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For Client Use

Investment Event

UK exits EU

The UK is set to enter into a transition period with the EU whereby it negotiates its future economic relationship with the bloc

Given the tight timescale and a number of complex and politically contentious issues to be agreed on, there is uncertainty about how these talks will progress

Our views

UK growth performance remains hindered by Brexit-related uncertainty, which may continue during the transition period. Nevertheless, we estimate attractive UK equity valuations and maintain our overweight view in a global multi-asset portfolio context

The UK officially departs from the European Union (EU)

Over three and a half years after the UK voted to leave the European Union (EU) in a referendum, the country will officially exit the bloc (at 11pm GMT on 31 January). This follows the UK Conservative Party's decisive election victory on 12 December 2019 that allowed UK Prime Minister Boris Johnson to ratify his Withdrawal Agreement (WA) in the UK Parliament. The EU completed its ratification of the agreement on 30 January.

Transition period – what next?

The UK now enters into a transition period whereby it will no longer participate in EU decision making bodies, although will remain subject to EU law, continue to pay into the EU budget, and retain access to the EU customs union and Single Market. This period is due to end on 31 December 2020, unless extended by one or two years before 1 July.

This period will be used to negotiate the future UK-EU relationship. The UK government has maintained talks will be completed this year, with EU officials – including Commission President von der Leyen – indicating that only a relatively limited deal can be agreed in this timeframe. A number of complex and politically contentious issues are likely to be discussed, including:

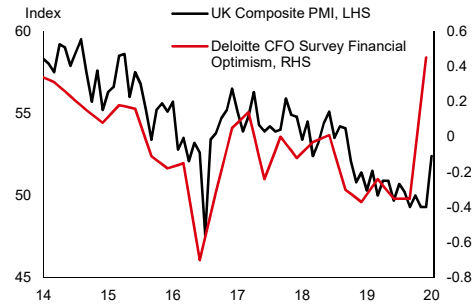
- EU and UK workers visa requirements
- Harmonisation of state aid rules and environmental/labour protection standards.
- The degree of future access to UK waters by EU fishermen
- The degree of supremacy of the European Court of Justice (ECJ) in various legal matters

UK economic outlook

Brexit-related uncertainty and soft global growth weighed on UK activity in 2019, with GDP growth in Q4 expected to have stalled. Positively, however, the household sector has proven to be fairly resilient, helped by rising wage growth and falling inflation boosting household real incomes. Recent gains in sterling means inflation has the scope to remain low in 2020. Overall, consumer spending is expected to remain the key driver of growth.

Meanwhile, following the outcome of December's general election, UK sentiment indicators have jumped higher (Figure 1).

Figure 1: UK survey data



Source: Macrobond, Bloomberg, Data as at 31 January 2020.
Past performance is not a reliable indicator of future performance

This is likely due to (i) greater clarity on the future course of Brexit, (ii) the avoidance of perceived business-unfriendly policies pledged by the UK Labour Party, and (iii) easing US-China trade tensions. Nevertheless, it is uncertain if this will translate into improved "hard" data in the coming months (i.e. data capturing actual activity).

Also, business investment could remain subdued, reflecting ongoing uncertainty over the precise nature of the future UK-EU relationship, and the perceived risk of a "no-trade deal" departure from the transition period at the end of this year. Even with a trade deal in place, cross-border activity may be hit by any regulatory differences between the UK and EU that would imply non-tariff barriers (e.g. border checks), and a relationship on financial services that is limited in scope.

Market considerations

Our risk premia framework suggests very favourable relative valuations for **UK investment**, and although Brexit-related uncertainty may continue to weigh on UK growth, the impact could be offset somewhat by policy support. This includes possible Bank of England easing this year, and higher government spending on infrastructure projects to be confirmed at March's budget. Overall, we maintain our existing overweight view on UK equities in global multi-asset portfolios.

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