

THE BANK OF ENGLAND RAISES RATES: BEARISH FOR THE POUND



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The Bank of England (BoE) raised rates for the first time in more than a decade and the pound dropped. What is your reading of this?

BD: The reaction of the pound to the MPC (Monetary Policy Committee) has been very negative. The pound experienced its biggest daily loss versus the Euro since the Brexit referendum and the UK 10 year declined by around 10 bps on the announcement. Globally, we have a bearish view on the pound. The Brexit negotiations are falling behind and the risks of failure are rising gradually. The BoE itself states that "There remain considerable risks to the outlook, which include the response of households, businesses and financial markets to developments related to the process of EU withdrawal." The uncertainties linked to the Brexit are already weighing on the macro indicators, which will prevent the BoE from pursuing a standard rate tightening cycle and this environment is negative for the currency. We also should underline that the UK is one of the countries with the largest current account deficit in the world as there has been little improvement of the current account dynamics despite the pound depreciation that followed the referendum. The latest data indicates that the market is only slightly short GBP and we think that this view is too optimistic.

What is your assessment of UK economy?

TP: The initial resistance of the UK economy to the result of the June 2016 Brexit referendum was much stronger than anticipated. Helped by a large GBP depreciation, GDP growth remained strong in H2 2016 whereas many observers had expected a recession. However, since the beginning of this year, cracks have appeared. Over the 3 first quarters of 2017, despite a small upward surprise in Q3, the underperformance relative to the Eurozone has been significant (with a real GDP advance of +0.9% vs +1.8%).

High inflation, directly related to the GBP depreciation, is eroding consumers' appetite while, despite a very low unemployment rate, there is still no acceleration in wages. Looking forward, even though inflation should gradually decline, we are expecting Brexit-related uncertainty to weigh heavily on investment decisions, both from corporations and households (the latter regarding real estate, which would also be vulnerable to further increases in interest rates). While the risk of a "very hard" Brexit (with no agreement) is not our base scenario, its perceived probability may increase, at least temporarily, in the coming months. More generally, as with a number of other developed economies well advanced in the current expansion cycle, there are also major interrogations about whether the current very low unemployment rate really means that the economy is running near its full capacity, a key question for monetary policy.

From a Multi-Asset perspective do you see any opportunities on UK assets?

FS. At this stage, we believe investors should keep a cautious view on UK assets. We believe that the recent move of the BoE comes at the wrong time and further increases the risk of stagflation in the UK, with CPI at 3% - the highest level in five years - and a weak GDP growth. As we expect the pound to continue to be under pressure, we believe investors should remain short GBP vs Euro and USD. In the fixed income space, we believe that real rates should be lower than the current level, so investors should keep a short view on real rates. On the equity market, we have a neutral view: while a weaker pound is a tailwind for exporters, the outlook for internal demand is weaker. In Equity, we prefer other markets: Eurozone (favoured by the European renaissance story), Japan and selectively on EM.

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