THE IMPACT OF THE BREXIT VOTE & THE ROAD AHEAD

June 30, 2016, 2 p.m. EDT

Operator: With that, let's go ahead and begin today's PNC Advisory Series event. It is my pleasure to turn today's call over to our moderator for today, and that is Paul Toth, Senior Vice President of Foreign Exchange with PNC Bank. Paul, with that, I'll turn the floor over to you.

Paul Toth: Thank you, Aaron. Good afternoon, everyone, and welcome to our PNC Advisory Series webinar, The Impact of the Brexit Vote and the Road Ahead. Thank you for joining us. I'm Paul Toth from PNC's Foreign Exchange Group. I'll be your moderator today.

Before we get started with our presentation, I wanted to highlight PNC's ongoing commitment to providing market insights, new ideas, and best practices like you are about to hear. Our commitment is reflected in the types of conversations our bankers are having with companies like yours every day. It is also reflected in our PNC Ideas thought leadership series, which features a monthly e-newsletter, live webinars, and a dedicated website at PNC.com/ideas.

The United Kingdom's vote to leave the European Union is unprecedented and has caused significant volatility and uncertainty around the world. This webinar will provide an overview of the decision and address its major impacts from multiple perspectives. We will also examine the key factors that will be influential going forward.

So today we are pleased to have Bill Adams, PNC's International Economist, Courtney Roberts, from PNC's UK office, and Tim McCarthy, a Senior Currency Trader from PNC's Foreign Exchange Group. We will facilitate a question-and-answer session at the end of the presentation. You can submit questions at any time throughout this presentation by using the Questions widget found in the lower portion of your screen.

So let's begin our dialogue by talking about the impact of the Brexit vote on the currency and other financial markets. Tim, can you lead us off and begin the discussion?

Tim McCarthy: Sure, Paul. Good afternoon, everybody. I'd like to discuss four points going forward here: the market position prior to the vote, the actual reaction that evening and into Friday morning, where markets are now, and what my view is in terms of expectations in the near and long term.

The best way to go about this is to look at a sterling chart. This chart goes back to actually when the referendum campaign started on April 15, but I need to back up a little bit and go to last year's vote, in which the Conservatives won an overwhelming majority to retain control of Parliament. This is what triggered Prime Minister Cameron's promise to hold an EU referendum.

The funny thing was is this kind of foreshadowed what we saw just last week. Odds makers had predicted that the Conservatives would win barely a majority — barely a minority, I should say — and they would have to form a government by incorporating other parties. Well, we all know what happened; they got that wrong. And Conservatives won overwhelmingly in a landslide victory. Polling data was completely wrong.

Fast-forward a year, and we'll run through what happened in late April through May and into June in terms of polling data. If you look at the chart, you'll see that basically until we hit June, the market is pretty stable. There are other forces at work in the currency markets at that time that traders were paying more attention to, particularly whether the Fed was going to hike rates or not.

Once we got to June 1, that's where things started to change. Polling data started to move in favor of the leave camp. And as you can see in the chart, sterling starts to sell off, equity started to sell off, and once we got out of the way with the poor job support from the Fed, that was completely off the table and everyone could focus on Brexit.

Polling data actually got to a point to where it was 55/45 in favor of leave, but odds makers still put the remain camp as the winner, 60/40. Things changed, though, on June 16, following the news that one of the Labor MPs, Jo Cox, was murdered in Huddersfield. The campaign was suspended. She was part of the remain camp, she was pro-Europe, and the campaign was suspended until the following week.

Over that weekend, there was a poll release that swung back to the remain camp. So if you're looking at the chart, that's where you see it start to move higher prior to the vote.

What happened there is the market, from early June when these polls started to swing, is it was getting themselves short sterling. There was very little worry that sterling was going to shoot higher, so the market was good and short. Equity markets were selling off as well. After that poll was released, shorts were covered. It was a pretty swift move up, and took us to June 23.

Final, the polls closed at 10 PM UK time, and there was an exit poll of sorts that showed remain in the lead. Well, that kind of emboldened sterling buyers. It rallied up to just above $1.50, and in fact, the leader of the UK Independence Party, Nigel Farage, came out and said, "It looks like a good night for remain."

Well, the tipping point that evening was polls coming out of the northeast, specifically city of Newcastle and Sunderland. Newcastle was expected to stay in the remain camp. They're a young college area, and their vote came very tight — 51/49 to remain. The big trigger was Sunderland. Sunderland voted 61 to 39 to leave, and that's where we start to see sterling get hit.

Just looking at the chart, this is an unprecedented move of 10%, nearly. Markets, when we came in Friday morning bright and early, were a bit illiquid, but nowhere the illiquidity that we saw when the Swiss National Bank pulled the floor on Euro Swiss, or in the financial crisis of 2008.

So where are we now? Well, over the past few days, we've seen markets stabilize. It hasn't been the doom and gloom that sterling was going to drop further. It's actually stabilized between the lows made around $1.315 and the upper end of the range around $1.35. The rest of the currencies have pretty much gone back to levels they saw pre-referendum, and the equity markets have rallied sharply.

But let me just throw some caution in here. I think this is the lull before the storm. There is much to do. We have Prime Minister Cameron, who resigned, so there will be a battle for leader of the Conservative Party, who will become the next Prime Minister. We also have the Labor Party up in arms, as they held a no-confidence vote to their leader, Jeremy Corbyn. It was 172 to 40 against his leadership, so we may have a change in leadership there.

From a currency perspective, I've included in this presentation a number of different currencies and their reaction that evening, because I think it will apply going forward. That evening, if you look at the chart, Japanese yen, and I'd even put Swiss franc on there, they are safe-haven currencies. In times of turmoil, money flows into Japan and into the Swiss franc. And that certainly was the case this evening. They both rallied sharply against the dollar. That being said, the dollar, too, was a safe haven as well.

Two other currencies I want to highlight, the Canadian dollar and the Australian dollar. These currencies, I would not put them in the camp of safe haven, but they broke no new ground that evening. They sold off a little bit, more of a function of US dollar buying than people wanting to bail out of Canada or Australia. I think that will be the case going forward. Any type of shock and turmoil there that we see out of Europe, I don't think it's going to cause a wholesale change in the view on Canada and Australia.

And finally, the last slide I'd like to look at is number 11; it's the Mexican peso slide. These are what we call risk-off currencies, and Mexico is just an example. As you can see from the chart, we nearly made new record highs that evening. Those currencies — Mexico, South African rand — those currencies will be sold off sharply. They always are in times of financial crisis.

Longer term, I think the moves in these will depend on how the process plays out, and I'm not going to get into that. I think Courtney will touch on that, as will Bill. The big thing is there are a lot of variables. We're in a very dark period of uncertainty when it comes to what's going to happen with the UK and Europe. My expectation is for the euro and the sterling to trade lower. We saw that just today, when the Bank of England Governor Carney came out and happened to make reference to potentially having to lower rates at his August meeting. The sterling sold off 200 bps on that, two big figures.

So over time, I would look for both of those currencies to trade off, but versus one and another, I think the euro will remain stronger against the sterling. Paul?

Paul Toth: Okay. Thanks for that perspective on the market impact, Tim. Now I'd like to turn it over to Courtney to outline some of the key issues and considerations related to the implementation of the Brexit decision. Courtney?

Courtney Roberts: Great, thank you, Paul. So just to maybe back up a bit for those who need a little more background or who weren't able to join our May call discussing the historic changes in Europe, so the key points of the leave campaign involved public finances, so how much the UK provides to the EU budget annually; trade agreements, so where the EU rules and regulations dictate the safety and protocol for the UK's products and services; and then thirdly and most importantly, immigration. So today, EU citizens are able to move freely about the member states, and the UK has had a large influx of immigrants over the last decade or so. So UK citizens argue that this puts a lot of stress on their public services such as education, healthcare, housing, jobs, et cetera.

So the results of the vote showed a 51.9% leave vote, with over 72% of the 30-plus million registered voters who came to the polls that day. So this is actually a higher turnout than their last year's general election. And if you've taken a look at the voting map, you'll see that London, Scotland and Northern Ireland voted to remain in the EU by a majority, while the rest of the UK voted to leave.

So what do those results mean? The UK is the first country of the 28 EU member states to embark down this road. So although the referendum result was not legally binding, the current Prime Minister, David Cameron, stated that the UK should move forward with invoking Article 50 of the Lisbon Treaty. Article 50 basically just states that any member leaving the EU must provide a two-year notice period to the EU Council prior to exiting.

So as Tim mentioned, Cameron resigned last Friday due to the results and will step down in October. He has stated that he will not invoke Article 50 and that he'll leave that up to the new Prime Minister who takes office in October or so. Nominations were due at noon today in the UK, and the Conservative Party will announce a new Prime Minister somewhere around September 9. So basically, they'll take those nominations, they'll vote them down to two candidates, and those results should be out in early September. So as of now, there's not another scheduled general election until the year 2020.

So since Cameron's statements came out last Friday, the EU Council has come back, challenging the UK to move forward with the notice period as soon as possible. So currently, the other EU countries are basically saying that they won't begin any negotiation talks, back door or otherwise, with the UK until Article 50 is invoked.

The negotiations will occur over a two-year time period, but they can be extended longer if all other 27 members of the EU unanimously agree to extend them. If they go over the two-year period without that unanimous vote, then the UK and the EU will trade under the World Trade Organization rules.

So there's estimates out there that it could really take up to 10 to 15 years to unplug the UK from the EU. But we expect that the EU Council will be really tough about their negotiations with the UK as to quiet doubts from other countries thinking about leaving the EU as well.

So in a nutshell, as Tim mentioned, there's still a lot of unknowns at this point, but we know nothing that will change, at least, for the next two years.

So following up on my comment that there are a lot of unknowns, we've outlined a couple of potential models on slide 13 that the UK could be negotiating towards. So there are thoughts that the UK will create a bespoke model, and for those of you who don't speak British, that means unique, in order to piece together the key components of what the leave voters wanted.

So the most important piece of the puzzle here is whether or not the UK will still have membership to the EU single market. And just a little background, the EU single market is the free trade area among EU member states. It only imposes tariffs on non-EU countries, and it allows businesses, such as financial institutions, to passport services to other EU member states without any hindrance to business.

So the EU Council stated yesterday that the UK will not be able to retain access to the single market without at least accepting free movement of people and contributing to EU budget amounts. So basically, they don't want to allow the UK to pick and choose the pieces and parts. It wants, without consequences, again kind of showing the other EU members that this is going to be a tough negotiation.

So the first option here outlines the current model for Norway. Now, this option still has membership to the EU single market, but it doesn't make contributions to the EU budget. It does, however, contribute to EEA grants and specific policy programs. The only problem with this model is that the price of maintaining free access to the single market is allowing free migration from EU member states and accepting EU regulations on businesses. So to the degree that pro-exit sentiment was driven by opposition to immigration regulation, this solution doesn't really solve anything for the leave campaign.

The second and third models may be more in line with what pro-Brexiters wanted, but where the UK could gain access to the EU single market in certain areas and comply with that corresponding legislation. At this point, though, we don't know what pieces and parts the UK will try to negotiate, and how likely the EU will be able to provide those benefits. So again, a lot of unknowns.

So let's talk about what this means for you and what's at stake. I've included a couple of thoughts on slide 14 on what you should be thinking about in addition to the currency volatility that Tim spoke about. So contingency planning is going to be incredibly important around these pieces over the next two-year period as negotiations start.

So the first, and what I think is probably the most important, is stopping immigration. So identifying where your employees are located, what type of citizenship they have or visas that they have. The UK may not have access to free movement of people going forward, and we don't know what that will mean to current UK citizens living in the EU or vice versa, EU citizens living in the UK.

As of today there was an article that came out that said there is a huge influx of applications of EU citizens applying for UK citizenship, as you might expect. So expect that backlog to grow over the next two years.

The other piece is subsidies. So depending on your industry, you may be receiving EU subsidies today, which could go away after that two-year period. For example, the farming industry in the UK is very dependent on the EU subsidies. There's also a lot of research done in the UK on behalf of pharmaceutical companies, so for example, in January the European Investment Fund put GBP 24.8 million toward scientific inventions, including new medicines. So identifying where your sourcing comes from and understanding if those pieces and parts may be affected by the withdrawal of subsidies is going to be important.

Third here, as we touched upon on the last slide, are trade agreements. Britain's EU exit could force US manufacturers with factories in the UK to start paying tariffs on goods sent from England to EU countries. Those goods would also have to go through customs, adding time and cost to business operations that could favor your European competitors. So we won't know what this will look like until negotiations begin — again, another consideration.

The fourth point here is around banking relationships. So you want to consider who you're doing business with in the EU and the UK and what services you receive from those banks. Today the EU has a passporting regime, as I mentioned, which allows banks to run the bulk of their European operations out of the UK. But passporting, which also applies to a range of other businesses, including asset managers, insurance companies, may no longer — so London in particular is heavily populated with US and international banks, and many of them were in the UK before the vote, that they could shift their business away from the UK.

In my conversations with our banking partners here in London, they'll take the next two years, create contingency plans to be able to operate out of other EU countries where they have licensing, but at least for now are not making any sudden movements. There may be a small shift of financial services employees that move to other EU locations in the interim, but I don't expect there to be a large movement unless the passporting rights get taken away. So this could also affect their services, the UK access to euro payment systems, such as SEPA, which is the equivalent of the US's ACH system, and TARGET2, which is their wire platform. Those are going to be important for the UK to negotiate as well.

Data privacy and technology — although this could be years away, Britain's exit from the European Union starts stripping companies of their ability to freely store info about EU residents on British soil, so potentially creating a new barrier for trade. Under EU law today, an independent country needs to convince the EU that it guarantees individual privacy for EU standards for companies. They're to retain access to everything from European payroll records to residents' cell phone location data. UK could face some hurdles here, including a possible review of surveillance practices. So this could really impact technology firms and the customers unless the UK negotiates a specific privacy deal.

So there's also business opportunities here for those looking to deploy capital. With some UK and EU companies taking a major hit in their stock price over the last few days, there could be an opening for opportunistic firms that are looking to grow.

So in addition to a couple of these key points, what I think you'll start to need to look at, there's other potential impacts that have been in the headlines as a result of the leave vote. So I just wanted to touch quickly upon them.

So Scotland, since 62% of the Scottish population voted to remain, the Scottish First Minister met with the EU Council Wednesday, which was yesterday, to discuss the path for Scotland to remain a part of the EU. Now, the EU Council came back and basically said, "We're not going to negotiate with anybody but the UK as a whole." So that could potentially trigger another Scottish referendum. Now, the last referendum was held in 2014, and there was a 55% remain vote at that point in time. So depending on the new political regime that goes into place in the UK over the next several months, this could be a real possibility.

From an Irish standpoint, there's also been talks of reunification of Northern Ireland and Ireland, so Northern Ireland's First Minister called for a poll on a united Ireland shortly after voting results. Commentary's kind of quieted down a bit since Friday, but it might come back up if Scotland looks to another referendum or as the UK starts to negotiate.

Other EU members, so there's been a lot in the headlines about other EU members maybe considering to leave as well. Right now there's a lot of posturing, I think, going on between the UK and the EU Council. And the EU Council will most likely make it really difficult and make an example out of the UK to illustrate to other EU members that leaving's not going to be easy, and there's a price to pay for it. So I wouldn't expect any other EU members to really take a look at this and put a vote in place until at least the negotiations are done after that two-year time period.

And then there's long-term effect of negotiations as well, so economists are pointing out that the longer the negotiations take, maybe a longer-term negative impact on the UK's GDP.

So that's probably a good point to stop and let Bill give you his perspective around the economic impacts of the voting results. Bill, I'll turn it over to you.

Bill Adams: Thanks, Courtney. Good afternoon, everyone. So as far as the economic impact and the economic forecast goes, this is where the business cycle stood in the UK prior to the vote. These are business sentiment surveys conducted by the Bank of England, and I've focused on a couple of survey components here that are reflecting forward-looking indicators. The green line is businesses' employment intentions, how much do they expect to hire in the near term. And then the orange and blue lines are reflecting business conditions and investment intentions in the business services and financial services sectors.

So thinking about the impact of Brexit on the UK, the effect is if the UK does withdraw from the EU, the effect is going to be impediments to British exports to the Continent. And these parts of the economy are the parts of the economy that I think are most dependent on exports to the rest of the European Union. Next slide, please.

This is the scale of British exports to the EU, and this is why this is so important to the British economy. About 44% of total UK exports are sold to other EU trading partners. Within that 44%, I think about 16% of total British exports are services exports to the rest of the EU. And Courtney mentioned that if the British government does formally notify the EU that they wish to withdraw from the Union, and two years elapse and there's no deal negotiated, there are World Trade Organization rules that will allow for free trade in goods between the UK and the EU. But those WTO rules generally do not create as easy avenues for exports of services, and in particular of financial services, but also business services. And so that is the part of the British economy that has the biggest prospect of higher trade barriers if the UK does indeed go through with Brexit.

So just the prospect of that is now causing British businesses to pull back on hiring, pull back on capital spending, pull back on all sorts of business decisions. And I think it is that effect, that drag on business sentiment and slowdown in business activity, that is going to be the biggest drag on the UK's economy in the short run.

So on top of that, we have this precipitous depreciation of the pound that Tim talked about. And a weaker pound means that imported food, imported energy, and other imported goods are going to be more expensive for British consumers, and that means that they have less disposable income left over after filling their refrigerator and filling their gas tanks to spend on other goods and services. So that drag on disposable consumer income, combined with a downturn in business capital spending and probably hiring as well, we think are likely to cause a recession in the UK in the next 12 to 18 months.

The impact on the rest of the European Union, we think, is going to be more modest. Excuse me, before I get to that, I want to talk about one of the arguments for Brexit and how that impacts the sort of economic long-term view.

So on the right-hand side of this chart, you see a rough estimate of the share of UK exports to other Commonwealth nations. And if you were following the debate of Brexit prior to the referendum, one of the growth strategies that the pro-leave camp was advocating was that, "Even if we lose access to the EU Common Market, we can sign trade agreements with Commonwealth nations, these former British colonies where we have strong cultural and historic ties, and we'll see economic growth from that that will offset the effect of leaving the EU or having reduced economic ties with them."

And you can see, just because the share of those Commonwealth nations in British exports is now so much lower than the share of exports going to the EU, the British companies, British exports would have to grow exports to the Commonwealth really, really rapidly to offset any potential decline in exports to the EU. So net–net, it seems while they could see additional growth from that, it seems like in the short run, more likely that this trade channel is negative for short-run British outlook. Next slide, please.

So if we're expecting a recession in the UK, what are the broader economic implications of that? And I think first is that the thinking across the British Channel, the rest of the European Union, or whether you're thinking of the Euro Zone specifically, I think it's a drag on growth, but it's a much smaller drag than you would see in the UK. If you're thinking of that trade channel and potential increased barriers to trade between the UK and the EU, the share of EU exports that go to the UK is around 13% of total EU exports of goods and services. And the EU's exports are also a smaller share of GDP in the EU than the UK's exports are as a share of the UK's GDP.

So the net effect on the euro area or the Euro Zone, we think that real GDP in 2016, we might see slower than we were expecting prior to this referendum. Maybe instead of 1.5% real GDP growth in the EU this year, we see something more like 1.3% or 1.2%. But I don't think that we're going to see an outright recession in the euro area.

Now, thinking more broadly about the rest of the global economy — next slide, please — the share of exports from the United States to the UK and to the EU, we're looking at an even smaller number here. So total US exports to the UK, 0.7% of GDP. Total US exports to other EU nations, just over 2% of US GDP. So a recession in the UK, if you assume a very, very severe recession, which is not in our baseline forecast, then say that 0.7% of US GDP drops by 10%, that's a 0.07% decline. That's a very small change in US GDP that won't come through — you know, I don't want to say it's rounding error, but it will be a minimal impact relative to other things that will affect the US outlook.

A recession in the rest of the EU could have a larger effect on the US economy. But again, we think that there will be a smaller drag on the EU economies ex the UK than there will be on the UK directly.

I think, thinking of the impacts on other countries outside of Europe, whether you're looking at China or Japan or Latin America, other emerging markets, those trade linkages are similar to the United States. They're going to be smaller than the trade linkages are between the UK and the EU. It's primarily the financial sector effects and a potential financial shock or a drag on global financial sentiment, business sentiment, that I think are the bigger threat to global growth out of this. So far, we haven't seen a lot of those potential downside risks materialize. We'll talk about that a little bit later in the presentation when we talk about the outlook for monetary policy. But I think that is sort of the remaining downside risk that we continue to monitor.

Paul Toth: Okay, thank you, Bill. Appreciate that insight. Courtney, Bill talked about how Brexit may impact the regional economy. Could you take a few minutes and talk about how it might impact the ability to do business in the region from a practical standpoint?

Courtney Roberts: Sure, thanks, Paul. So I include a couple of points on this slide that may impact you, depending on the type of industry you're in. I mentioned property prices here. So one of the expectations after the Brexit results was that there was going to be a London housing bubble. And from what we've seen over the weekend, prices dropped a little bit, but overseas investors from Africa, the Middle East, the US and elsewhere are buying up London property. There may be longer-term effects here that might impact other property markets as those property prices fall or companies look to move out of the UK.

I also have branding and intellectual property down on here. So there may be new laws that come about as a result of the UK leaving the EU that could impact laws elsewhere. So that's just something to keep in consideration.

Industry shifts away from the EU, so this could be kind of combined with this fourth bullet around legal consulting, as well as thin tech firms. So the sectors that are most affected based on revenue exposure to the UK are energy, information technology, and material movement to other parts of the world.

So also, London is a huge hub for legal and consulting firms. So post the two-year time period, these firms could be looking to move elsewhere and kind of grow hubs in other parts of the world. Thin tech firms also, there's a huge hub in London. And as funding slows down, as people are holding off on making, doing venture capital investments and elsewhere, we could see a huge slowdown. And we might be able to see that the thin tech industry shifts to other markets as well.

So I think a couple of the key takeaways here are the gain in visibility quickly to understand where your legal agreements are in place, where you're trading in Europe and elsewhere, where you're sourcing from, understanding that travel costs may go up, so a lot of the travel companies that are based in Europe as well as the UK took a big hit in their stock price over the last couple of days. And also, there may be job costs and hiring freezes. So there might be this two-year time period where a lot of job growth doesn't happen within the UK or the EU.

So a lot of things to consider. Obviously, a lot more things could come up as negotiations begin. But some key points that we wanted you to think about as you move forward with your business planning and think contingency planning.

Paul Toth: Okay, thank you, Courtney. For the last section before we open it up to questions from the audience, Tim and Bill, could you discuss the impact of the decision on future volatility and on central bank rate decisions?

Bill Adams: Sure, thanks, Paul. Could we have the next slide, please? So I mentioned financial volatility a moment ago. And this is a slide of major global stock indices. And you can see that we saw big declines in the day when the Brexit decision was announced. This sort of continued for a day or two afterwards. And so this is — I was mentioning that financial shock channel. And economists think about financial shock channel. And economists think about the stock market backwards. We know that the reason we're around is we're supposed be able to tell people what will happen to the stock market based on what's going on in the real economy. But because that's too hard, we look at what happens in the stock market and say how that will go back and affect the real economy.

So I think if we were to see a 10% or 20% sell-off in stocks, that's the sort of negative financial shock that would make businesses hesitant to issue new shares and engage in capital spending. It would slow down mergers and acquisitions activity. It would cause households to become potentially more cautious about consumer spending. And so you could see a lot of negative pass-through from a large and sustained decline in stock prices or other asset prices if that were to happen.

Now, if you extended this chart another day or two, the orange line on the FTSE 100 actually shot up at the close of trading today after Bank of England Governor Mark Carney announced that he's likely, or the Bank of England is likely, to cut rates again or to increase monetary stimulus this summer. So stock prices in the UK, they're back up to their highest since August of 2015. And higher stock prices do not constitute a financial shock.

So that particular downside risk, I think, still is there. We're certainly not through the end of Brexit. And if the UK government goes ahead with notifying the EU that they want to leave, there's at least probably two years of negotiations after that that would be coming. So we're pretty early in this political crisis. But in the immediate financial aftermath of the referendum, it looks like the shock so far has not been enough to dramatically change the economic outlook outside of the UK.

Tim, do you want to talk about how that ties in with FX markets?

Tim McCarthy: Well, yes, I'll just go on to say that prior to the vote and, actually, the evening of and morning after, central banks said that they would be well coordinated if there was any type of major run on sterling. You know, it's down 10%, but that was the adjustment to be expected. We've seen stabilization. I think Janet Yellen looked incredibly smart, holding off on a rate hike. I think that we've gone from earlier this year, where there were going to be four rate hikes, I think potentially the Fed's on hold for quite some time. And I think all central banks will be coordinated in their efforts.

We've even seen the ECB come out today and say that with Brexit, they may expand the pool of assets that can be used for QE, and Governor Carney came out and said as well, as Bill mentioned about cutting rates, probably at their August meeting. There is a meeting in July, but he told the market to look at July and August as a package, as they want to see what the first releases of economic data after the referendum, how that will play out. He also said that if rate cuts do hurt bank profitability, that he will increase the size of QE.

So I think from that standpoint, we're not going to see huge volatility in the market. I think central banks are well positioned as opposed to other crises to act as a good buffer for the currency markets.

Bill Adams: Thanks, Tim. So before we open to questions, I want to talk about one big offset to that potential financial volatility, which is on this next slide on global monetary policy and global risk-free interest rates. And here we've seen risk-free interest rates in all of these major advanced economy currencies. They've all come down after Brexit. In the US, I think this is expectations being pushed back for the next interest rate hike from the Federal Reserve. After the vote for Brexit, we think they're probably going to hold off for their next rate hike until December.

And then in the UK, which we mentioned, where we expect additional monetary easing, and in the Euro Zone and in Japan, we expect central banks there to either cut benchmark interest rates or lower them further into negative territory, or to expand the monthly rate of their asset purchases, or to make a combination of the two. So this is pushing down benchmark long-term interest rates around the world in advanced economies. That's a big boost to consumers, who will be able to finance mortgages at lower interest rates. It's a boost to construction industries and housing markets in countries where those industries are relatively healthy, like the United States. And it's a major offset to some of these downside risks from the Brexit event.

And I think to that, this decline in US long-term interest rates, or global advanced economy risk-free rates, if this Brexit political crisis drags on for two or three or more years, I think the more immediate legacy is going to be long-term rates, risk-free rates in advanced economies stay lower for longer, and that will be the immediate effect on the global macroeconomic outlook.

Paul Toth: So Tim, do you want to add anything about low rates?

Tim McCarthy: No, I think I've touched on, you know, what I think rates are going to do.

Paul Toth: Okay. Well, Courtney, Bill, and Tim, thanks for taking time to review the prepared topics. We would now like to open the session up for questions from the audience. So as a reminder, you can ask questions using the Q&A window located on your screen. If you don't see the Q&A window, simply click the Q&A widget found in the lower center portion of your screen. And if we don't have enough time to answer all the questions during the broadcast, then we will answer your questions directly via email afterward. So let's take a look at our first question.

So the first question, and I think we'll direct this one to Courtney, is, "Will there be any changes in trade goods documentations required tariffs between the UK and the EU during the next two years?"

Courtney Roberts: No, there will not, from our standpoint. As I mentioned, none of the EU countries will start negotiations with the UK until Article 50 has been invoked. And those changes won't take place until after that two-year time period has run out.

Paul Toth: Okay. Thank you, Courtney. The next question is a little bit more of an opinion, so maybe each of you could give a perspective on it. And the question is that the UK may take a second vote as to whether they want to leave the EU. We know this. The question is, "Do you think that there will be a revote and that the UK will choose differently than they did the first time?" So let's start with Tim.

Tim McCarthy: I don't think there will be a revote. The leading Conservative candidate came out today, Theresa May, and said that if she becomes Prime Minister, there will be no revote. I don't think it will happen. I think, with the vote the way it played out and 17-plus million people voting to leave, I would find it hard-pressed for them to go against the majority, although the new catch phrase, instead of Brexit or Bremain is now Bregret. So I'd say no.

Courtney Roberts: Actually, Regrexit is the hashtag.

Tim McCarthy: Yes. Well, there's also Bregret.

Paul Toth: Well, since you're talking, what do you think, Courtney?

Courtney Roberts: I also don't think there will be a revote, although there's a lot of talks about that going on right now. There's been a lot of protests here in London. There's also a petition that's been signed by more than 4 million people that Parliament's taking a look at right now, which is the majority of the leave voters — you know, some of the leave campaign had come out on Friday and basically backed down on some of their promises, which I think kind of pushed this petition to be signed by so many voters at this point. But I also don't think there's going to be a revote. Like Tim said, many of the Conservative Party have come out and said, "Let's move on. We've got your decision. Let's start making plans, and let's start moving forward," including David Cameron. So I don't think that there will be a chance — there's a small chance of a second referendum, but I don't think it will happen.

Paul Toth: Bill, how about you?

Bill Adams: I think I would agree with the other two speakers, that we're unlikely to get a revote. I think it's more likely that we just get sort of a never-mind outcome of this, where the government comes up with some reason to say, "Even though the referendum told us that we should notify the EU that we want to withdraw, we're just not going to do it." And it sounds pretty outrageous to say that that is possible, but that's almost literally what the Greek government did after the end of the year of back-and-forth in 2015 about whether or not they were going to implement the EU's austerity package.

And I think today, the increase in the FTSI, I think that came both after Governor Carney's announcement that he thinks more monetary easing is likely, and also after the former Mayor of London announced that he would not be running for Prime Minister. And it seems like, and since he was a major — since he wanted to be Prime Minister before the referendum, and since he was an advocate of Brexit, it seems like maybe this is reflecting internal politicking in the Conservative Party in the UK, or it is possible that there are people who have stated that they support the vote, but none of them, or at least some of them do not really want to be the Prime Minister to pull the trigger on taking the UK out of the EU.

Paul Toth: Great. Thanks, Bill. So for the next question, maybe Courtney or Tim, one of you could address the question. "What was the major purpose in Cameron resigning, from a strategical perspective?"

Courtney Roberts: I think I can kind of take a first stab, and maybe I'll let Tim follow up with it. Yes, so David Cameron basically came out — I mean, he was also almost in tears on Friday — and he does not feel like he can lead the country further, or the UK further because he supported the remain vote. So he wants somebody that had campaigned for the leave vote to take charge of the country. He doesn't want to have anything to do with invoking Article 50. He wants to help put the government on the right foot and put committees together to start planning negotiations and start taking a look at what needs to be done. But he does not himself feel that he can lead the country. So that's what I got out of the decision. So strategically, I think they want someone who has faith in the leave campaign to actually lead the country going forward.

Paul Toth: That makes a lot of sense. Thanks a lot, Courtney. Tim, maybe you could address the question about, "Will the worst fallout from the Brexit, probably in terms of the pound, occur as a result of what's already happened, like has it already happened, or will it happen closer to David Cameron leaving office?"

Tim McCarthy: I think we've seen the worst of the fallout. I don't see sterling depreciating another 10% like what we did election night. I think, going forward, the sterling will obviously be lower. But I don't think that we will see shocks to the system like we saw that night. I think that people in government, the EU — I think everybody will bend over backwards to try and take some of this volatility out of the market.

Paul Toth: And then, Tim, I think that segues into this other question about sterling levels 30 days from now. "Given the volatility in the market, what kind of range do you see for sterling over the next 30 days?"

Tim McCarthy: Next 30 days? I'd see it as low as $1.25, as high as $1.35.

Paul Toth: Okay, great, thanks. Bill, as it pertains to Germany and the UK specifically — you had talked a lot about EU — there's a question that says that German exports to the UK will be hurt more than UK exports to Germany. So do you have perspective on that particular trade flow between those two countries?

Bill Adams: It's a great question. So this, I think, goes back to Courtney's slides earlier on what are the alternatives to EU membership for the United Kingdom. So if you take a sort of the most adverse scenario for EU or German-UK trade, that would be that the UK and the EU don't come to any agreement in that two-year negotiation following notification under Article 50, and then they revert to WTO trade rules. Those WTO trade rules will allow Germany to export automobiles and capital goods to the UK and durable consumer goods.

But WTO allows relatively open trading of goods. The WTO rules do not have provisions for trade in services to the same extent. And so Germany is this powerhouse in global manufacturing exports. The UK is a powerhouse in global services exports. And if they switch to a system of rules where it allows goods exports, albeit with some tariffs, but doesn't allow services exports, it seems to me that that would be more negative for UK trade than for German trade.

I think you could argue, though, one of the reasons why Germany's Chancellor Angela Merkel has been trying to strike a balance between being tough but also saying that she wants the UK to stay is because she wants to maintain that market access for German companies. But I think the, in terms of those rules, I personally see more downside for those British services exports than German goods exports.

Paul Toth: Great. Thanks, Bill. Courtney, back to you. So there was a question asking for a little bit more detail around what does the Scottish and Northern Ireland question have to do with whether the UK stays in or leaves the EU? So maybe just a little more color about why those two things are relevant.

Courtney Roberts: Sure. So if we do move forward with the UK exiting the EU, Scotland would like to maintain the benefits of EU membership. So what they would have to do is they would have to hold a second referendum within the UK to vote whether or not they remain to be a part of the UK. So if that vote comes out to be a no, then Scotland would be able to pull out of the UK and negotiate with EU on its own behalf to gain membership. Similar to Northern Ireland being a part of the UK, if they do decide to take a poll to start the reunification of Ireland, that also would pull Northern Ireland out of the UK, kind of leaving Wales and England to be the countries that remain.

So that's why it's relevant. As I mentioned before, the first Scottish referendum in 2014, there was a 55% vote to remain. So I would imagine that sentiments would have changed if the UK does move forward with leaving the EU, that Scotland may leave as well.

Paul Toth: Okay, great. The next question I'm going to direct to Tim. It says, "How do you view pound sterling exchange rate volatility?" And I'm going to combine that and ask you to also talk about exchange rate volatility in the currency options market.

Tim McCarthy: Well, in the lead-up to the vote, sterling volatility was highly elevated, levels not seen in quite some time. In the day prior to the vote, pricing was virtually nonexistent in the interbank market. What we've seen afterwards is volatility in a still elevated state, but nowhere near the levels we saw. In other currencies, such as the euro, vols have normalized. They've gotten back to pre-referendum levels.

As I said before, I think volatility in sterling, I think there will be points where if Article 50 gets triggered, stuff like that, I think there will be short-term volatility. But I think the Bank of England, I think the ECB, the Fed, I think all the central banks are going to bend over backwards to try and take this volatility out of the market.

Paul Toth: Okay, great. Bill, could you talk a little bit about your expectations about whether global central banks, including the Fed, are going to need to add liquidity to the banking system, or if global central banks in the banking systems are stable enough without them having to take action as a result of this recent move in the market?

Bill Adams: I think the — well, so first of all, global central banks, pretty much every central bank around the world, put out a statement after the referendum results came in and said, "We're monitoring the results closely. We're monitoring capital markets and financial markets and credit markets closely. And we stand ready to intervene, if necessary, to preserve financial stability." So I think just the promise that the central banks do stand at the ready — the Bank of England's been most specific about this because it's their referendum. And they say that under their existing facilities, they could lend up to GBP250 billion to British credit markets without taking any new actions or authorizing any new facilities. I think that is — just the promise of that, I think, is containing some of this financial risk.

The other big tool that's standing out there is all of those major advanced economy central banks have agreements with each other so that if a central bank in Japan, if one of their local commercial banks had a sudden need for funding in dollars or in pounds, then the central banks can use swaps to ensure that that doesn't create a financial crisis or a funding crisis.

Paul Toth: Okay. Okay, so as we're coming to the end here, just a couple more questions. This one for Courtney. Courtney, will new trade agreements be required between the US and the UK as a result of the Brexit vote?

Courtney Roberts: Yes, there will. At the end of that two-year time period, as the UK pulls out of the EU, when President Obama was here a couple of months ago, he mentioned that those would need renegotiated, so the US would have specific trade agreements with the UK at the end of that two-year period that they'd have to negotiate as well.

Paul Toth: Great, thank you, Courtney. Then the last question, we'll just quickly go around with everyone, starting with Tim. I'd like to end on a positive note, and so this question is, "There's certainly a fair amount of concern over this situation. But what could the main positive outcome of it be?"

Tim McCarthy: Main positive outcome. I would say, to Bill's point, if they don't trigger Article 50 and this thing drags out, or if they do and negotiations continue and the UK and the Euro Zone come to a positive agreement on trade, and things normalize.

Paul Toth: Okay.

Bill Adams: This is Bill. I would say that in the short run, the big plus for the global outlook is that these risk-free interest rates have dropped around the world, and so it's even cheaper for businesses to finance, it's even cheaper for consumers to get mortgage credit, and that should be a boost to the short-term growth outlook outside of the UK and the Euro Zone.

Paul Toth: Okay. Courtney, what's your opinion?

Courtney Roberts: I think from a voting pro-Brexiter standpoint, if the UK can figure out a way to negotiate terms for immigration that they're happy with as well as the EU is happy is and end well on regulations and rules for trade, they kind of set the UK off and work hand in hand with the EU, I think that could be a benefit. And I'm not saying that can't happen. So we might see a positive result of them still working hand in hand with the EU, but not kind of rocking the boat to break the EU apart.

Paul Toth: Okay, thank you. So that concludes our presentation for today. I'd like to thank Bill, Courtney, and Tim for a great presentation. You all provided timely insights and perspectives. I'd also like to thank everyone who joined the call today. I appreciate your attending. A PDF of today's presentation is available for you to download from the green Resource List folder widget in the lower center portion of your screen.

You will also see a link to a short survey on your screen. Your feedback is important to us, and we greatly appreciate your thoughts on today's session and our presenters. If you want to know more about international markets and how they may affect you, please reach out to your Relationship Manager, and they can arrange an additional conversation with our international team.

This concludes our presentation for today. Thanks again for joining us.

CIB TM PDF 0616-067-332002