Brexit Referendum: A 50/50 Bet

Sterling to Move Sharply on Brexit Vote

- The UK Government has set **June 23rd as the date for its 'In-Out' referendum vote** on Britain's continued membership of the EU. Opinion polls are pointing to a very close outcome. The issue has now moved centre stage in the UK. We view Brexit as the **main event risk for the UK and Ireland in 2016** as a vote to leave would have profound economic and political consequences for both countries. It is **now a 50/50 call in our view, on whether the UK votes to leave or remain in the EU.**

- **Brexit would clearly impact UK financial markets. UK stocks could be expected to take a major hit** on a Brexit vote, because of the risk to future earnings, especially for those companies exporting to the EU. Meantime, the BoE could be expected to keep rates on hold for an even longer period of time, or even loosen policy further, because of the negative impact on the economy of a vote for Brexit. The impact on gilt yields is less clear: higher inflation on sterling weakness, a likely rise in the budget deficit and increased uncertainty would argue for higher yields but a weaker economy and more accommodative monetary policy would point to lower yields. Overall, we could see a steeper yield curve.

- **Brexit is a major event risk for sterling**, especially in the aftermath of its near 20% appreciation on a trade-weighted basis between 2013 and 2015, which was partly fuelled by expectations of UK rate hikes. The euro fell from close to 90p vs. sterling in 2011 to 80p in 2014 and a 70-74p trading range in 2015.

- **Some of the gains made by sterling, though, have unwound** over the past three months. This is partly due to the fact that markets are starting to think about Brexit as something which is more than just a remote possibility. **The euro has risen by more than 10% against sterling since the start of December**, climbing from 70p to 78p. Meanwhile, GBP/USD has fallen from a high of $1.59 last summer, to around $1.40 recently. **GBP/USD is now getting close to its 2009 trough of $1.38.** This represents the lowest exchange rate for sterling vs. dollar since 1985 and so is a strong support level for the currency.

- **Should the UK vote to remain** in the EU, we would expect sterling to recover some lost ground, rising back up to 74-75p vs. the euro, with GBP/USD climbing towards the $1.50 level. This rise in sterling would benefit Irish exporters to the UK. We don't see sterling moving back up to last year's highs of around 70p versus the euro and $1.59 against the dollar, as markets are no longer expecting the BoE to raise rates anytime soon.

- **Sterling can be expected to see further sharp loses in the event of a vote for Brexit.** This will lead to cheaper imports from the UK but hit Irish exports to that market. At a minimum, **the euro is likely to rise to its 2013 range of 85-86p but it could easily climb to its 2011 high of 90p on a messy Brexit,** where relations are soured with the EU and there are a lot of difficulties in reaching some form of a trade deal. The euro is also likely to lose ground, as a Brexit would be seen as a severe blow to the EU. EUR/USD could fall to last year's low of $1.05. GBP/USD is likely to breach 30 year lows, falling to around $1.25 and possibly going as low as $1.15 on a messy Brexit.

Forex Forecasts for Various Brexit Outcomes

OUTCOME	EUR/GBP	EUR/USD	GBP/USD
REMAIN	0.74	1.11	1.50
ORDERLY BREXIT	0.86	1.07	1.25
MESSY BREXIT	0.90	1.05	1.17

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Brexit would have major implications for the UK & Ireland

- **Most studies show that leaving the EU would have a negative impact on the UK economy.** It could take up to a decade for the full economic impact to be felt in terms of FDI, trade flows, migration etc. There would obviously be negative knock-on effects for Ireland given its close ties with the UK.

- **It is very difficult to quantify the full macro-economic effects of Brexit on the UK and Irish economies.** We don't know what the post-Brexit trade arrangements would be between the UK and EU. Brexit would also be a prolonged and complicated process, creating much uncertainty that would impact on economic activity. FDI into the UK would be negatively impacted, especially if there is uncertainty over free trade with the EU. The EU economy itself is also likely to be negatively impacted.

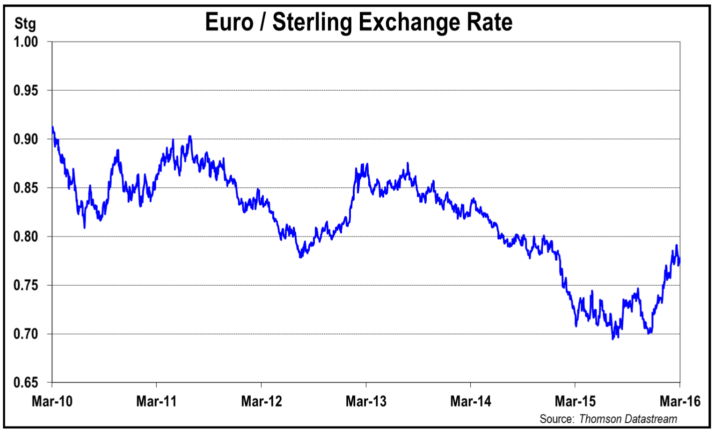
- The critical question centres around what type of trade arrangements would be put in place between the UK and EU post a Brexit. **The more the UK seeks to regain control over policy and regulations, the more difficult it will be for it to negotiate a worthwhile trade deal with the EU.** In order to secure a preferential trade deal, the UK is likely to have to adhere to EU rules and regulations.

- **It would be a major drawback for the UK if it had to fall back on WTO rules**, which is likely to involve the imposition of trade tariffs. Some 45% of UK exports go to the EU, so it is a vital market. On the other hand, the UK takes just 10% of EU exports. Thus, the UK is not as vital to the EU for trade as the EU is to the UK.

- **Ireland has very close trade and economic links with the UK and so would be greatly impacted by Brexit.** Ireland is the UK's fifth biggest export market. Meanwhile, the UK is by far the most important market for Irish indigenous exporting firms. Those trading with the UK, at a minimum, would face increased administrative and regulatory costs and possibly tariffs. A recent ESRI report suggests that there could also be a significant decline in bilateral trade. Sectors such as agriculture, retailing, energy and financial services are likely to be most impacted by Brexit.

- The border with **Northern Ireland would become an external EU land border** post Brexit. This could give rise to all sorts of issues in terms of customs posts, passport controls etc, depending on the extent to which Brexit impacted the movement of goods, services and people between the UK and EU.

- **Brexit would also be a prolonged and complicated process, creating much uncertainty** that would impact on economic activity. EU law (Article 50) provides for a two year period for discussions on arrangements for exiting the EU after a country decides that it wants to leave. This period might be extended. The earliest the UK would leave the EU is likely to be mid-2018 but the effects of Brexit will start to be felt from once the referendum vote is taken.



- Indeed, **we are already seeing an impact, with sterling losing considerable ground** since the start of December on growing concerns about a possible Brexit. There are also reports that the uncertainty in the lead up to the referendum vote is impacting on economic activity in the UK, especially investment.