August 2016

# KEEP CALM AND GET A GRIP ON UK DATA POST-BREXIT VOTE

## Economic and market outlook

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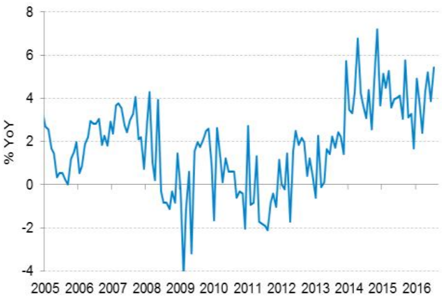
In our previous commentary ("the post-referendum siren of the UK economy"), we discussed that although UK business and consumer surveys showed a sharp fall in confidence in the immediate aftermath of the Brexit vote, it is still too early to conclude that activity has deteriorated. As we start to receive official economic data for July, the data confirms our expectation that UK activity has been resilient so far.

Although the UK GfK consumer confidence nose-dived after the Brexit vote, retail sales were up 1.4% in July, well ahead of market expectations. This confirms solid consumer spending despite the dismal survey measures amid economic uncertainty. The resilience in consumption in July was also validated by the British Retail Consortium (BRC) sales report and the John Lewis weekly retail sales figures. It does not appear that households have reacted negatively to Brexit yet.

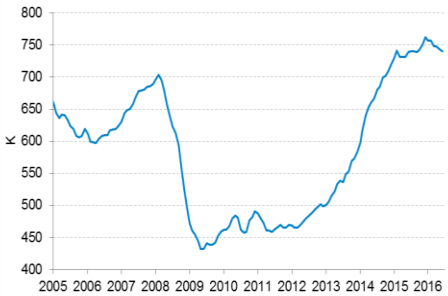
**UK retail sales**




Source: Datastream

Although we are still in the early stages of the aftermath of the Brexit vote, the UK labour market data is showing no sign of negative impact either. Job vacancies dropped trivially in July but remained robust. As employers' concerns about the economy are usually expressed through a reduction in jobs being advertised, the resilience in vacancies shows the situation is not as pessimistic as some surveys have suggested. Due to the strength in the labour market, household consumption is unlikely to plummet.

**UK job vacancies**



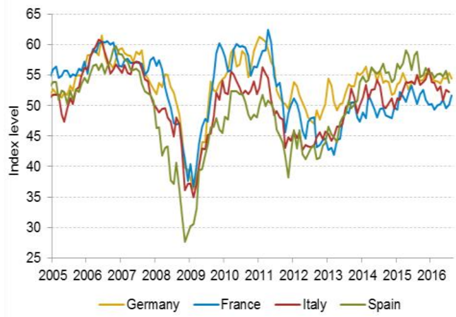

Source: Datastream

On the business side, the UK Purchasing Managers' Index (PMI), (a survey-based indicator of business activity) dipped into contraction territory in July. While Brexit uncertainty will most likely weigh on business investment, we may hear from an increasing number of corporates that they will do more to develop new markets and opportunities. For instance, the £540 million joint investment by GlaxoSmithKline and Google to form a bio-electronic research centre, and SoftBank's £24.3 billion purchase of ARM Holdings shows that multinationals are undeterred by Brexit and remain confident to invest in the UK.

Although the early signs post-Brexit are positive so far, we are cognizant that the impact will take time to show and we will closely monitor how hard data evolves over the next couple of months. While we acknowledge there is a lot of uncertainty and the road ahead will be turbulent, we think the consensus of the UK growth expectation of only half a percent for 2017 appears too pessimistic and there maybe potential upside surprises.

With regards to monetary policy, the Bank of England (BoE) is expected to cut interest rates from 0.25% to 0.1% by the end of the year, but has signalled its reluctance on negative interest rates. Although there are signs that inflation is picking up (e.g. the bounce in producer prices in July), the BoE will be inflation tolerant. We believe the extensive easing measures that the BoE has introduced in its August meeting are more counter-productive than helpful.

**Eurozone Composite PMIs**

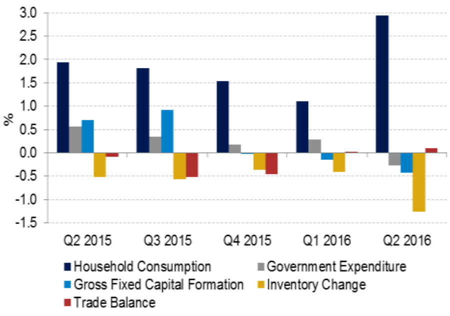



Source: Datastream

Eurozone activity was solid in the first half of 2016 and remained resilient after the Brexit vote, but we think there are signs the region will lose momentum in the second half.

Although German GDP growth surprised to the upside in the second quarter (+0.4%) after a strong expansion in the first quarter (+0.7%), it was mainly driven by net export while business investment was weak. With the strong contribution from net exports likely to fade, we expect to see more moderate growth in the second half, amid resilience in household consumption. Although Spain also surprised to the upside in the second quarter GDP growth, the trend is softening. Meanwhile, France and Italy stagnated in the second quarter, with a weak outlook indicated by the sluggish PMIs. From this recent trend, we see a two-tier situation in the Eurozone – strong Germany and a weak periphery. However, Germany's domestic activity is unlikely to be strong enough to lift the rest of the region. Given the more cautious outlook in the Eurozone in the second half, we think the European Central Bank (ECB) will be pressured to provide further stimulus.

### Contributions to US GDP growth



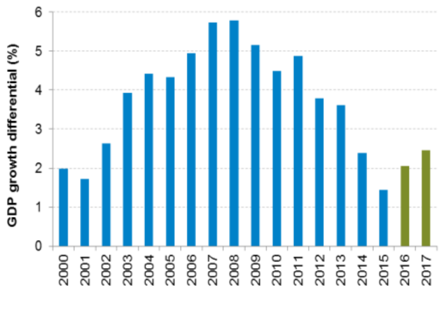

Source: Datastream

Across the Atlantic, we continue to see solid growth in the US. Although US second quarter GDP growth disappointed, it was mainly due to the drag from inventory change (which is often prone to reversals), while household consumption and employment growth remained robust. We believe the US economy will continue to display reasonable momentum and there is evidence that inflation pressure is building up gently. We think the disappointment in second quarter GDP growth is likely to take some pressure off the Federal Reserve (the Fed) to increase interest rates despite the rapid tightening in the labour market. A rate increase in September is highly unlikely, but we may see one rate increase after the presidential election, if the economy maintains its current momentum and barring no external shock either.

In the Far East, China's economic data disappointed and indicated a broad-based weakness in July. There is downside risk to growth in the second half, due to the softening property market, continued weakness in private investment, a sharp fall in credit and the waning effect of policy support. We believe the Chinese authorities will eventually resort to its usual tricks (i.e. further easing measures such as a boost to credit and infrastructure spending) to defend its growth target.

On a positive note, despite some growth concerns on China, there are signs that emerging markets as a whole are improving incrementally. We believe part of the pickup is a genuine improvement thanks to the recovery in commodity prices and export. However, part of it is just less contraction in GDP growth (for instance, in Brazil and Russia) compared to last year. After all, emerging markets are likely to thrive against the backdrop of a more dovish US interest rates profile and softness of the US dollar. Overall, growth differential between emerging markets and developed markets is likely to widen this year after narrowing for the past four years – a key signal to be more optimistic in emerging markets.

### Growth differential between emerging markets and developed markets




Source: Datastream



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