



## Summary

### Emerging countries

#### Hangover

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### United Kingdom

#### After the referendum

UK's historic vote to leave the European Union is now likely to be followed by a long process of negotiating the exit and the new relationship.

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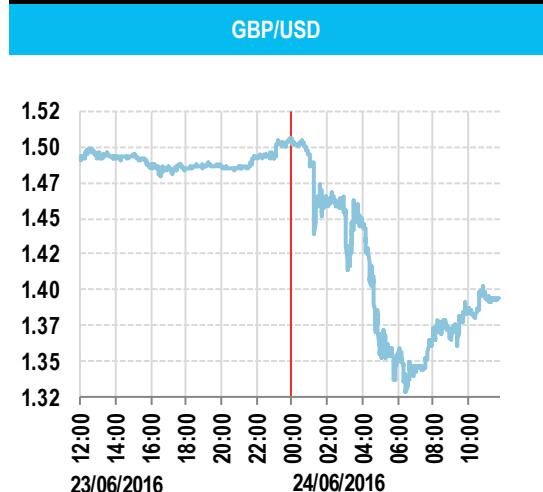
### Also in :



## UK votes to leave the EU

- Brexit camp won the referendum
- Financial markets reacted negatively
- A long negotiation process lies ahead

The Brexit camp has won the referendum on UK's European Union (EU) membership. The financial markets, which anticipated a "remain" victory, reacted negatively: GBP and the equity markets were particularly hard hit, even though the initial reaction has since eased somewhat (see chart). All major central banks (Bank of England as well as the Bank of Japan, the European Central Bank and the Federal Reserve) have declared to be ready to ensure markets' liquidity. The UK vote paves the way for potentially long negotiations on exit conditions and the new relationship with the EU. Article 50 of the Lisbon Treaty provides for the possibility of a 2-year period, but an extension could be granted if the European Council, in agreement with the member state concerned, decides unanimously to do so. The negotiations will begin once the UK government sends the European Council notification that it intends to leave the EU. Before that can happen, a new executive team will have to be formed after David Cameron announced his resignation as Prime Minister. The UK has likely entered a prolonged period of uncertainty that will weigh on its economy (see Focus 1).



Source: Bloomberg

## THE WEEK ON THE MARKETS

Week 17-6-16 > 24-6-16 at 16:00:00

↘ CAC 40	4 194	► 4 150	-1.1 %
↘ S&P 500	2 071	► 2 058	-0.6 %
↗ Volatility (VIX)	19.4	► 21.2	+1.8 %
↘ Euribor 3M (%)	-0.27	► -0.28	-1.6 pb
↘ Libor \$ 3M (%)	0.64	► 0.62	-1.6 pb
↘ OAT 10y (%)	0.43	► 0.36	-6.6 pb
↘ Bund 10y (%)	0.02	► -0.06	-8.3 pb
↘ US Tr. 10y (%)	1.61	► 1.58	-3.3 pb
↘ Euro vs dollar	1.13	► 1.11	-2.1 %
↗ Gold (ounce, \$)	1 295	► 1 320	+1.9 %
↘ Oil (Brent, \$)	49.2	► 48.6	-1.2 %

Source: Bloomberg



## Emerging countries

### Hangover

- A few commodity exporting countries are in a truly alarming financial situation.
- Although commodity prices have rebounded since February, there is still room for a downward correction.
- An emerging market sovereign debt crisis similar in nature and size to the Latin American crisis of the 1980s seems unlikely.
- Yet the financial buffers (foreign reserves and assets sovereign funds that can be rapidly converted into hard currency) are eroding much faster than previously expected.

For emerging countries that are commodity exporters, the party is not only over, to use Ricardo Hausmann's expression<sup>1</sup>, but a massive hangover is looming. Since 2015, there has been a rise in the cases of extension of repayment periods, and even a few cases of default, by sovereign or quasi-sovereign counterparties on their external and domestic commitments (the Brazilian State of Rio, Mozambique and Trinidad & Tobago for the first; the Republic of Congo for the second). There have also been severe devaluations (Argentina, Kazakhstan) and the emergency tightening of forex controls (Angola, Azerbaijan, Kazakhstan, Nigeria, Venezuela and Zambia). We are also seeing late payments to local suppliers (Saudi Arabia) and employees (the Brazilian State of Rio). Three years after the eurozone crisis, is the emerging world about to be swept by a sovereign debt crisis? Like a wildfire, a trigger and a propitious ground are both needed to spark a crisis.

#### Commodity prices: an unfinished correction?

In this case, the trigger is obviously the decline in commodity prices. Despite a marked rebound since February, notably for oil and metals, commodity prices still have a long way to go before erasing the 2014-15 downturn. Moreover, the downward phase of the current *super cycle* is likely not over. In a study by B. Erten & J.A. Ocampo on data covering the period 1865-2010, the 1986 oil bust (which in our opinion is the period that most resembles the current situation) sent oil prices plunging (in real terms) to about 80% below the long-term trend (which was trending upwards), while metal and food commodity prices were down about 40% and 20%, respectively<sup>2</sup>. In 2010, the price gap (from the trend) was positive at about 30% for oil and metal prices, and 10% for agricultural commodities. Since 2010, we estimate that the price gap has become negative again, but only

<sup>1</sup>"The end of the emerging-market party", an article published in August 2013 on the Project Syndicate website, by Ricardo Hausman, former Chief Economist of the Inter-American Development Bank and Minister of Planning for Venezuela, and currently a professor at Harvard University and Director of the Center for International Development.

<sup>2</sup> Metal and agricultural commodity price trends had reached the bottom of a very long downturn in a super cycle that started at the beginning of the last century. See B. Erten & J.A. Ocampo, "Super cycles of commodity prices since the mid-nineteenth century" DESA working paper n°110 - Anna Dorbec, "Commodity prices: how long will the blues last?" Conjoncture BNP Paribas Jan. 2016

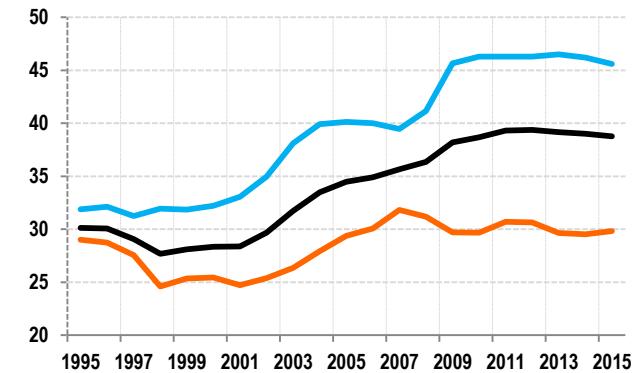
#### ■ Investment overhang

Investment rate (volume - % GDP)

— Main commodity exporters

— China

— Other main commodity importers



Chart

Sources: IMF, IIF, BNP Paribas

by about 25% for oil and 20% for metals, which suggests that there is still room for a correction, at least compared to the long stagnation of 1986-2005. For agricultural commodity prices, the differential is still slightly positive<sup>3</sup>.

In addition to these short-term corrections, the trend is downward for at least two reasons. First, China's economic slowdown is bound to continue. Second, the commodity producing countries have only just begun to scale back investment (see chart). Consequently, there is currently surplus production capacity. With the exploitation of shale oil and gas in the hydrocarbon sector, capacity is even more reactive to price variations than in the past, which means that higher prices rapidly generate additional supply. In the medium-to-long term, a greater elasticity of supply to price fluctuations reduces, all other factors being equal, the cyclical nature of prices (but not volatility of course). In the short term, however, when combined with sluggish demand, it continues to squeeze prices.

#### Sovereign debt: the oak tree has turned into a fragile willow

Fortunately the ground is less propitious for the outbreak of a sovereign debt crisis than in the past. Over the very last years, there have been very few sovereign defaults in the emerging countries. Compared to the past, the default rate could have been much higher. A very long-term retrospective study shows that the rate of countries entering a new default in 2010-2015 (in both the emerging and advanced countries) averaged slightly more than 5% a year (including for the year 2015 alone), whereas it had reached about

<sup>3</sup> Ordinarily, the business cycle and contagion effects do not affect agricultural commodity prices as much as oil and metal prices, because supply is predominately affected by purely exogenous or structural factors (i.e. weather conditions and substitutes for fossil fuels, respectively).



35% between 1981 and 1986 (i.e. before the oil price bust of 1986)<sup>4</sup>. At the time, the main reason was the tightening of US monetary policy, which drove Mexico into default, the typical example of the “original sin” (countries resorting to external hard-currency financing, in this case in dollars, because of the lack of domestic funds in the local currency), and triggered the (first) Latin American sovereign debt crisis.

The reasons for the low rate of new defaults until 2015 are well known: the oil producing countries accumulated financial resources either as foreign reserves or assets in sovereign funds. Moreover, sovereign debt ratios are lower, debt maturity is longer and the share of hard currency debt is lower than in the early 1980s. All in all, the debt servicing charge is not as high nor as risky.

An emerging market sovereign debt crisis of the kind and size of the Latin American crisis in the 1980s is, *a priori*, very unlikely. Yet for countries that depend heavily on oil and metal prices, the financial buffers that were built up during the upward phase of the *super cycle* (foreign reserves and assets of sovereign funds easily convertible into currency) are eroding much faster than expected, notably in Africa, which explains the reintroduction of currency controls. Yet as economic history shows, this is generally the last rampart before default.

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<sup>4</sup> C. Reinhart V. Reinhart & C. Trebesch: “Global cycles: capital flows, commodities and sovereign defaults, 1815-2015” NBER working paper n°21958 - February 2016.



## United Kingdom After the referendum

- UK's historic vote to leave the European Union is now likely to be followed by a long process of negotiating the exit and the new relationship.
- Within the Conservative party speculation over a change of leadership will probably now mount.
- With Scotland's electorate having expressed a desire to remain in the EU there is a possibility for calls for a second Scottish independence referendum.
- Uncertainty over the future UK-EU relationship and the UK political outlook will weigh on the economy. We expect it to stagnate over the next two to three quarters. Overall, we expect the level of GDP in 2018 to be almost 2% lower than previously forecast.
- Sterling is expected to weaken which will put upward pressure on inflation. We see CPI inflation at 2.7% in 2018, against our previous 2.0% forecast.
- We expect the Bank of England to ease policy cutting the Bank rate to zero and upping asset purchases (QE) by GBP 100bn.

### The start of a long process

UK's historic vote to leave the European Union will now in all likelihood lead to negotiations about the exit and the new relationship with the EU. We expect the process of leaving the EU to be protracted. The first step is for the UK government to notify the European Council of its intention to withdraw. We think it is unlikely that this notification will happen before the end of 2016. When it does it triggers negotiations for a withdrawal agreement, with a firm two-year deadline, after which European rules (or at least some of them) no longer automatically apply. Until that point, the UK remains bound by EU law. Negotiating a withdrawal agreement in the following two-year window looks challenging, in light of the substantial trade ties between the UK and EU, the breadth of EU-related UK legislation that has built up over 40 years of membership and the substantial numbers of EU citizens resident in the UK and vice versa whose status must be decided.

If the UK were to opt to join the European Economic Area (EEA), this could be implemented more quickly than a bespoke agreement. However, EEA membership means the UK would have to apply European laws relating to the Single Market, continue to pay a contribution to the EU budget (albeit a reduced one) and accept free movement of labour for EU citizens. If EEA membership proves not to be a viable (long-term) option, one of the most difficult and economically important areas to address will be the UK's future trading relationship with the EU and its member states. There is also the need to forge trade deals with over 50 non-EU countries that the UK currently trades with on the basis of agreements signed by the EU. Trade negotiations are typically long processes.

### Political uncertainty

The domestic political outlook is surrounded by a significant degree of uncertainty. Could Mr Cameron survive as prime minister following a vote to leave the EU, given his position as the lead proponent for remaining in the EU and the hostile nature of the campaign? Another question is whether the UK's vote to leave the EU could lead to a second Scottish independence referendum. Such a possibility would add to what may well be a relatively unstable domestic political situation over the coming years.

### Negative economic impact

We expect the economy to be negatively affected through four main channels: uncertainty and confidence; financial markets; foreign direct investment and other capital flows; and trade and income flows. There are, however, some potential gains from an exit that could soften the impact: an end to the UK's contribution to EU budget, or at least a reduction, should the UK end up as a European Economic Area (EEA) member; an ability to agree bilateral trade deals with non-EU economies (currently this is done by the EU on behalf of the UK); greater control over regulation, which could raise productivity and supply-side potential; and increased competitiveness, since sterling is expected to weaken.

Overall, as a result of the UK voting to leave the EU, we have revised down our forecasts for growth by about 0.3 percentage point (pp) this year and almost 1.5pp next year. We also expect 2018 growth to be marginally lower than previously assumed. In sum, the level of GDP is almost 2% lower than we had expected it to be in our previous forecasts. The main points are as follows:

- Heightened uncertainty and financial-market volatility will cause markedly weaker investment.
- Corporate retrenchment is also likely to be evident in reduced job creation and higher unemployment.
- An assumed 10% persistent fall in sterling relative to its trade-weighted value at the end of May puts upward pressure on inflation via import prices.
- Lower nominal wage growth and higher inflation squeeze real wages, which stagnate in 2017 and rise only modestly in 2018. Consumer spending is consequently expected to be notably weaker than had the UK opted to remain in the EU.

We expect policy easing by the Bank of England: a reduction in the Bank rate to zero from 50 basis points, the activation of liquidity measures and a GBP 100bn increase in QE.

Of course, all the forecasts presented here are significantly more uncertain than normal.

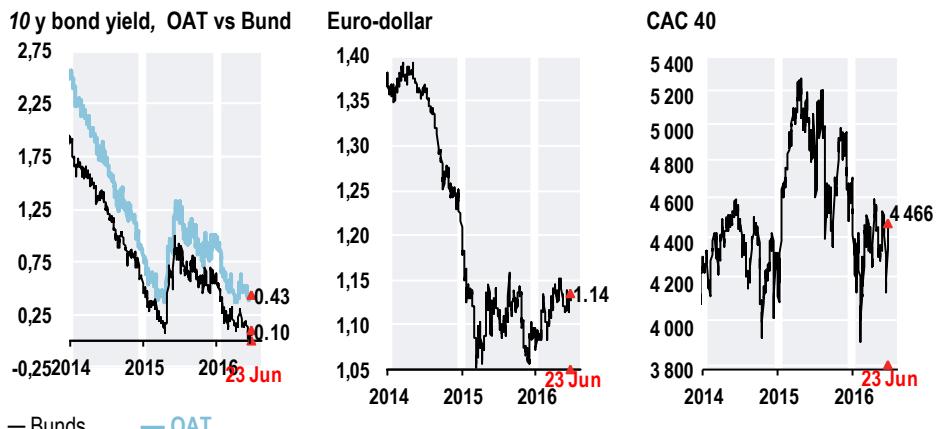


## Markets overview

## The essentials

Week 17-6-16 &gt; 24-6-16 at 16:00:00

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## Money &amp; Bond Markets

		highest' 16	lowest' 16	
€ ECB	0.00	0.05	at 01/01	0.00 at 16/03
Eonia	-0.35	-0.13	at 01/01	-0.36 at 26/05
Euribor 3M	-0.27	-0.13	at 01/01	-0.27 at 23/06
Euribor 12M	-0.03	0.06	at 01/01	-0.03 at 21/06
\$ FED	0.50	0.50	at 01/01	0.50 at 01/01
Libor 3M	0.64	0.69	at 31/05	0.61 at 04/01
Libor 12M	1.25	1.34	at 31/05	1.12 at 12/02
£ BoE	0.50	0.50	at 01/01	0.50 at 01/01
Libor 3M	0.59	0.59	at 15/02	0.57 at 15/06
Libor 12M	0.99	1.07	at 01/01	0.95 at 14/06

At 23-6-16

	Yield (%)	highest' 16	lowest' 16	10y bond yield & spreads, at 23-6-16
€ AVG 5-7y	0.12	0.49 at 12/01	0.11 at 09/06	7.93% Greece 782 pb
Bund 2y	-0.56	-0.34 at 01/01	-0.60 at 17/06	3.11% Portugal 300 pb
Bund 10y	0.10	0.63 at 01/01	-0.02 at 16/06	1.47% Spain 137 pb
OAT 10y	0.43	0.98 at 01/01	0.36 at 05/04	1.42% Italy 131 pb
Corp. BBB	1.63	2.50 at 20/01	1.60 at 10/06	0.78% Ireland 67 pb
\$ Treas. 2y	0.77	1.06 at 01/01	0.64 at 11/02	0.47% Belgium 37 pb
Treas. 10y	1.74	2.27 at 01/01	1.56 at 16/06	0.43% France 33 pb
Corp. BBB	3.57	4.50 at 12/02	3.54 at 10/06	0.39% Finland 28 pb
£ Treas. 2y	0.52	0.65 at 01/01	0.28 at 08/02	0.30% Netherland 19 pb
Treas. 10y	1.51	1.96 at 01/01	1.24 at 15/06	0.26% Austria 15 pb

At 23-6-16

## Commodities

	Spot price in dollars	lowest' 16	2016(€)
Oil, Brent	51	28 at 20/01	+35.5%
Gold (ounce)	1 264	1 062 at 01/01	+13.8%
Metals, LMEX	2 338	2 049 at 12/01	+1.6%
Copper (ton)	4 777	4 328 at 15/01	-2.9%
CRB Foods	368	329 at 11/01	+5.0%
wheat (ton)	167	146 at 04/01	+3.8%
Corn (ton)	145	134 at 31/03	+0.9%

At 23-6-16

Variations



## Exchange Rates

€=	highest' 16	lowest' 16	2016
USD	1.14	1.15 at 03/05	1.07 at 05/01 +4.5%
GBP	0.77	0.81 at 08/04	0.73 at 05/01 +4.0%
CHF	1.09	1.11 at 04/02	1.08 at 16/06 -0.1%
JPY	119.99	131.84 at 01/02	115.85 at 16/06 -8.2%
AUD	1.50	1.60 at 11/02	1.45 at 20/04 +0.3%
CNY	7.47	7.49 at 08/06	6.99 at 05/01 +5.8%
BRL	3.82	4.53 at 16/02	3.82 at 23/06 -11.2%
RUB	73.02	91.22 at 11/02	72.28 at 21/06 -8.0%
INR	76.36	77.50 at 11/02	71.42 at 05/01 +6.3%

At 23-6-16

Variations

## Equity indices

Index	highest' 16	lowest' 16	2016	2016(€)
CAC 40	4 466	4 637 at 01/01	3 897 at 11/02	-3.7% -3.7%
S&P500	2 113	2 119 at 08/06	1 829 at 11/02	+3.4% -1.0%
DAX	10 257	10 743 at 01/01	8 753 at 11/02	-4.5% -4.5%
Nikkei	16 238	19 034 at 01/01	14 953 at 12/02	-14.7% -7.1%
China*	55	59 at 01/01	48 at 12/02	-6.7% -10.8%
India*	461	466 at 08/06	393 at 11/02	+2.1% -3.9%
Brazil*	1 425	1 454 at 29/04	860 at 21/01	+16.8% +31.6%
Russia*	488	509 at 28/04	331 at 20/01	+8.9% +15.3%

Variations

\* Indices MCSI



These economic and financial forecasts do not incorporate the British referendum results.

## Economic forecasts

En %	GDP Growth			Inflation			Curr. account / GDP			Fiscal balances / GDP		
	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e	2015	2016 e	2017 e
<b>Advanced</b>	1.9	1.5	1.5	0.3	0.7	1.6				-2.5	-3.1	-3.1
United States	2.4	1.7	1.6	0.1	1.3	2.2	-2.7	-2.8	-2.9	-2.5	-3.1	-3.1
Japan	0.5	0.2	0.2	0.5	0.0	0.7	3.3	3.6	3.3	-4.6	-4.3	-4.2
United Kingdom	2.3	1.7	2.1	0.1	0.6	1.8	-5.2	-5.0	-4.0	-3.9	-3.2	-2.2
<b>Euro Area</b>	1.6	1.5	1.3	0.0	0.1	1.3	3.2	2.9	2.7	-2.1	-2.0	-1.8
Germany	1.4	1.5	1.3	0.1	0.3	1.6	8.6	8.4	7.8	0.7	0.2	0.2
France	1.2	1.4	1.3	0.1	0.4	1.2	-0.2	-0.1	-0.7	-3.5	-3.3	-3.0
Italy	0.6	1.0	0.7	0.1	-0.1	0.9	2.2	1.9	1.8	-2.6	-2.7	-2.5
Spain	3.2	2.8	2.0	-0.6	-0.6	1.3	1.4	1.2	1.1	-5.1	-4.0	-3.1
Netherlands	2.0	1.8	1.6	0.2	0.4	0.9	9.4	9.5	9.2	-1.8	-1.8	-1.6
Belgium	1.4	1.2	1.5	0.6	1.5	1.4	0.8	1.6	1.9	-2.6	-2.6	-2.4
Portugal	1.5	1.1	1.1	0.5	0.6	1.4	0.8	0.6	0.4	-4.4	-2.9	-2.7
<b>Emerging</b>	4.1	4.2	4.9	6.1	6.4	5.5						
China	6.9	6.6	6.3	1.4	1.9	2.2	3.1	3.2	2.4	-2.4	-3.0	-3.2
India	7.3	7.8	8.4	4.9	5.6	5.0	-1.3	-0.9	-1.3	-4.1	-3.9	-3.5
Brazil	-3.8	-3.0	2.0	9.0	8.6	5.0	-3.3	-1.1	-1.6	-10.3	-8.7	-7.0
Russia	-3.7	-0.5	2.0	15.6	7.4	6.4	5.3	3.5	3.6	-3.7	-4.5	-3.8
<b>World</b>	3.1	3.0	3.4	3.6	4.0	3.8						

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)

## Financial forecasts

Interest rates	2015				2016				2015	2016e	2017e	
	Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e				
End period												
<b>US</b>	Fed Funds	0.25	0.25	0.25	0.5	0.5	0.25-0.50	0.25-0.50	0.25-0.50	0.01	0.25-0.50	0.25-0.50
	3-month Libor \$	0.27	0.28	0.33	0.61	0.63	0.66	0.65	0.70	0.61	0.70	1.05
	10-year T-notes	1.93	2.35	2.03	2.27	1.79	1.84	1.55	1.60	2.27	1.60	1.75
<b>EMU</b>	Refinancing rate	0.05	0.05	0.05	0.05	0.00	0.00	0.00	0.00	0.05	0.00	0.00
	3-month Euribor	0.02	-0.01	-0.04	-0.13	-0.24	-0.26	-0.30	-0.30	-0.13	-0.30	-0.30
	10-year Bund	0.18	0.77	0.59	0.63	0.16	0.17	0.00	-0.20	0.63	-0.20	-0.20
	10-year OAT	0.42	1.20	0.90	0.98	0.41	0.51	0.30	0.10	0.98	0.10	0.10
	10-year BTP	1.29	2.31	1.73	1.60	1.23	1.49	1.10	0.80	1.60	0.80	0.80
<b>UK</b>	Base rate	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	0.50	1.00
	3-month Libor £	0.57	0.58	0.58	0.59	0.59	0.59	0.75	0.75	0.59	0.75	1.25
	10-year Gilt	1.58	2.03	1.77	1.96	1.42	1.46	1.35	1.50	1.96	1.50	1.80
<b>Japan</b>	Overnight call rate	0.02	0.01	0.01	0.04	-0.00	-0.30	-0.30	-0.30	0.04	-0.30	-0.50
	3-month JPY Libor	0.17	0.17	0.17	0.17	0.10	0.06	-0.05	-0.10	0.17	-0.10	-0.25
	10-year JGB	0.40	0.44	0.35	0.25	-0.04	-0.12	-0.20	-0.20	0.25	-0.20	-0.30

Exchange rates	2015				2016				2015	2016e	2017e	
	Q1	Q2	Q3	Q4	Q1	Q2e	Q3e	Q4e				
End period												
USD	EUR / USD	1.07	1.11	1.12	1.09	1.14	1.16	1.15	1.14	1.09	1.14	1.05
	USD / JPY	120	122	120	120	112	108	108	110	120	110	124
EUR	EUR / GBP	0.72	0.71	0.74	0.74	0.79	0.77	0.74	0.72	0.74	0.72	0.68
	EUR / CHF	1.04	1.04	1.09	1.09	1.09	1.14	1.14	1.16	1.09	1.16	0.01
	EUR/JPY	129	136	134	131	128	125	124	125	131	125	130

Source : BNP Paribas Group Economic Research / GlobalMarkets (e: Estimates & forecasts)



## Most recent articles

<b>JUNE</b>	17 June	<b>16-23</b>	Global: TTIP, a challenging obstacle course Eurozone: TLTR0-II, a weapon of choice Germany: Low rates and savings behaviour of households
	10 June	<b>16-22</b>	Global: The rise in the price of oil: short term relief, longer term concern? France: Loss of momentum?
	03 June	<b>16-21</b>	Eurozone: Patience and cautious optimism Germany: Savings surplus harms growth potential
<b>MAY</b>	27 May	<b>16-20</b>	Global: Updated economic forecasts: The challenge of 2017 Eurozone: A reverse snowball effect
	20 May	<b>16-19</b>	Eurozone: A slightly less buoyant environment Greece: A compromise will provide some relief
	13 May	<b>16-18</b>	United States: At a crossroads Eurozone: ECB: a race against time Spain: The persistent labour market duality
<b>APRIL</b>	29 April	<b>16-17</b>	Global: Helicopter money United States: Déjà vu? European Union: The Juncker Plan is still on track France: Stable business climate masks contrasting trends
	22 April	<b>16-16</b>	China: Public finances under pressure United States: Stripped to the core
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	08 April	<b>16-14</b>	United States: Already over? Japan: Gloomy Tankan
	01 April	<b>16-13</b>	United States: You don't change a winning team Japan: The year starts off slowly France: Significant reduction in the 2015 fiscal deficit
<b>MARCH</b>	25 March	<b>16-12</b>	France: A slow but unobstructed recovery Netherlands: Getting its house in order
	18 March	<b>16-11</b>	China: Priority on stabilising growth United States: Safety first Spain: Deadlocked
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