Market Bulletin

15 January 2021

What are the implications of the Brexit deal for the economy and markets?

It is hard to remember a time when Brexit was not dominating British headlines, but at the midnight hour, UK and EU negotiators finally reached agreement on a new trade deal. This piece addresses the key questions surrounding the deal: what is covered, how does it impact the outlook for the UK economy, and what are the market implications?

What does the Brexit deal cover?

The EU-UK Trade and Cooperation Agreement is a patchwork of compromises that enables both sides to claim victories, with the EU preserving the integrity of the single market and the UK ensuring tariff-free and quota-free goods trade. For goods sectors, the deal is far better than the alternative of World Trade Organisation (WTO) terms, although trade will still face significant non-tariff barriers. For example, a lack of mutual recognition of conformity assessments – whereby each side agrees to recognise the other's product standards without requiring its own checks – increases the likelihood of delays at the border. The deal is less comprehensive on services sectors (which make up about 80% of the UK economy), with only loose commitments on market access and no equivalence for financial services. Both sides are aiming to agree a Memorandum of Understanding for the financial sector by March, but it is unclear whether this will substantially change the existing deal.

What are the implications for the UK economy?

Compared to the alternative of the transition period ending with no deal being reached, the deal is a clear positive for the UK economy. For context, the UK Office for Budget Responsibility's November forecast pencilled in a 2-percentage point reduction in UK real GDP for 2021 in the event of no deal. The government will hope a reduction in Brexit-related uncertainty will boost UK business investment, which has stagnated alarmingly in recent years. Over the medium term, the economic impact will in part be determined by the extent to which the UK government decides to diverge from EU regulation. The more that the UK looks to forge its own regulatory path, the greater the reduction in EU market access that will likely follow. The deal may also evolve going forward, with a review of the full agreement scheduled every five years (which incidentally ensures that Brexit will be back on the agenda when the next UK general election comes around).

How might the deal impact the Bank of England (BoE)?

As political uncertainty dissipates, the BoE will be focused on ensuring that sufficient support is in place to shepherd the UK economy through a difficult few months. While the outlook has deteriorated in light of new lockdowns, the BoE acted pre-emptively in November to expand asset purchases by £150 billion, creating ample room to ramp up the pace of Gilt purchases, if required, without announcing a major policy change. A move to negative interest rates cannot be ruled out later in the year if inflation remains below target, but views across the Monetary Policy Committee currently appear split on the efficacy of further rate cuts.

AUTHOR

Karen Ward
Chief Market Strategist for EMEA

What is the outlook for sterling?

We expect the importance of domestic politics as a driver of the pound to diminish as global forces take hold. The Brexit deal has clearly played a role in the sterling rally over recent months, but this move has also been driven by vaccine approvals, given the disproportionate hit to the UK economy from the pandemic last year. Our base case of a robust rebound in activity in the second half of this year should support modest further weakening of the US dollar vs. most major currencies, including the British pound. While forecasting currency moves is always challenging, we would view somewhere in the region of 5% upside for the pound vs. the US dollar by year end as a reasonable estimate in our central scenario.

What is the outlook for UK equities?

In our view, Brexit is only one piece of the puzzle for UK equities. Of greater consequence is the relative performance of the UK with regards to the handling of the virus and reopening of the economy. And the prospect for a rally in global financials, energy and material given the relatively high weighting of these three sectors in the UK index (42% of the FTSE 100 vs. 16% of the S&P 500). An acceleration in the global economy driven by the release of pent-up demand later in the year should bode well for UK stocks on a relative basis, particularly if we see a steepening in global yield curves. Valuations are also supportive: 12-month forward price-to-earnings valuations began this year close to two standard deviations below their long-term average vs. MSCI World.

Another factor that stands in the UK market's favour is the relatively high level of income that it offers. The dividend yield on the FTSE All-Share stands at around 3.5%, close to double that of the global stock market and particularly attractive in the context of near-record low bond yields. 2020 was a tough year for income investors as dividends were cut alongside interest rates, but analyst expectations for future payouts from UK companies are now bouncing back sharply. The resumption of UK bank dividends in 2021 is particularly notable given that the sector has historically been one of the largest dividend payers.

In summary, following almost five years of steady outflows from UK equity funds at an industry level, investor appetite may now be set to improve as the political clouds clear.

The Market Insights program provides comprehensive data and commentary on global markets without reference to products. Designed as a tool to help clients understand the markets and support investment decision-making, the program explores the implications of current economic data and changing market conditions. For the purposes of MiFID II, the JPM Market Insights and Portfolio Insights programs are marketing communications and are not in scope for any MiFID II / MiFIR requirements specifically related to investment research. Furthermore, the J.P. Morgan Asset Management Market Insights and Portfolio Insights programs, as non- independent research, have not been prepared in accordance with legal requirements designed to promote the independence of investment research, nor are they subject to any prohibition on dealing ahead of the dissemination of investment research.

This document is a general communication being provided for informational purposes only. It is educational in nature and not designed to be taken as advice or a recommendation for any specific investment product, strategy, plan feature or other purpose in any jurisdiction, nor is it a commitment from J.P. Morgan Asset Management or any of its subsidiaries to participate in any of the transactions mentioned herein. Any examples used are generic, hypothetical and for illustration purposes only. This material does not contain sufficient information to support an investment decision and it should not be relied upon by you in evaluating the merits of investing in any securities or products. In addition, users should make an independent assessment of the legal, regulatory, tax, credit, and accounting implications and determine, together with their own financial professional, if any investment mentioned herein is believed to be appropriate to their personal goals. Investors should ensure that they obtain all available relevant information before making any investment. Any forecasts, figures, opinions or investment techniques and strategies set out are for information purposes only, based on certain assumptions and current market conditions and are subject to change without prior notice. All information presented herein is considered to be accurate at the time of production, but no warranty of accuracy is given and no liability in respect of any error or omission is accepted. It should be noted that investment involves risks, the value of investments and the income from them may fluctuate in accordance with market conditions and taxation agreements and investors may not get back the full amount invested. Both past performance and yields are not a reliable indicator of current and future results. J.P. Morgan Asset Management is the brand for the asset management business of JPMorgan Chase & Co. and its affiliates worldwide. To the extent permitted by applicable law, we may record telephone calls and monitor electronic communications to comply with our legal and regulatory obligations and internal policies. Personal data will be collected, stored and processed by J.P. Morgan Asset Management in accordance with our privacy policies at https://am.jpmorgan.com/global/privacy. This communication is issued by the following entities: In the United States, by J.P. Morgan Investment Management Inc. or J.P. Morgan Alternative Asset Management, Inc., both regulated by the Securities and Exchange Commission; in Latin America, for intended recipients' use only, by local J.P. Morgan entities, as the case may be.; in Canada, for institutional clients' use only, by JPMorgan Asset Management (Canada) Inc., which is a registered Portfolio Manager and Exempt Market Dealer in all Canadian provinces and territories except the Yukon and is also registered as an Investment Fund Manager in British Columbia, Ontario, Quebec and Newfoundland and Labrador. In the United Kingdom, by JPMorgan Asset Management (UK) Limited, which is authorized and regulated by the Financial Conduct Authority; in other European jurisdictions, by JPMorgan Asset Management (Europe) S.à r.l. In Asia Pacific ("APAC"), by the following issuing entities and in the respective jurisdictions in which they are primarily regulated: JPMorgan Asset Management (Asia Pacific) Limited, or JPMorgan Funds (Asia) Limited, or JPMorgan Asset Management Real Assets (Asia) Limited, each of which is regulated by the Securities and Futures Commission of Hong Kong; JPMorgan Asset Management (Singapore) Limited (Co. Reg. No. 197601586K), this advertisement or publication has not been reviewed by the Monetary Authority of Singapore; JPMorgan Asset Management (Taiwan) Limited; JPMorgan Asset Management (Japan) Limited, which is a member of the Investment Trusts Association, Japan, the Japan Investment Advisers Association, Type II Financial Instruments Firms Association and the Japan Securities Dealers Association and is regulated by the Financial Services Agency (registration number "Kanto Local Finance Bureau (Financial Instruments Firm) No. 330"); in Australia, to wholesale clients only as defined in section 761A and 761G of the Corporations Act 2001 (Commonwealth), by JPMorgan Asset Management (Australia) Limited (ABN 55143832080) (AFSL 376919). For all other markets in APAC, to intended recipients only. For U.S. only: If you are a person with a disability and need additional support in viewing the material, please call us at 1-800-343-1113 for assistance.

Copyright 2021 JPMorgan Chase & Co. All rights reserved.

0903c02a82ae3f67