brexit or not: Eurozone Stronger", Mathilde Lemoine, Group Chief Economist, Edmond de Rothschild Economic Research, A-Périodical 1, 11 April 2016



In this context, if, given the short time remaining for the negotiations, the UK and European authorities settle on an agreement on the withdrawal and the broad guidelines for the future trade relationship, economic uncertainty would remain high in the UK in 2019, especially as the UK authorities are still unable to provide clear indications of the sources of growth they intend to offer for their economy to offset any significant loss in their capacity to export financial services.

Thus, if an agreement is found by March 2019 setting out firm withdrawal conditions and the general framework for the UK/EU relationship, the uncertainty surrounding the economic outlook would still be there pending a clear definition of a new trade partnership. Therefore:

- ▶ According to our model, GDP growth would slow to 1.0% in 2019. Growth in private investment would continue to decelerate to 1.9% in 2018 and 1.5% in 2019 after 4% in 2017, like residential investment. Moreover, yearly growth in real estate prices slowed from more than 8.3% in May 2016 to 1.2% in September 2018. Household consumption would continue to weaken, while households' purchasing power is likely to continue to stagnate and the value of their real estate assets would continue to erode. The lasting nature of this uncertainty in the end could, moreover, lead households to increase their precautionary savings. Growth in private consumption could reach 1% in 2018, and only 0.8% in 2019. Foreign trade would not be able to offset the weaker domestic demand despite a drop in imports if, as we have observed since 2016, the weakness of the pound was to support exports more in value than in volume terms (i.e. an increase in the margins of exporters).
- ▶ Among the hardest-hit sectors, those that depend on domestic demand would be the first to be affected in the short term: clothing, food, and automotives. Exporting sectors could be affected in the short term (rise in trade tariffs) and the medium term (with the impact of the depreciation of the pound sterling first affecting import prices and then export volumes): chemicals, machinery and equipment, raw materials and automotives. Lastly, financial services would be responsible for 50% of the export losses, according to our estimates. The accumulated losses would be GBP15 billion in goods and GBP15 billion in services over the next three years. These estimates are moderate, as export volumes (44% of total UK exports) to the European Union could be partly redeployed to markets outside Europe (for example the US).
- ▶ Overall inflation would not decrease due to the recent drop in the pound sterling (the nominal effective exchange rate of the pound sterling has depreciated by 3.5% between April and September 2018). Thus, although we expect that the pound could stabilise at its low level (close to GBP0.90 for EUR1 and below the level of USD1.30 for GBP1), inflation would come in at 2.3% in 2019.
- ▶ The Bank of England's room for manoeuvre to support the economy would be reduced. While the stabilisation of inflation should allow it to not have to raise its key rate in 2019, it could not, conversely, lower it if necessary as this would weigh further on the trend of the pound. Moreover, as far as the slowdown remains moderate, i.e. if the UK economy does not enter a recession, the Bank of England is likely to be reluctant to implement a new sovereign bond purchase programme, in a context where its previous asset purchase programmes has led it to hold a portfolio with a size that already represents 28% of GDP.
- ▶ Despite the slowdown of the economy, 10-year government yields could rise slightly as the uncertainty relating to the Brexit conditions implies a potential threat to the UK's structural fundamentals (need for external financing of the public deficit) which are already weak. Thus, we expect the yield on the 10-year Gilt to stand at 1.35% on average in 2019.

A failure of the negotiations leading to a no-deal Brexit in March 2019 is not our central scenario. Conversely, as we have shown, this risk has increased significantly in the past months. If it were to materialise, we forecast that the UK economy would immediately enter into a recession. In detail:

- ▶ According to our model, the UK would be in recession in 2019 and its GDP could contract by -1.2%. Uncertainty would be exacerbated and would lead to a significant drop in corporate investment, which could prove to be lasting given the particularly long time that would be needed for the UK to set up new trade agreements. Residential investment would also drop sharply. Household consumption would fall sharply. The depreciation of the pound sterling by more than 15% would raise imported inflation and thus the real purchasing power of UK households. Property prices could contract by 25% to 35% over the next three years, implying an erosion in the value of their real estate assets. Despite a depreciation in the pound, foreign trade would deteriorate sharply, with exports being penalised by the rise in the trade tariffs applied by the main trade partners. Initially the UK would not have trade agreements with the European countries, nor would it have agreements with the 53 third countries that have signed agreements with the EU. Moreover, beyond the loss of the European financial passport, it would lose the European regulatory equivalent for services, which would affect all of its trade in services (even non-financial) with the European Union.
- ▶ Among the sectors that would be the hardest hit, financial services would double their losses compared to a situation in which an agreement has been made, losses of close to GBP30 billion over three years. The goods exporting sectors (transport, oil, chemicals, automotives) would also see a drop in their export volumes of more than GBP20 billion. Notably, the construction and real estate sectors would be affected in a durable manner by the weakness of domestic demand, the rise in inflation and a probable rise in interest rates (more likely "than a fall", according to Mark



Carney). The European partners that would be the most affected via their exports of goods would be Germany (8 billion euros), the Netherlands (4 billion euros), France and Belgium (3 billion euros). Those most affected by services would be France, Germany and Italy (more than 1 billion euro each). These figures represent between 0.6% and 0.8% of total exports for each country, which confirms the moderate impact of Brexit on the economic activity of the eurozone.

- ▶ [The fall in the pound sterling](#), which according to our forecasts could end up at close to USD1.10 and EUR1.05 for GBP1, would result in a sharp rise in inflation, which could stand at 3.5% on average in 2019.
- ▶ [In this context, according to our scenario the Bank of England is unlikely to opt for a cut in its key rate that would risk a greater depreciation of the pound sterling. Conversely, it could implement a new sovereign bond purchase programme.](#)
- ▶ [Despite this quantitative easing, UK sovereign yields are set to remain under upwards pressure](#) while the deterioration in the structural outlook of the economy could lead rating agencies to downgrade the UK's credit ratings, which would contribute to reducing the attractiveness of these securities in a context in which the drop in the pound sterling would, moreover, lead foreign investors to shift away from UK assets. Thus, we expect the yield on the 10-year Gilt could stand at 2.5% as of 2019.

## IMPLICATIONS

- ▶ [In the event of an agreement on the Brexit conditions, growth in the UK economy would be just 1% in 2019.](#) The effects of the new trade agreements will not be felt until 2020. Under the assumption of a Norwegian" (EFTA) model, the effects on foreign trade would remain contained and mainly concentrated on the chemicals, machinery, raw materials and automotive sectors. Under the assumption of a "Canadian" (CETA) model, the loss would be more significant for financial services (6.5% of GDP, 21% of UK exports) and would reach GBP15 billion. The yield on the 10-year Gilt would reach 1.35% in 2019.
- ▶ [In the event of a no-deal Brexit, the UK's economy would contract by 1.2%.](#) The depreciation of the pound sterling would exceed 15% (GBP1=USD1.10 and GBP1=EUR1.05) and would have an impact on foreign trade and private demand. The inflation rate would reach 3.5% in 2019. Thus, private consumption would contract by 0.5% from 2019 due to the rise in imported inflation, the increase in the unemployment rate (by 4% to 10% according to the Bank of England) and the beginning of the depreciation of non-financial assets resulting from the correction of property prices by 25% to 35% over the next three years. Private productive investment would see a decline due to the higher uncertainty. The potential losses on exported goods could thus reach more than GBP25bn. Financial services, as a result of the loss of the European passport, could also lose more than GBP30bn. Lastly, despite this scenario, the financial system could meet the needs of UK companies and households in light of the stress tests carried out by the Bank of England. The yield on the 10-year Gilt would reach 2.50% in 2019.
- ▶ [The effect would be limited on eurozone growth.](#) The financial sector would benefit from favourable flows resulting from the UK losing the European passport and the relocation of euro clearing houses. These financial flows would offset the negative impact of Brexit on European exports to the UK, which nevertheless represent 13% of total exports. The main European partners (Germany, the Netherlands, France, Belgium) would only be affected for up to 0.6% to 0.8% of their total exports over a period of three years. Lastly, the redeployment of some of the UK's financial activities to the eurozone would strengthen the solidity of the single currency.

## APPENDIX 1 – LATEST CHANGES ON FINANCIAL MARKETS

PERFORMANCE IN LOCAL CURRENCY	LAST PRICE	WEEKLY CHANGE	MONTHLY CHANGE	YEAR-TO-DATE CHANGE	1-YEAR CHANGE
<b>Equities (total return)</b>					
World (MSCI)	519	1.3%	1.3%	3.2%	10.0%
United States (S&P 500)	2'905	1.2%	2.5%	10.2%	18.7%
Eurozone (Euro Stoxx)	375	1.4%	-1.3%	-0.1%	1.0%
Germany (DAX)	12'075	1.4%	-1.9%	-6.1%	-3.3%
France (CAC 40)	5'349	1.9%	-0.9%	3.4%	5.6%
Spain (IBEX 35)	9'415	2.1%	-1.5%	-4.1%	-6.1%
Italy (FTSE MIB)	21'044	2.1%	-0.1%	-2.1%	-3.4%
Portugal (PSI 20)	5'329	1.0%	-4.0%	1.8%	5.6%
United Kingdom (FTSE 100)	7'290	0.4%	-3.7%	-1.9%	4.2%
Switzerland (SMI)	8'920	1.4%	-0.4%	-1.2%	2.3%
Japan (Nikkei)	23'095	3.5%	3.4%	2.5%	18.8%
Emerging Markets (MSCI)	1'029	0.6%	-1.1%	-9.3%	-4.0%
<b>Sovereign Bonds, 10Y (change in basis point)</b>					
United States	3.01%	7.7	14.8	60.3	80.7
Eurozone	0.46%	6.4	16.0	4.0	3.3
Germany	0.46%	6.4	16.0	4.0	3.3
France	0.77%	6.4	11.2	-0.6	6.6
Spain	1.48%	3.4	3.9	-7.3	-11.2
Italy	2.88%	-2.9	-23.8	87.1	80.3
Portugal	1.83%	-4.4	-1.4	-7.8	-94.8
United Kingdom	1.54%	7.5	30.8	35.4	23.8
Switzerland	-0.02%	5.6	13.3	15.5	5.6
Japan	0.11%	0.7	2.0	7.0	9.3
Emerging Markets (local currency)	5.29%	0.3	-2.5	48.1	50.0
<b>Corporate Bonds (change in basis point)</b>					
United States (IG Corp.)	4.05%	1.6	10.5	79.8	90.3
Eurozone (IG Corp.)	1.07%	-0.3	15.6	29.6	29.7
Emerging Markets	6.14%	-4.1	8.5	163.8	184.0
<b>High-Yield Bonds (change in basis point)</b>					
United States (HY Corp.)	6.22%	-10.1	-9.0	50.6	73.2
Eurozone (HY Corp.)	3.80%	-6.9	7.5	79.9	80.9
<b>Convertible Bonds (price change)</b>					
United States (Convert. Barclays)	54	1.7%	2.2%	8.6%	9.7%
Eurozone (Convert. Exane)	7'779	0.6%	-0.2%	0.6%	2.0%
<b>Commodities</b>					
Commodities (TR)	401	-0.2%	-0.1%	-4.8%	-2.5%
Gold	1'203	0.3%	1.6%	-9.8%	-10.8%
Crude Oil (Brent)	78	1.9%	9.5%	17.0%	41.9%
<b>Currencies</b>					
Dollar Index	94.6	-0.5%	-1.5%	2.7%	3.0%
EURUSD	1.17	0.7%	2.1%	-2.8%	-2.4%
GBPUSD	1.31	0.8%	3.0%	-2.8%	-2.7%
USDCHF	1.04	-1.2%	-3.3%	-1.2%	0.1%
USDJPY	112.0	0.8%	1.4%	-0.6%	0.4%

Source : Bloomberg

## APPENDIX 2 – MAIN ECONOMIC INDICATORS

Main Economic Indicators - Released (10 - 14 September) and to be released (17 - 21 September)						
<b>US</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
12/09	PPI, YoY	Aug.	0.0	0.0	0.0	-
12/09	Core PPI, YoY	Aug.	0.0	0.0	0.0	-
13/09	CPI, YoY	Aug.	2.8%	2.7%	2.9%	-
13/09	Core CPI, YoY	Aug.	2.4%	2.2%	2.4%	-
14/09	Retail Sales, MoM	Aug.	0.4%	0.1%	0.5%	0.7%
14/09	Manufacturing Production, MoM	Aug.	0.3%	-	0.3%	-
19/09	Housing Starts, month	Aug.	1235k	-	1168k	-
19/09	Building Permits, month	Aug.	1310k	-	1311k	1303k
20/09	Existing Home Sales, month	Aug.	5.38m	-	5.34m	-
<b>Euro zone</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
13/09	ECB - Refinancing rate		0.0%	0.0%	0.0%	-
13/09	ECB - Deposit rate		-0.4%	-0.4%	-0.4%	-
17/09	Core HICP, YoY	Aug. F	1.0%	-	1.0%	-
17/09	HICP, YoY	Aug. F	2.0%	-	2.0%	-
21/09	Manufacturing PMI, month	Sept. P	54.5	-	54.6	-
21/09	Services PMI, month	Sept. P	54.4	-	54.4	-
21/09	Composite PMI, month	Sept. P	54.5	-	54.5	-
<b>Germany</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
11/09	ZEW Survey Current Situation, month	Sept.	72.0	76.0	72.6	-
11/09	ZEW Survey Expectations, month	Sept.	-13.0	-10.6	-13.7	-
13/09	HICP, YoY	Aug. F	1.9%	1.9%	1.9%	-
21/09	Manufacturing PMI, month	Sept. P	55.7	-	55.9	-
21/09	Services PMI, month	Sept. P	55.0	-	55.0	-
21/09	Composite PMI, month	Sept. P	55.4	-	55.6	-
<b>France</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
13/09	HICP, YoY	Aug. F	2.6%	2.6%	2.6%	-
21/09	GDP, QoQ	Q2 F	0.2%	-	0.2%	-
21/09	GDP, YoY	Q2 F	1.7%	-	1.7%	-
21/09	Manufacturing PMI, month	Sept. P	53.3	-	53.5	-
21/09	Services PMI, month	Sept. P	55.3	-	55.4	-
21/09	Composite PMI, month	Sept. P	54.6	-	54.9	-
<b>Switzerland</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
20/09	Exports Real, MoM	Aug.	-	-	-1.4%	-
20/09	Imports Real, MoM	Aug.	-	-	-1.4%	-
20/09	SNB 3-Month Libor Lower Target Range		-1.3%	-	-1.3%	-
20/09	SNB 3-Month Libor Upper Target Range		-0.3%	-	-0.3%	-
21/09	Money Supply M3, YoY	Aug.	-	-	2.4%	-
<b>UK</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
10/09	Visible Trade Balance £Mn, month	July	-£11740	-£9973	-£11383	-£10679
13/09	Bank of England Bank Rate		0.8%	0.8%	0.8%	-
13/09	BOE Asset Purchase Target	Sept.	435b	435b	435b	-
17/09	Rightmove House Price Index, MoM	Sept.	-	-	-2.3%	-
17/09	Rightmove House Price Index, YoY	Sept.	-	-	1.1%	-
19/09	CPI, YoY	Aug.	2.4%	-	2.5%	-
19/09	Core CPI, YoY	Aug.	1.8%	-	1.9%	-
20/09	Retail Sales Inc. Auto Fuel, MoM	Aug.	-0.2%	-	0.7%	-
<b>Japan</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
10/09	GDP, QoQ	Q2 F	0.7%	0.7%	-0.2%	-
10/09	GDP, YoY	Q2 F	-	1.3%	1.0%	-
14/09	Industrial production, MoM	July F	-	-0.1%	-0.1%	-
19/09	BOJ Short-Term Policy Rate		-	-	-0.1%	-
19/09	BOJ Long-Term Policy Rate		-	-	0.0%	-
21/09	CPI, YoY	Aug.	1.1%	-	0.9%	-
<b>China</b>						
Date	Indicator	Period	Consensus	Actual	Prior	Revised
10/09	PPI, YoY	Aug.	4.0%	4.1%	4.6%	-
10/09	CPI, YoY	Aug.	2.1%	2.3%	2.1%	-
12/09	New Yuan Loans CNY, month	Aug.	1400.0b	1280.0b	1450.0b	-
14/09	Retail Sales, YoY	Aug.	8.8%	9.0%	8.8%	-
14/09	Industrial Production, YoY	Aug.	6.1%	6.1%	6.0%	-
14/09	Fixed Assets Ex Rural, YTD YoY	Aug.	5.6%	5.3%	5.5%	-

## APPENDIX 4 – OUR GROWTH AND INFLATION FORECASTS

GDP GROWTH IN VOLUME (%)	2015	2016	2017	Q1 18	Q2 18f	Q3 18f	Q4 18f	2018f	Consensus	Q1 19f	Q2 19f	2019f	Consensus
United States	2.9	1.5	2.3	2.9	3.2	2.9	3.0	3.0	2.8	2.7	2.9	2.8	2.5
Eurozone	2.0	1.8	2.5	2.5	2.0	1.5	1.4	1.8	2.3	1.4	1.5	1.6	2.0
France	1.0	1.1	2.0	2.1	1.8	1.5	1.2	1.6	2.0	1.2	1.4	1.5	1.8
Germany	1.5	1.9	2.5	2.3	2.2	1.9	1.7	2.0	2.3	1.7	1.8	1.8	2.0
Spain	3.4	3.3	3.3	2.8	2.4	2.6	2.7	2.6	2.7	2.6	2.4	2.1	2.3
Italy	0.8	1.0	1.6	1.5	1.4	1.3	1.2	1.4	1.4	1.0	1.1	1.1	1.2
Luxembourg	2.9	3.1	2.3	3.2	2.9	2.8	3.3	3.0	3.5	2.9	3.1	2.9	3.0
Portugal	1.8	1.6	2.7	0.9	-0.4	0.7	0.8	2.0	2.3	0.9	-0.4	1.9	1.9
Europe ex-Eurozone													
United Kingdom	2.3	1.9	1.8	1.2	1.3	1.2	1.0	1.2	1.5	1.2	1.0	1.0	1.5
Switzerland	1.2	1.4	1.1	2.2	2.3	2.3	2.2	2.2	2.1	2.0	1.9	1.9	1.7
Israel	2.6	3.9	3.3	4.0	3.7	3.4	3.3	3.6	3.5	3.3	3.6	3.5	3.4
Japan	1.4	1.0	1.7	0.9	1.2	1.1	1.1	1.1	1.3	1.3	1.0	0.9	1.0
Emerging countries	4.0	4.1	4.9	5.4	5.2	5.1	5.0	5.1	-	5.0	4.9	4.9	-
China	6.9	6.7	6.9	6.8	6.7	6.5	6.5	6.6	6.6	6.5	6.4	6.4	6.4
Brazil	-3.5	-3.5	1.0	2.1	2.2	2.3	2.5	2.3	2.5	2.5	2.5	2.5	2.8
India	7.6	7.9	6.3	7.3	7.3	7.4	7.4	7.4	7.3	7.4	7.5	7.5	7.5

CONSUMER PRICE INDEX (%)	2015	2016	2017	Q1 18	Q2 18f	Q3 18f	Q4 18f	2018f	Consensus	Q1 19f	Q2 19f	2019f	Consensus
United States	0.1	1.3	2.1	2.2	2.7	2.8	2.7	2.6	2.5	2.5	2.2	2.3	2.2
Eurozone	0.0	0.2	1.5	1.3	1.6	1.9	1.8	1.7	1.5	1.7	1.6	1.6	1.5
France	0.0	0.2	1.0	1.6	1.7	1.6	1.5	1.6	1.6	1.4	1.2	1.3	1.5
Germany	0.3	0.5	1.8	1.6	1.8	1.8	1.7	1.7	1.6	1.6	1.4	1.5	1.7
Spain	-0.5	-0.2	2.0	1.2	1.6	1.5	1.4	1.5	1.5	1.4	1.4	1.4	1.6
Italy	0.0	-0.1	1.2	1.4	1.6	1.4	1.4	1.4	1.2	1.3	1.3	1.3	1.3
Luxembourg	0.1	0.0	2.1	1.2	1.3	1.9	1.8	1.5	1.5	1.8	1.8	1.9	2.0
Portugal	0.5	0.6	1.4	0.7	1.4	1.2	1.2	1.2	1.4	1.2	1.1	1.2	1.5
Europe ex-Eurozone													
United Kingdom	0.0	0.7	2.7	2.7	2.5	2.4	2.3	2.5	2.5	2.3	2.3	2.3	2.1
Switzerland	-1.1	-0.4	0.5	0.7	0.9	0.9	1.0	0.9	0.7	1.0	1.1	1.1	0.9
Israel	-0.6	-0.5	0.2	0.2	0.6	0.9	1.0	0.7	0.8	1.0	1.1	1.2	1.2
Japan	0.8	-0.1	0.5	0.7	0.8	0.8	0.9	0.8	1.0	0.9	0.9	1.0	1.1
Emerging countries	4.3	3.8	3.0	3.1	3.4	3.6	3.4	3.4	-	3.3	3.4	3.3	-
China	1.4	2.0	1.6	2.2	2.1	2.3	2.2	2.2	2.3	2.2	2.3	2.3	2.3
Brazil	9.0	8.8	3.5	2.8	3.0	3.5	3.4	3.2	3.3	3.7	4.0	3.8	4.0
India	4.9	5.0	3.3	4.6	4.9	5.2	5.0	4.9	4.7	4.9	4.8	4.8	4.7

## APPENDIX 5 – OUR INTEREST RATE AND CURRENCY FORECASTS

INTEREST RATES AND YIELDS (%)*	2015	2016	2017	Q1 18	Q2 18f	Q3 18f	Q4 18f	2018f	Consensus	Q1 19f	Q2 19f	2019f	Consensus
<b>United States</b>													
Policy rate	0.50	0.75	1.50	1.75	2.00	2.25	2.50	2.50	2.40	2.75	3.00	3.25	3.05
2-year yield	0.68	0.83	1.39	2.27	2.45	2.65	2.80	2.54	2.51	3.00	3.20	3.30	3.01
10-year yield	2.13	1.83	2.33	2.74	3.00	3.20	3.30	3.06	2.95	3.35	3.40	3.45	3.36
<b>Eurozone</b>													
Policy rate	0.05	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.30
2-year Schatz yield	-0.25	-0.59	-0.72	-0.60	-0.50	-0.40	-0.30	-0.45	-0.50	-0.20	-0.15	-0.05	-0.07
10-year Bund yield	0.54	0.14	0.37	0.50	0.70	0.85	1.00	0.76	0.73	1.15	1.25	1.35	1.22
2-year OAT yield	-0.18	-0.51	-0.48	-0.49	-0.40	-0.30	-0.25	-0.36	-0.37	-0.15	-0.10	0.00	0.19
10-year OAT yield	0.86	0.48	0.81	0.72	0.90	1.05	1.20	0.97	1.14	1.30	1.40	1.50	1.82
<b>United Kingdom</b>													
Policy rate	0.50	0.25	0.50	0.50	0.50	0.50	0.50	0.50	0.80	0.50	0.50	0.50	1.15
2-year yield	0.54	0.29	0.25	0.82	0.80	0.80	0.75	0.79	0.98	0.70	0.70	0.70	1.41
10-year yield	1.82	1.22	1.20	1.35	1.40	1.45	1.45	1.41	1.60	1.40	1.35	1.35	2.01
<b>Switzerland</b>													
Policy rate	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.75	-0.70	-0.75	-0.75	-0.50	-0.50
2-year yield	-0.89	-0.91	-0.85	-0.85	-0.75	-0.60	-0.50	-0.68	-0.64	-0.40	-0.25	-0.05	-0.06
10-year yield	-0.09	-0.35	-0.09	0.03	0.10	0.30	0.45	0.22	0.23	0.65	0.80	0.85	0.72
<b>Japan</b>													
Policy rate	0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	-0.10	0.00	-0.10	-0.10	-0.10	0.00
2-year yield	0.01	-0.21	-0.17	-0.13	-0.10	-0.10	-0.10	-0.11	-0.13	-0.10	-0.05	0.00	-0.09
10-year yield	0.36	-0.04	0.06	0.05	0.05	0.05	0.10	0.06	0.11	0.15	0.25	0.30	0.16
<b>Emerging countries - Policy rates</b>													
China	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35	4.35
Brazil	14.25	13.75	7.00	6.50	6.50	6.50	6.50	6.50	6.50	6.50	6.75	7.25	7.75
India	6.75	6.25	6.00	6.00	6.00	6.25	6.25	6.25	6.15	6.25	6.50	6.50	6.35

\* data at end of period for trimestrial values and period average for annual values

EXCHANGE RATE**	2015	2016	2017	Q1 18	Q2 18f	Q3 18f	Q4 18f	2018f	Consensus	Q1 19f	Q2 19f	2019f	Consensus
<b>Dollar</b>													
EUR/USD	1.08	1.11	1.13	1.23	1.20	1.17	1.15	1.19	1.24	1.15	1.16	1.17	1.29
USD/JPY	120	109	112	108	110	113	115	112	108	115	115	115	105
GBP/USD	1.47	1.36	1.29	1.39	1.36	1.33	1.29	1.34	1.40	1.29	1.29	1.29	1.44
USD/CHF	1.00	0.98	0.98	0.95	0.99	1.03	1.04	1.00	0.96	1.06	1.08	1.06	0.95
USD/CNY	6.28	6.65	6.75	6.36	6.38	6.40	6.45	6.40	6.36	6.45	6.45	6.45	6.28
USD/BRL	3.34	3.48	3.19	3.24	3.45	3.50	3.50	3.45	3.40	3.50	3.55	3.50	3.31
<b>Euro</b>													
EUR/JPY	130	120	127	133	132	132	132	132	133	132	133	133	135
EUR/GBP	0.73	0.81	0.88	0.88	0.88	0.88	0.89	0.88	0.88	0.89	0.90	0.91	0.89
EUR/CHF	1.09	1.09	1.11	1.17	1.19	1.20	1.20	1.19	1.18	1.22	1.25	1.24	1.21
EUR/SEK	9.36	9.47	9.64	9.97	10.10	9.90	9.75	9.93	10.10	9.65	9.55	9.45	9.50

\*\*period average

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