



R&R Weekly Column
By Brunello Rosa



Will Covid Provide Boris Johnson With The Perfect Excuse For A No-Deal Brexit?

According to the [most recent statistics](#), the UK is now third in the ranking of countries most affected by Coronavirus, after the US and Spain. It is second (after the US) in terms of number of deaths, with around 32,000 reported victims. Given the severity of the situation, the government, [after initial hesitation](#), launched a complete lockdown of the country and its [economy on March 23rd](#). Now, the government [seems ready to relax some of these rules](#) (for example, on daily exercise), while also tightening boarder controls (e.g. imposing a 14-day quarantine on anybody arriving in the UK). The central government – but not, for example, the devolved government in Scotland – is ready to move from the slogans “Stay Home/Protect the NHS/Save Lives” to “Stay Alert/Control The Virus/Save Lives”.

The impact of the pandemic and lockdown on the UK economy was recently estimated by the Bank of England, [in the “illustrative scenario” described in its May Monetary Policy Report](#). The Bank estimated a 14% drop in the UK’s economic activity in 2020, followed by a V-shaped recovery of 15% in 2021. This estimate takes into consideration the overall policy response, namely [a massive fiscal stimulus accompanied by a large monetary easing package](#), including rate cuts, increased QE and credit easing measures. The fiscal stimulus includes the innovative Job-Retention Scheme, by which the government will pay 80% of the salary of “furloughed” employees (up to GBP 2,500 a month) as long as their companies do not fire them, until June 30. The monetary stimulus includes a form of direct fiscal deficit, with the re-activation of the Bank’s [“Ways and Means”, i.e. the Treasury account at the BoE](#).

While the pandemic and containment measures take their toll on the UK economy, the other major chapter of the UK’s political economy, [Brexit negotiations](#), has re-started. As we have discussed in our [previous analysis](#), the UK has no intention to seek another extension to the implementation period beyond December 2020. The EU now seems to have accepted this position, which initially was motivated by the UK’s intention not to repeat the experience of requesting multiple extensions as occurred during the prime ministership of Theresa May, which led to political chaos. But now there are two additional motivations, which we consider to be even stronger.

First, as we explained in our analysis, “no deal” Brexit is the only logical conclusion of the approach brought forward by Johnson and his political side of the Conservative party, which won in a resounding way at the [December 2019 elections](#). *Second*, the economic damage caused by the pandemic and the containment measures will easily mask any economic damage deriving from “no-deal” Brexit. The most visible aspect, namely travel restrictions and border controls, would be implemented anyway due to Covid.

Thus for now the UK government has all the advantages of not seeking for an extension by June 30 while knowing that it can always get one at the very last minute). It will make “no deal” more likely, thereby strengthening its negotiating position at the table. And if a hard Brexit does occur, it is probably what hard-Brexiters such as Boris Johnson and his chief advisor Dominic Cummings, Dominic Raab (currently foreign minister and senior secretary of state) and Michael Gove (in charge of Brexit planning) ultimately want.

What happens if a no-deal, hard Brexit eventually occurs as a result of this tough negotiating approach? Well, the economic damage deriving from leaving the customs union and the single market without a deal, as well as increased border controls and customs checks, will likely be attributed by the government to the pandemic and the lockdown, rather than to the hard Brexit. The UK will also be free to respond to the additional economic shock by completely dis-aligning itself from the EU in terms of taxation, regulation, as well as product and labour standards. In the post-Covid world, where every country will try to do as much as possible just to remain afloat, the UK position might even not be perceived particularly at odds with that of other European countries, including those who will remain in the EU.

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Looking Ahead

The Week Ahead: US Retail Sales and Inflation Expected To Decline Further, EZ GDP Expected To Contract Sharply In Q1

In the US, retail sales are expected to decline by -10.0% m-o-m in April (p: -8.7%). April's CPI inflation is projected to drop to 0.8% y-o-y (p: 1.5%) - on account of lower energy prices - and core-CPI to decline to 1.7% y-o-y (p: 2.1%).

In the EZ, Q1-2020 preliminary GDP is forecasted at -3.3% y-o-y (p: 1.0%), as COVID-19 takes a toll on economic activity. March's IP is also expected to further contract by -12.0% (p: -0.1%).

In New Zealand, the RBNZ is expected to provide further stimulus while keeping its key policy rate unchanged at 0.25%.

The Quarter Ahead: Higher Debt, Disruptions To Global Supply Chains

The **COVID-19-induced economic shock** is deep and widespread, and will spur a sharp rise in public sector debt. Travel restrictions are likely to remain in place, with adverse impacts on trade and tourism.

In the US, while president Trump criticized China for "failing to hold up the January trade deal", his economic advisers released a reassuring statement, that "the agreement was valid and the truce intact". However, the Trump administration is reportedly planning to punish China for the pandemic, via: *i)* sanctions; *ii)* canceling US debt obligations; and *iii)* drawing up new trade policies. After large banks' earnings plummeted in Q1-2020 the Fed stated "the global banking system is more resilient and better placed to sustain financing to the real economy (...) than in the aftermath of the 2008 global financial crisis".

In the EZ, the EC decided to keep travel restrictions and internal border controls in place for another 30 days, until June 15, as "part of extraordinary measures that limit the spread of Coronavirus".

Systemic **Central Banks** policies will mostly focus on 'lending facilities', i.e.: *i)* the Fed's GFC-era revamped 'Commercial Paper Funding Facility'; *ii)* the expanded ECB's TLTROs; and *iii)* BoJ's new 'Special Operations'.

In the UK, the BoE forecast the economy to shrink by 14% in 2020, the biggest annual contraction since a decline of 15% in 1706.

In Australia, the RBA forecast GDP to shrink by around 10% in H1, and by 6% over 2020.

Last Week's Review

Real Economy: Unemployment On The Rise, Inflation Begins To Decline, Risks Remain Elevated

In the US, April's labor market suffered its worst month in history, as: *i)* nonfarm payrolls witnessed their largest drop ever, to -20.5m (c: 22.0m; p: 0.87m); *ii)* the unemployment rate spiked to 14.0%, a record high (c: 14.0%; p: 4.4%); and *iii)* average hourly earnings rose (a: 7.9% y-o-y; c: 3.3%; p: 3.3%) - as job losses mostly hit low-pay workers.

In the EZ, retail sales tumbled by -9.2% y-o-y (c: -10.5%; p: 2.5%), as lockdown measures forced: *i)* businesses closures; and *ii)* discretionary savings - as consumers stayed at home.

In the UK, the BoE forecast the deepest recession in 300 years, with GDP plunging by almost 30% in H1-2020; as a result, policymakers kept the key rate at its historical low of 0.10%, while maintaining the QE program at GBP 645bn.

In Australia, the RBA kept the cash rate at a record low of 0.25%.

In Norway, Norges Bank cut its policy rate by 25bps, to a record low of 0.00% (p: 0.25%), as economic activity was hit by: *i)* the sharp fall in oil prices; and *ii)* COVID-19's severe impact on surrounding countries.

Financial Markets: CBs Support Risk Appetite; Stocks Rise Despite US Labor Data, Bonds Flat

Market drivers: as extensive CB support keeps underpinning both safe and risky assets, the markets have likely priced in the upcoming severe economic recession, and investors look beyond tragic economic data.

Stocks: w-o-w, global indices rose (MSCI ACWI, +2.4%, to 490), driven by the US (S&P 500, +3.5% to 2,930), as investors focused on: *i)* the reopening of parts of the economy; along with *ii)* advances in the fight against COVID-19. EMs fell (MSCI EMs, -0.6% to 912) despite a positive performance from China (Shanghai Comp., +1.2% to 2,895). Volatility is declining from April levels (VIX S&P 500, -9.2 to 28.0), but it is still above its 52w and 10y averages.

Bonds: w-o-w, returns remained flat (BAML Global, -0.3% to 292.0) and 10y government yields rose across DMs (UST, +4bps to 0.68%; German bunds, +5bps to -0.53%; French OAT, +7 bps to -0.03%). The markets priced in expectations for the Fed to embark on a 'negative interest rates policy' (NIRP), despite the Fed's stated unwillingness to take official short-term rates below 0%.

FX: w-o-w, demand for USD strengthened (DXY, +0.7% to 99.734), and demand for EUR and GBP weakened (EUR/USD, -1.3% to 1.084; GBP/USD, -0.8% to 1.241). EM currencies fell marginally (MSCI EM FX index, -0.1% to 1,567).

Commodities: Industrial commodities prices posted gains and oil prices rose for the second consecutive week (Brent, +17.1% to 31.0 USD/b; WTI, +25.1% to 24.7 USD/b), as producers rapidly shut production. Gold maintained its safe haven appeal (+0.1 to 1,701 USD/Oz.), driven by abundant liquidity of monetary and fiscal stimuli.



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Abbreviations, Acronyms and Definitions

a	Actual	LN	Northern League, Italy
AKP	Justice and Development Party, Turkey	MSS	Five Star Movement, Italy
ann.	annualized	m-o-m	Month-on-month
ARS	Argentinian Peso	mb	Million barrels
avg.	Average	mb/d	Million barrels per day
bn	Billion	MENA	Middle East and North Africa
BoC	Bank of Canada	MHP	Nationalist Movement Party, Turkey
BoE	Bank of England	mn	Million
BoJ	Bank of Japan	MPC	Monetary Policy Committee
bpd	Barrels per day	NAFTA	North-American Free Trade Agreement
bps	Basis points	NATO	North Atlantic Treaty Organization
BS	Balance sheet	OECD	Organization for Economic Cooperation and Development
c	Consensus	Opec	Organization of Petroleum Exporting Countries
C/A	Current account	p	Previous
CB	Central bank	P2P	Peer-to-peer
CBB	Central Bank of Bahrain	PBoC	People's Bank of China
CBK	Central Bank of Kuwait	PCE	Personal Consumption Expenditures
CBT	Central Bank of Turkey	PE	Price to earnings ratio
CDU	Christian Democratic Union, Germany	PM	Prime minister
CNY	Chinese Yuan	PMI	Purchasing managers' index
CPI	Consumer Price Index	pps	Percentage points
DJIA	Dow Jones Industrial Average Index	pw	Previous week
DJEM	Dow Jones Emerging Markets Index	QCB	Qatar Central Bank
d-o-d	Day-on-day	QAR	Qatari Riyal
DXY	US Dollar Index	QE	Quantitative easing
EC	European Commission	q-o-q	Quarter-on-quarter
ECB	European Central Bank	RE	Real estate
ECJ	European Court of Justice	RBA	Reserve Bank of Australia
EIA	US Energy Information Agency	RRR	Reserve Requirement Ratio
EM	Emerging Markets	RUB	Russian Rouble
EP	European Parliament	SWF	Sovereign Wealth Fund
EPS	Earnings per share	tn	Trillion
EU	European Union	TRY	Turkish Lira
EUR	Euro	UAE	United Arab Emirates
EZ	Eurozone	UK	United Kingdom
Fed	US Federal Reserve	US	United States
FOMC	US Federal Open Market Committee	USD	United States Dollar
FRB	US Federal Reserve Board	USD/b	USD per barrel
FX	Foreign exchange	UST	US Treasury bills/bonds
FY	Fiscal Year	VAT	Value added tax
GCC	Gulf Cooperation Council	VIX	Chicago Board Options Exchange Volatility Index
GBP	British pound	WTI	West Texas Intermediate
GDP	Gross domestic product	WTO	World Trade Organisation
IMF	International Monetary Fund	w	Week
INR	Indian Rupee	w-o-w	Week-on-week
IPO	Initial public offering	y	Year
IRR	Iranian Rial	y-o-y	Year-on-year
JPY	Japanese yen	y-t-d	Year-to-date
k	thousand	ZAR	South African Rand
KSA	Kingdom of Saudi Arabia	2y; 10y	2-year; 10-year