HouseView

Special Edition

The Brexit vote and its consequences

- **UK voters have chosen by a narrow margin to leave the European Union.**
- **The outcome of the UK vote is initially a major shock for markets, and could in the long run damage economic growth and cause more political risks.**
- **Brexit puts further pressure on risky assets, oil prices and the British pound.**
- **Outcome could trigger further quantitative easing.**

Brexit outcome sends shock wave through markets

"Brexit" it is. The news that a majority of British voters want to leave the EU has sent a shock wave through financial markets. Investors must now digest the uncertainty created by the referendum and markets will surely face many unclear repercussions.

"What we do know is that this is a political crisis, which will not automatically trigger a worldwide recession or a liquidity crisis in the financial system", said Valentijn van Nieuwenhuijzen, Head of Multi Asset at NN Investment Partners.

Britons voted 51.9 percent to 48.1 percent to leave the EU, voicing their desire to take greater control of the country's economy and its borders. More than 72 percent of eligible voters turned out to take part in the referendum. Shortly after the news, Prime Minister David Cameron announced he would resign, creating another dimension of uncertainty in British politics.

Financial authorities around the world have said a Brexit will reverberate through an already fragile global economy. The long-run economic and political consequences could be significant and will probably have a negative impact on economic growth. Van Nieuwenhuijzen estimates the negative impact on this year's GDP growth at 1% for the UK and 0.3-0.5% for the Eurozone.

Britain's decision will certainly have great political repercussions for the EU and for the UK itself. A drive for independence in Scotland, and maybe even Northern Ireland, may be likely in the near term and cause further political unrest.

"There is huge uncertainty, especially for the UK, politically and economically," says Van Nieuwenhuijzen. "Recession there seems likely, but policy action will be key in determining how deep it will be."

Big surprise for markets

Stock markets reacted with heavy losses as investors sought protection in safe havens, putting further pressure on yields in important treasury markets.

The outcome of the British referendum came as a surprise for financial markets. Investors had been showing much caution in the weeks leading up to the poll, but in the final days before the vote, many were anticipating a more positive result, with hedge funds taking corresponding positions and stock markets posting solid gains.

That picture drastically changed the day after the vote, with heavy losses for stock markets, a drop in oil price and a historic plunge in the British pound to lows not seen since 1985. How long the upheaval in the markets will last is impossible to say now, according to Van Nieuwenhuijzen.

"Much depends on how central banks will react," he said. "This outcome could trigger further quantitative easing."

Stock markets lost as much as 10 percent in their first reactions to the vote, with the Asian stock markets receiving the first blow. The Japanese yen soared amid demand for a safe-haven currency, while the Nikkei stock index tumbled almost 8 percent.

Financial stocks were the biggest underperformers in early trading, due to the impact on interest margins. Losses on the London stock market were relatively limited, with sterling's decline seen as good news for British exporters.

Decision to leave starts a period of uncertainty

Britain's decision represents the first exit of a member state from the European Union. It marks the start of years-long negotiations over trade, business and political links with the 28 European Union, which will have to navigate uncharted and complicated waters.

British voters have opened a Pandora's box. The procedural steps to unwind the UK's membership are not fully clear, and following the initial shock to financial markets, political risks are on the rise, according to Van Nieuwenhuijzen.

"Investors have to realize that the backlash against globalisation is here to stay and may be gaining strength in the aftermath of Brexit," he said. "This will be an ongoing uncertainty for financial markets. Political risks in a number of important European countries will increase and an unusual US election cycle is not too far away either."

Appetite for risky assets will be suppressed for some time

A UK vote to stay in the EU would have triggered an increased appetite of investors to allocate money to markets again. In that case, risky assets rather than close-to-zero yielding government bonds would have been the most likely recipients of these investor flows. With a Brexit we expect markets to remain volatile, but we also look for opportunities that could arise should investor panic become extreme.

In a broader sense, the outcome of the referendum will make it very hard for positive medium-term trends in financial markets to re-establish themselves. Those trends are carried by such factors as an improvement in global growth momentum and dovish central banks in developed markets. This dovishness does not necessarily mean the US Federal Reserve will not raise rates any more this year – a December hike is still a possibility -- but the US central bank will remain very conscious of downside risks, perhaps even more so now.

Aside from a Fed hike, other risks can have an impact on markets. The outlook for corporate earnings is clearly challenging with low productivity growth and the persistent uncertainty about global economic growth. And as mentioned before, political risks will remain a potentially disturbing factor for markets and will only intensify following the British decision to leave the EU.

The backlash against globalisation is here to stay

A voter revolt is not only possible in the UK, but also in other European countries. France's Marine Le Pen and Geert Wilders of the Netherlands have already called for EU membership referenda. That could result in more shocks for markets. Further unrest could lead to a structural increase in risk premiums. It could also affect the real economy and tighten financial conditions, thereby reducing growth momentum.

The central theme is thus revolt at the ballot box, which has been evidently for a few years already. So far the "revolutionaries" had been unable to gain enough power to realise an overhaul of existing institutions. The UK exit vote is a first in this respect. The crucial question for markets is whether or not they have been too complacent about political risks, concludes Van Nieuwenhuijzen.

"It is important to stress that we do not know how strong these mechanisms will be. What we do know is that it is not likely to be a shock in the proportion of the Lehman collapse or the euro crisis, with no immediate danger for the global financial system. That doesn't mean though that the repercussions will be less serious in the long run, primarily in the real economy," he said.

"Currently at NN Investment Partners we are still long risk, while being underweight in commodities and government bonds. We are underweight in European and Emerging Market equities, and overweight in US equities. European assets are likely to get a higher equity risk premium leading to multiple contraction. Peripheral spreads, credit/high-yield spreads, and European banks in equity space are key to watch to assess contagion into Europe. All showed substantial rises (in spreads) in the first hours of trading."

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A propos de NN Investment Partners

NN Investment Partners est le gérant d'actifs de NN Group N.V, société cotée en Bourse sur Euronext Amsterdam. Son siège social se situe à La Haye aux Pays-Bas. NN Investment Partners compte plus de 1100 collaborateurs, et gère près de 187 Milliards d'€* (204 Milliards d'USD*) dans 16 pays, en Europe, en Asie, au Moyen-Orient et aux Etats-Unis, pour le compte de tous types d'investisseurs, qu'ils soient institutionnels ou particuliers.

NN Investment Partners met en œuvre sa recherche et ses analyses internes, ses équipes implantées à travers le monde, ainsi que sa gestion des risques, pour offrir un large éventail de stratégies, de supports d'investissement, et de services de conseil dans toutes les principales classes d'actifs et styles d'investissement. Pour plus d'information : www.nnip.com

Le 7 avril 2015, ING Investment Management est devenu NN Investment Partners. NN Investment Partners fait partie de NN Group N.V., une société cotée en Bourse.

NN Group est actuellement détenu à 14,1% par ING Group. (net d'actions propres).Le Groupe ING a l'intention de céder le reste de ses parts dans le Groupe NN avant le 31 décembre 2016, ce qui correspond à l'agenda qui a été accepté par ING auprès de la Commission Européenne.

* Données au 30 décembre 2015