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Trading places - Is the turnaround in economic fortunes real, and what might it mean?

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All data is as at 9th October 2017.



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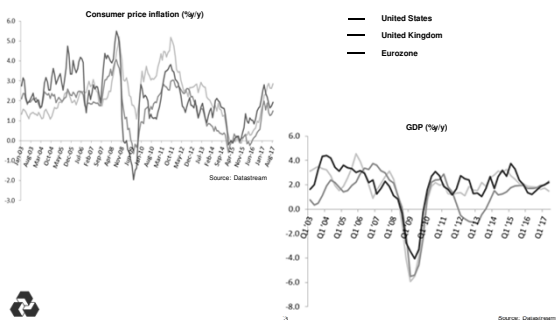
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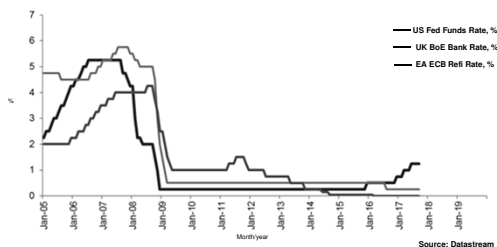
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The global economy – Inflation up, GDP slow, Euroland improving



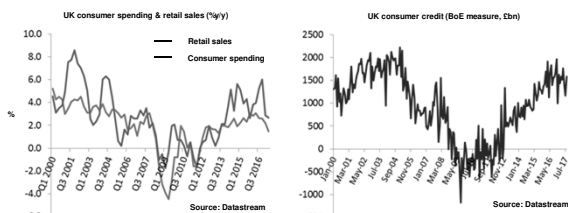
Source: Datastream

Monetary policy – is ultra loose monetary policy still needed?



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The UK – signs of a weaker domestic economy in H1 '17

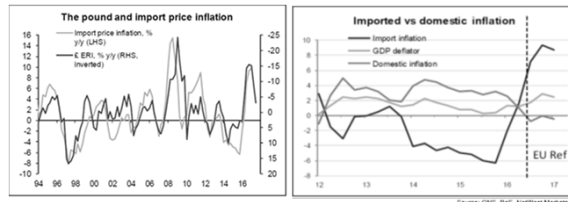


- In 2016, consumption expenditure has remained the solid foundation for growth. H1 & H2 2017 disappointed in the face of higher inflation.
- UK net trade is expected to help, but the figures have not yet shown much improvement.
- The BoE remain willing to accept some overshoot of inflation, but how much, or is growth still more important than inflation?



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The UK – is the inflation rise temporary?

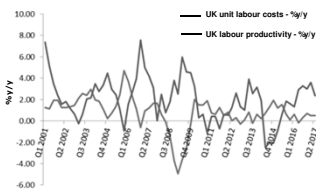


- We estimate that a sustained 15% depreciation (appreciation) in sterling boosts (lowers) import price inflation by 7.5 percentage points.
- There is considerable uncertainty about the extent to which firms will be able to pass on cost increases to consumers and whether this will trigger wage inflation – we are sceptical.
- Given that the overall GDP deflator (which correlates closely with CPI inflation) is running around 2.5%, this implies 'domestic' inflation is close to 0%.
- With the effect of the GBP depreciation now working through the CPI inflation calculation and we could see CPI inflation begin to fall before year end.



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Productivity – a puzzle that needs unlocking



- UK productivity growth was assumed to trend around 2% prior to the financial crisis, although in reality it was probably a little below this on average.
- Post the financial crisis we have rarely seen productivity growth at or close to 2%.
- A lack of productivity growth would, under normal circumstances prompt higher levels of inflation.
- The ONS have recently admitted that UK unit labour costs are significantly higher in Q2 than originally indicated.
- Higher unit labour costs could prompt a change in strategy from the Bank of England, although other areas of the UK economy are underperforming.

Source: Datastream



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Brexit – the timelines

29-Mar	UK trigger Article 50
29-Apr	EU Summit on UK's EU exit
08-Jun	UK general election (hung parliament - Conservatives largest party)
19-Jun	Formal negotiations begin between UK/EU
24-Sep	German general election
15-Oct	Austrian general election
Q4	UK Budget
19-20 Oct	Council of Europe meeting
14-16 Dec	Council of Europe meeting
20-May-18	Italian general election to be held no later than this
end Q3 2018	Conclusion of negotiations?
Q1 2019	UK to leave EU

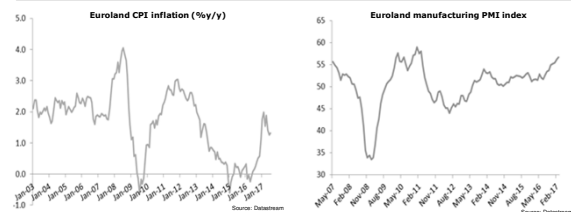
The UK/EU Brexit negotiations are set to follow a 3 stage approach:

- 1) Negotiations on the UK-EU split.
- 2) Negotiations on the bill for that split, based on the UK's financial pre-commitments.
- 3) Negotiations on a future agreement on trade.



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The Euroland recovery - changing the ECB's approach?

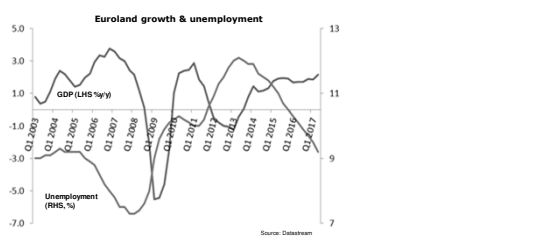


- A recovering Euroland economy has led to higher inflation, but a recovering EUR is exercising downward pressure on headline rates now.
- Will the ECB be forced to change their approach given the strength in the data?



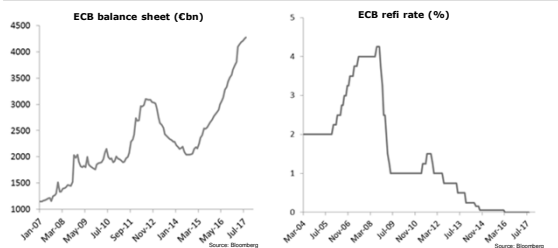
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The Euroland recovery - changing the ECB's approach?



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The Euroland recovery - changing the ECB's approach?

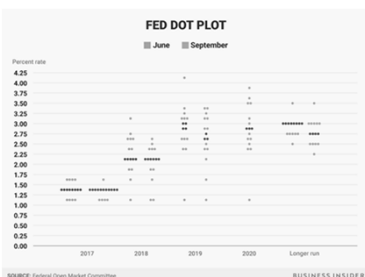


- A announcement to reduce in the pace of monetary expansion may come in the next few months, but there seem few signs of a desire to tighten monetary policy over the months and quarters ahead.
- Perhaps the deposit rate could be made less negative, but given the strength of the EUR, the ECB will likely be cautious over any such actions.



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The US – not all about the dot plots



- The Federal Reserve's monetary policy strategy may be switching from just rate increases to balance sheet reduction.
- Their plan though is likely to be influenced by the US President's plans to alter the tax regimes on personal incomes and corporate profits.
- His ability to push through this agenda with the Senate and House will be in part prompted by the debate over the debt ceiling.
- Tighter US monetary policy and looser fiscal policy could prompt a significant USD appreciation.



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