

Schroders

Economic and Strategy Viewpoint

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Global update: Panic over, what's next? (page 2)

- Markets have regained their risk appetite following action by central banks, a firming in commodity prices and evidence that the tail risks of a US recession and of a China hard landing are not materialising. Going forward we will need to see greater evidence of stronger activity for the rally to continue; however, this is also likely to bring the Federal Reserve back into play, posing a challenge for investors.

UK: The risks of Brexit (page 7)

- As the Brexit debate rages and referendum approaches, we assess the risk of the UK voting to leave the EU and the potential impact on the UK economy. The EU is the UK's largest trading partner and a key source of foreign direct investment along with a major source of migrants.
- In the near-term, a vote to leave the EU in June would hit both foreign sourced and domestic investment, while we forecast UK consumers to cut spending as confidence is dented. Assuming sterling falls further, net trade may make a positive contribution, but the overall impact would be lower growth and higher inflation compared to our baseline forecast.
- In the long-term, the impact on the UK economy will be determined by how much access to the single market the UK manages to retain, how migration flows are impacted by government policy, and how much the UK government manages to save in subscription costs. Most studies offer a range of scenarios concluding that the most likely outcome would be lower long-term growth compared to remaining in the EU.

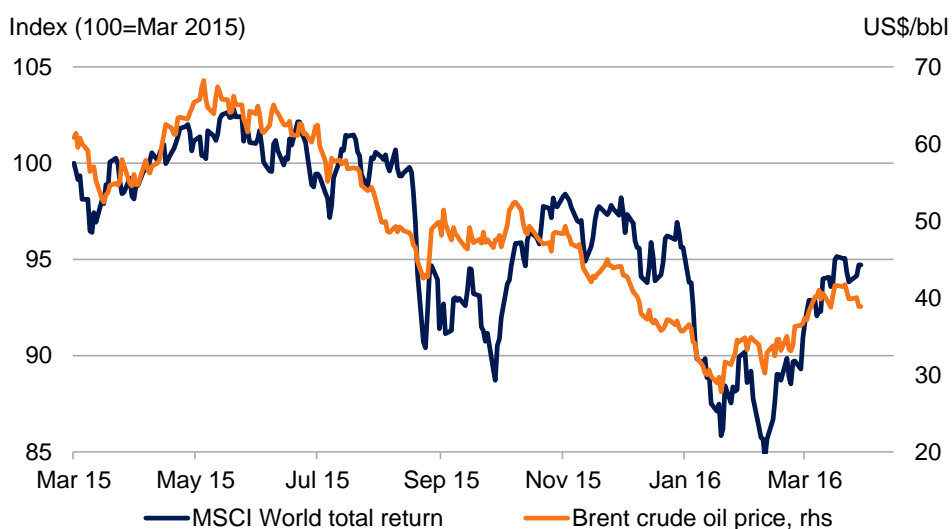
Emerging markets: Time to buy? (page 19)

- The recent EM rally has piqued interest in the asset class again, but to us little fundamental seems to have changed. The time will come to buy EM again, but not yet.

Views at a glance (page 23)

- A short summary of our main macro views and where we see the risks to the world economy.

Chart: Oil price recovery boosts equity markets



Source: Thomson Datastream, Schroders Economics Group, 30 March 2016.

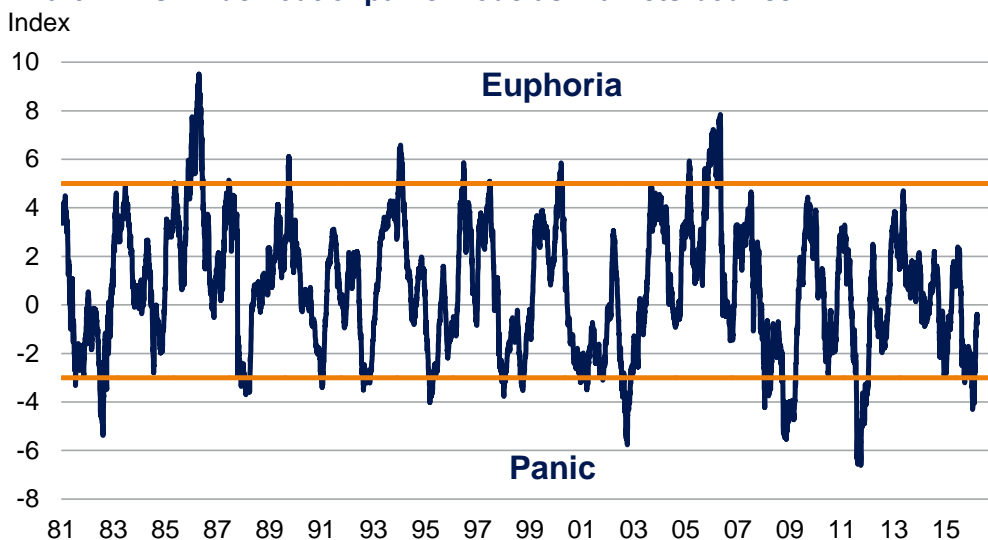
Panic over, what's next?

Markets rebound as tail risks diminish

Risk appetite regained

After hitting the panic button in January, investors have regained some composure: equities and credit have rallied whilst bond yields have risen and the risk appetite index has moved out of panic mode (chart 1).

Chart 1: Risk index out of panic mode as markets bounce



Source: Credit Suisse, Schroder Economics Group. 29 March 2016.

Action by central banks and firmer data have helped restore confidence

Arguably, the market simply became oversold and was due a bounce, but the key macro factors underlying this were the actions of central banks and firmer economic data, which have reduced the tail risks facing the world economy.

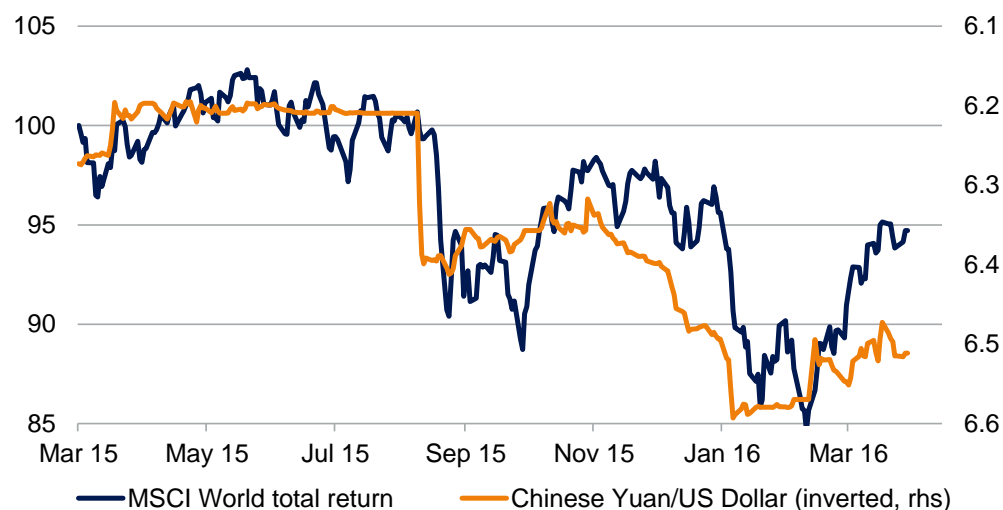
On the first, we would highlight comments from Governor Zhou at the People's Bank of China (PBoC), who has made it clear that he was not looking to devalue the Chinese yuan (CNY) in trade-weighted terms. In addition, various Federal Reserve (Fed) governors offered dovish remarks on US monetary policy, which culminated in the decision not to tighten in March, alongside a lowering of the committee's projection for interest rates going forward (the "dot-plot"). Further rate cuts from the Bank of Japan (BoJ) and European Central Bank (ECB) have also helped, although we still have doubts about the efficacy of negative interest rates.

On China, those comments from Governor Zhou were significant as they were a signal that policymakers were comfortable with growth and not looking for a significant devaluation of the CNY. The hard data in China has indicated that growth continues, although admittedly the distortions from Chinese New Year make it difficult to read the true picture. Nonetheless, it was encouraging to see a smaller drop in foreign exchange reserves in February, indicating that the authorities are getting a grip on capital outflows and the currency. The G20 meeting at the beginning of March indicated that China has tacit permission to use capital controls focused on stabilising the currency, even if this goes against the requirements of the International Monetary Fund (IMF) in granting Special Drawing Rights status to the renminbi.

Coming back to the markets, these developments have resulted in a firmer CNY, a stable to softer dollar and a rise in oil prices, which has supported global equities (see chart front page and below).

Chart 2: Global equities supported by firmer CNY

Index (100=Mar 2015)



Source: Thomson Datastream, Schroders Economics Group. 30 March 2016

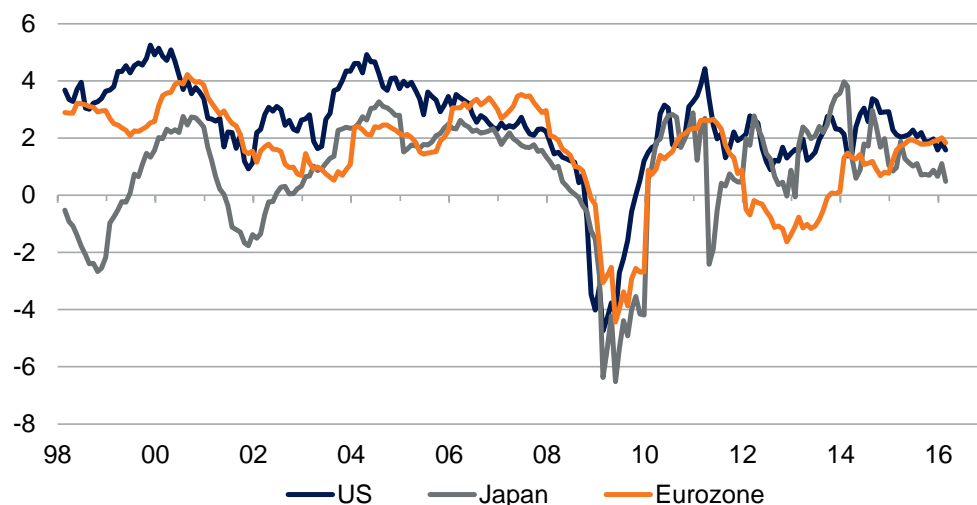
On the activity side, the indications are that consumer spending is generally firm, but industry continues to struggle with the slowdown in global trade growth and an inventory overhang. Overall global growth is still sluggish and, for the US the latest estimates for Q1 GDP growth are currently only 0.6% annualised after some disappointing consumer and trade figures (well short of our 2.4% baseline estimate). Europe is holding steady, but Japan is deteriorating.

The tail risks have eased, but has the outlook brightened?

So having been down the hill and back up again, the question is whether markets can go on to scale new heights, or will plunge back into the valley. The answer really depends on whether the outlook for global activity will improve. We can explain the rally in terms of a reduction in tail risks and this may carry assets higher from here, but for a sustained improvement we need to see better growth in real GDP and corporate earnings.

Chart 3: G-trackers: steady growth in the US and Europe, Japan deteriorates

y/y%



Note: G-trackers use a collection of growth indicators (such as PMI surveys and consensus growth expectations). The aim is to use a variety of indicators released during the month to track the outturn of real GDP growth.

Source: Schroders Economics Group. 29 February 2016.

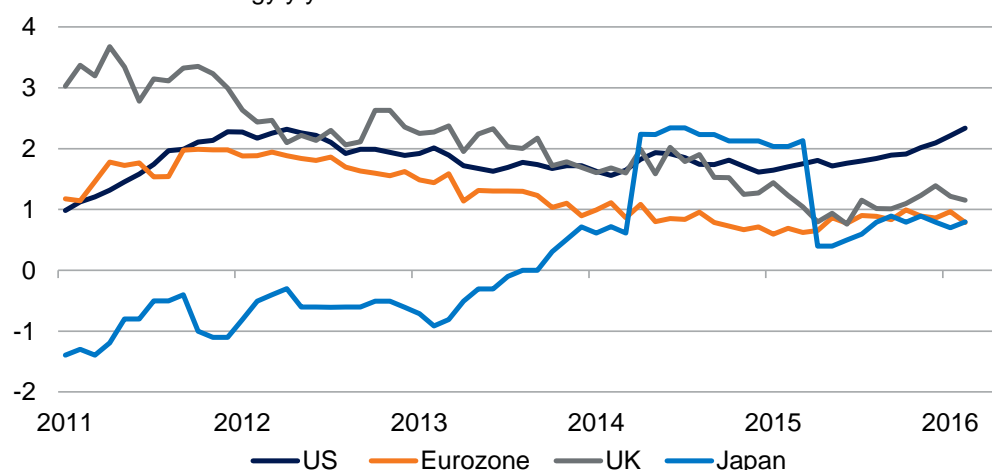
Indicators signal steady growth, but no acceleration

At this stage, it is difficult to make the case for an acceleration in real GDP growth. Our indicators point to steady, but not spectacular growth, a continuation of the pattern of recent years where the world economy struggles to get growth much above 2.5% (see chart 3).

Alongside this, our inflation indicators are picking up. Much of this reflects the turn in oil prices, which will lift headline inflation rates later in the year. Core inflation rates (in other words, the rate that excludes volatile components such as food and energy) are generally low and stable at around 1% in the Eurozone, UK and Japan. This is an important factor behind the further easing by the BoJ and ECB, whilst a UK rate rise has been pushed out further. However, we have seen an uptick in US core CPI inflation to its highest level for 5 years (chart 4).

Chart 4: Core inflation rates diverge as the US rises

CPI ex. food and energy y/y%



Source: Thomson Reuters Datastream, Schroders Economics Group, 30 March 2016.

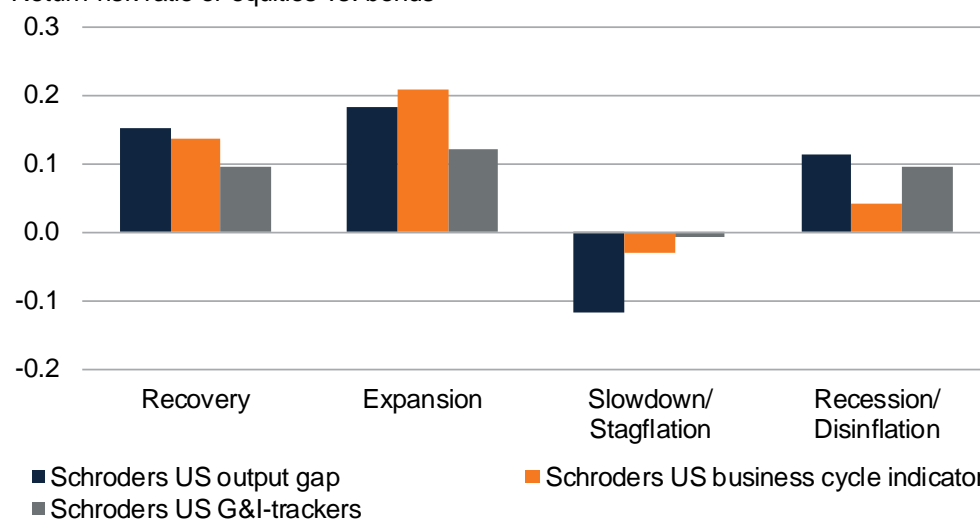
Wage growth in the US has yet to accelerate, but the divergence in inflation trends is a reminder that the US is at a later stage of the cycle than the rest of the world and will need higher interest rates. Although we do not see a major inflation problem in the US as external factors weigh on prices, some tightening will be needed.

This is important as it means that the current calm in the markets around Fed tightening can only be temporary. As growth resumes and inflation returns to its 2% target, the Fed will raise rates, twice this year in our view. The process of rate normalisation will resume. As a consequence, financial market volatility is likely to return.

This conclusion is reinforced by our broad cyclical analysis for US markets. Two of our three cyclical indicators are in the “slowdown” phase (i.e. growth is slowing and inflation rising), where lack of growth and concern over tighter monetary policy cause equities to underperform bonds. The slower moving output gap indicator is in the expansion phase (stronger growth and higher inflation) which suggests a better outcome for risk assets, although this tends to be a better medium-term than near term predictor (chart 5 on next page).

Chart 5: Performance of equities vs. bonds over each phase of the cycle

Return-risk ratio of equities vs. bonds



Fed still expected to tighten monetary policy

Note: Average monthly performance of US S&P 500 compared to US 10-year Treasury bonds adjusted for volatility. Calculations based on total return indices over completed phases of the cycle since the 1950s. Source: Schrodgers Economics Group, 29 February 2016.

As expectations of Fed tightening return, we are also likely to see another phase of US dollar strength. This would then put pressure on China to depreciate the CNY against the dollar to keep the trade-weighted currency stable, potentially reigniting concerns over the economy and whether the authorities are attempting to export overcapacity to the rest of the world. Emerging markets may well suffer in this environment.

It is possible that the selloff in markets then drives the Fed back and it stays on hold. Markets could then rally again, as we have just seen. However, this is not sustainable in our view given the very low level of US interest rates and the late stage of the economic cycle which argues for some normalisation of policy.

Investors have tended to respond to this by avoiding US equities and focusing on parts of the world in an earlier phase of the cycle for inflation and monetary policy. In the past, this has led us to tilt our portfolios toward Europe and Japan.

However, three reasons have led us to take a more defensive tack this time around.

...raising the prospect of further dollar strength and renewed market volatility

First, although the ECB and BoJ are easing policy, many investors are driven by dollar interest rates and liquidity. The Fed sets the tone in global markets.

Second, rate cuts by the ECB and BoJ have become less effective now that they are in negative territory. Indeed, it can even be argued that negative rates are counterproductive partly because they hit bank earnings and hence risk a restriction in credit, and partly due to the dire message they send to the private sector about the state of the economy.

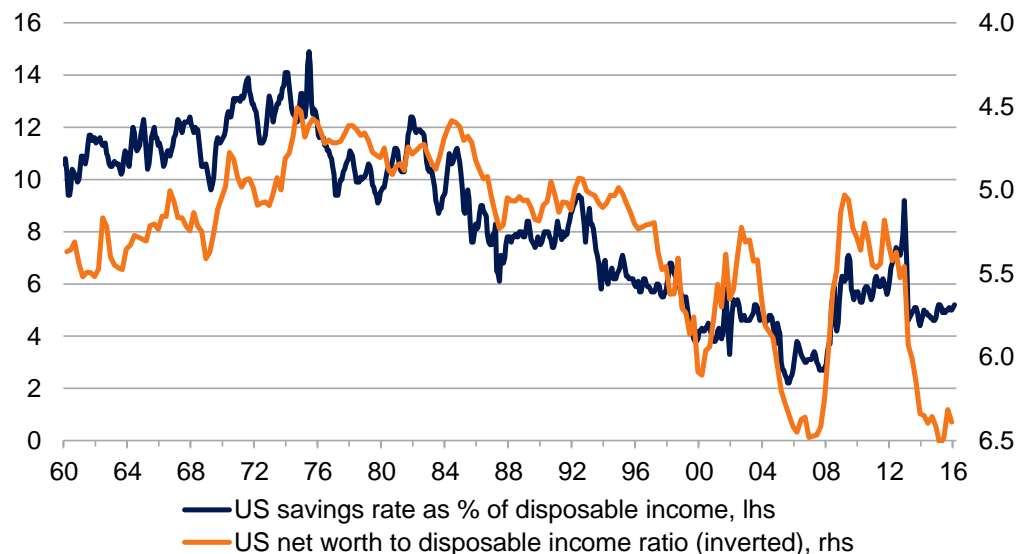
Third, recent easing by the BoJ and ECB has been followed by an appreciation of their respective currencies. This may not persist, but it removes one of the main channels of monetary easing and supports for activity. In this environment, global equity investors would be better off favouring the less volatile US market.

This means that the outlook for equities comes back to the outlook for growth. Could we be surprised on the upside?

There are scenarios where growth is stronger than expected. One would be where the lags from the fall in oil prices continue to feed through and support consumer spending. It should not be forgotten that these lags are long as consumers take time to recognise when a change is permanent rather than temporary. We have also noted that the savings rate in the US remains high and

whilst this might be a permanent feature of the post-crisis world, the improvement in wealth suggests that consumption could get a boost from lower savings in 2016 (chart 6).

Chart 6: Scope for lower saving/stronger consumption in the US



Source: Thomson Datastream, Schrodgers Economics Group, 30 March 2016.

Another scenario would be an improvement in productivity. At this stage this looks unlikely, given the weakness of capital investment spending and so, as we have argued before, we may have to wait until government's recognise that monetary policy has run its course and that other means of stimulus need to be deployed.

UK: The risks of Brexit

What will be the impact of the UK voting to leave the EU

As the UK referendum on EU membership approaches, we consider the risk of Brexit and the potential impact on the UK economy

When the UK joined the European Economic Community (EEC) in 1973 it was a growing regional organisation with the aim of forging economic co-operation and integration, including a common market and customs union. Prime Minister Edward Heath said: *"It is going to be a gradual development and obviously things are not going to happen overnight. But from the point of view of our everyday lives we will find there is a great cross-fertilisation of knowledge and information, not only in business but in every other sphere. And this will enable us to be more efficient and more competitive in gaining more markets not only in Europe but in the rest of the world."* 43 years later, the UK is about to decide whether it wants to remain in a club that has grown and morphed into a political project, which is now skewed in power towards a fragile and fraught monetary union.

Perhaps the UK had misunderstood the objectives of the European project from the start, and should have seen the signs when the UK's application to join the EEC was refused in 1963 and 1967 because French President of the time Charles de Gaulle doubted the UK's political will. Former UK Chancellor Lord Nigel Lawson is a key spokesperson for the leave campaign and argues that the European Union (EU) is no longer the economic club he originally voted to join, but primarily a political construct with the key goal of ever-closer union. He also argues that the decision of whether to stay or leave is largely a political one, although admits there would be some economic consequences (see [Schroders TalkingPoint: The Brexit Debate: In or out?](#))

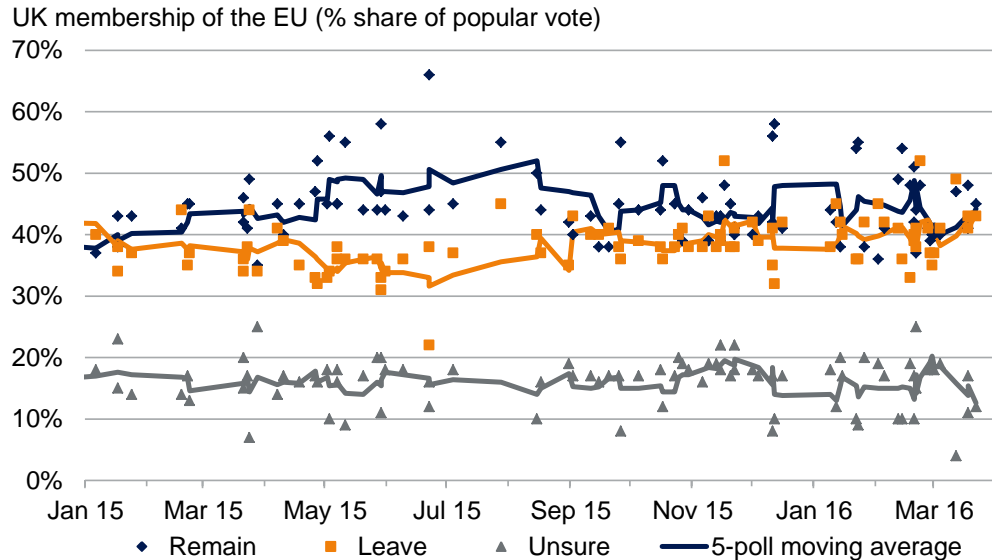
In this note, we discuss the risk of Brexit and the potential impact on the UK economy both in the near-term and further out should the UK vote to leave. The analysis and evidence presented is designed to inform investors and not to persuade voters in the upcoming referendum.

Likelihood of Brexit rising

Opinion polls suggest the gap between 'leave' and 'remain' has almost disappeared

Opinion polls on the referendum have narrowed over the past month. The remain campaign's lead has fallen by around ten percentage points to just a single point using our simple five-poll moving average (chart 7). Polling analysts have noticed a significant pattern in polling data in that polls conducted online seems to be biased towards leaving the EU, but polling conducted by telephone seems to be biased the other way. However, regardless of the methodology and past biases, over the past month, almost all of the polls have swung towards leave, signalling a shift in the country's mood. Approximately 13% of those polled are undecided, who in the past tend to vote for the status quo; however, given how tight polling is and the direction of travel, a Brexit result is now a very real possibility.

Chart 7: Opinion polls suggest marginal lead for remain



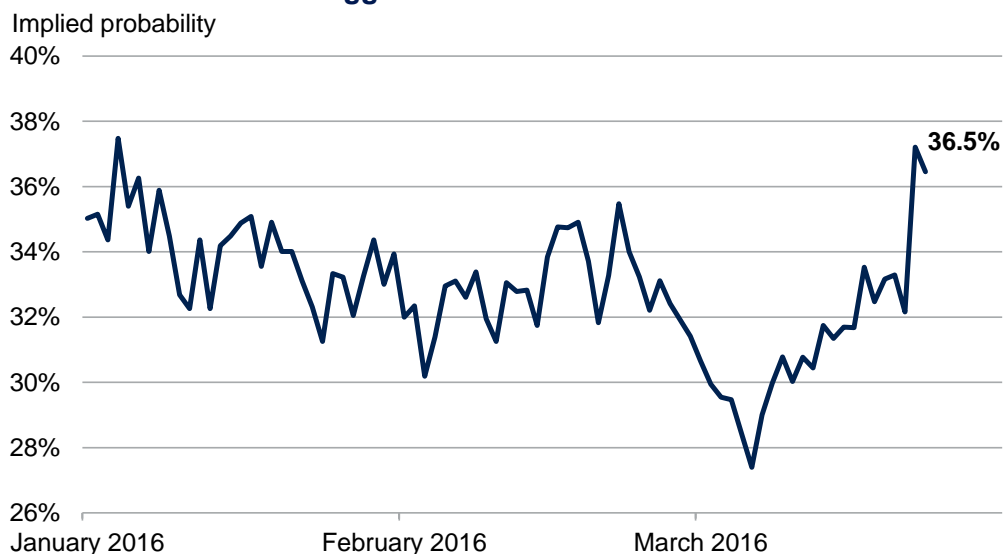
Source: ComRes, ICM, ORB, YouGov, BMG Research, Survation, Ipsos MORI Panelbase, Pew Research Centre, Norstat, Populus, TNS-BMRB. Schroders Economics Group. Last survey conducted 24 March 2016.

Opinions polls remain valuable, but are not as reliable as they used to be, especially after poor calls on the last general election and the Scottish independence referendum. Betting exchanges, which have outperformed polls of late, suggest that the implied probability of the UK voting for Brexit is much lower at 36% (chart 8).

Arguably, betting exchanges offer a more accurate picture as probabilities are based on market pricing and real money taking positions, compared to simple opinion polls where those polled may choose not to be truthful.

It is worth mentioning that the probability of Brexit spiked up following the terrible terrorist attacks in Brussels, just as it did in November after the Paris attacks. The public's reaction has not yet been captured by opinion polls due to the delay in getting those results, however, bad news out of Europe, be it migration, terrorism or even political disagreement seems to galvanise support to leave the EU. As spring arrives and the flow of migrants from the Middle East rises again, we could see further swings in opinion polls and betting odds towards Brexit.

Chart 8: Book makers suggest a lower chance of Brexit



Source: Oddschecker.com. Schroders Economics Group. 23 March 2016.

Betting markets, however, suggest the probability of Brexit is lower

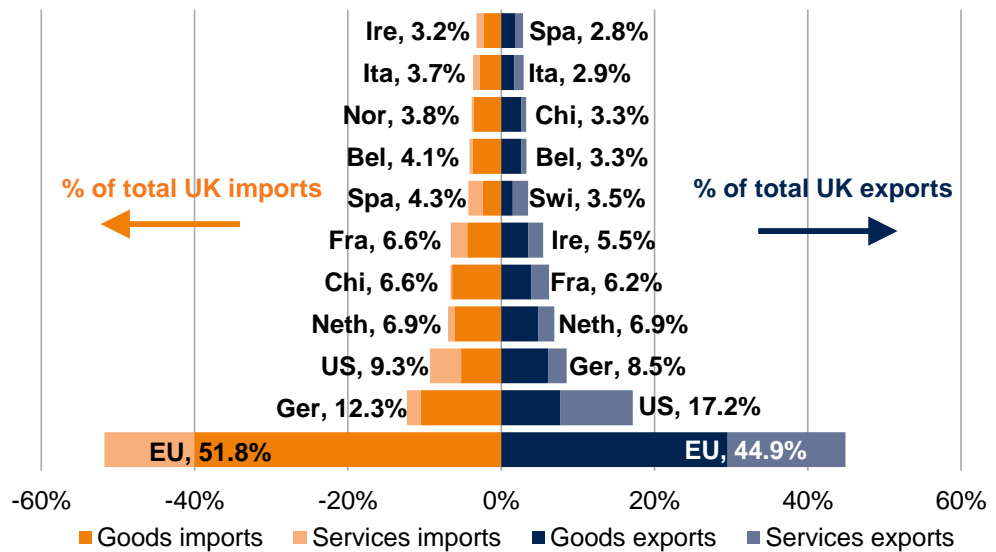
UK's trade relationship with the EU

In order to assess the risk to the UK economy, we need to consider the UK's economic relationship with the EU. The UK makes up 15% of EU GDP, 17% of the EU's domestic demand, but only 12.7% of the EU's population. As one of the richest member states, the UK's contribution to the single market is substantial.

One of the key arguments against leaving the EU is the risk to the UK's trade relationship with its largest trading partners. Between 2012 and 2014, 44.9% of the UK's exports in goods and services headed to the rest of the EU (chart 9). Delving into exports to individual countries, the top destination is the US (17.2%) followed by Germany (8.5%), the Netherlands (6.9%) and France (6.2%). Only 3.3% of exports head to China, a top target for the current government, although exports to China are still more than those to Italy or Spain.

Chart 9: UK's top trade partners (2012 – 14 average)

The EU is the UK's biggest trade partner with 45% of UK exports heading to the rest of the union



Source: ONS, Schroders Economics Group. 24 March 2016.

In terms of imports, again, the rest of the EU is the biggest source of imports, with 51.8%. Germany is the top source of imports with 12.3%, followed by the US (9.3%), the Netherlands (6.9%) and China (6.6%).

When exports and imports are combined and put into the context of the UK economy, we find that the UK runs a 3.2% of GDP trade deficit with Europe, but partly offsetting this is a 1.3% of GDP trade surplus with the rest of the world (chart 10). Strictly from the trade relationship, we could conclude that net trade with the rest of the EU has a negative impact on the economy; however, this would not be accurate as this only captures the value added, and ignores the additional benefits from jobs, investment and spending associated with the trade relationship.

When imports are considered alongside exports, the UK appears as a major export market for the rest of the EU

Chart 10: UK net trade with EU and rest of the world (goods and services)

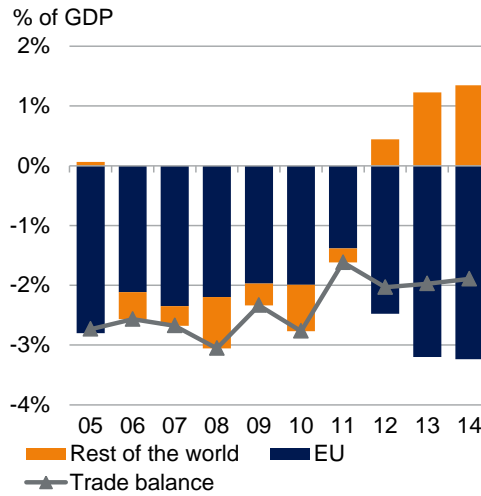
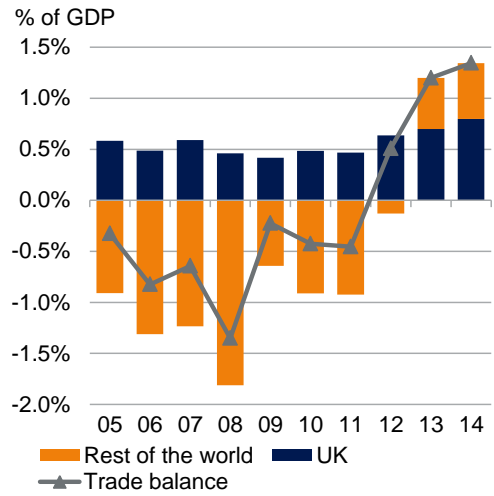


Chart 11: EU net trade with UK and rest of the world (goods only)



Source: ONS, Eurostat, Schrodgers Economics Group. 24 March 2016.

Looking at the relationship from the perspective of the rest of the EU we find that although only 10% of EU exports (goods) go to the UK, almost two-thirds of the rest of the EU's trade surplus in 2014 is thanks to its trade with the UK (chart 11). This highlights the importance of the UK as a market for the rest of the EU.

UK's capital relationship with the EU

In addition to trade, investment flows are equally important in assessing the potential impact from Brexit. Europe has historically been a key source of foreign direct investment (FDI) for the UK averaging about 3% of GDP; however, flows have been understandably weaker since the global financial crisis and the European sovereign debt crisis (chart 12), and are barely positive at present. Meanwhile, inward flows from around the world have followed a similar pattern, but have remained more robust in recent years. In 2014, inward FDI from the rest of the world was worth 1.3% of GDP, compared to just 0.3% of GDP from the rest of the EU.

If the UK were to leave the EU, then we could see lower FDI flows in the future, partly due to regulation (investment restricted from either side) but also due to possible reduced access to the EU's single market. The latter may not only impact EU FDI, but also FDI flows from the rest of the world.

Chart 12: Inward FDI flows

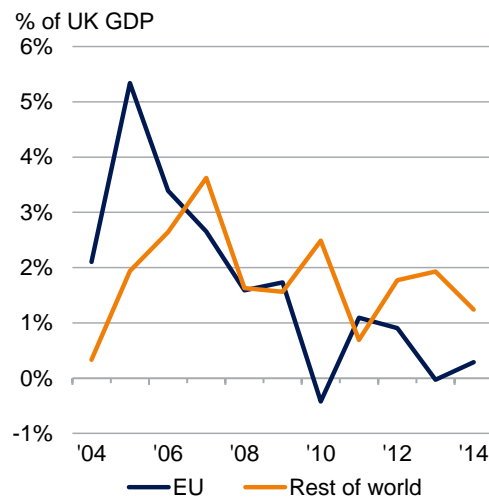
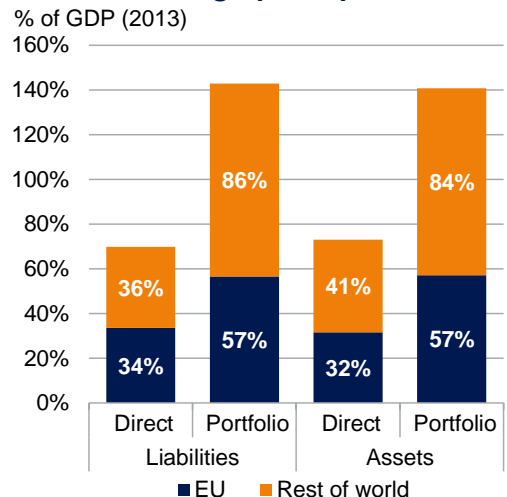


Chart 13: Geographic split of UK IIP



Source: ONS, Schrodgers Economics Group. 24 March 2016.

The UK has seen a large amount of FDI from the EU, some of which could leave in the event of Brexit

In addition to FDI flows, the stock of existing investments could be at risk. FDI investment is classified in the national accounts as investment in companies where the share of ownership exceeds 20%. This distinguishes stickier long-term investments from short-term portfolio flows. In examining the stock of existing investment, we find that investors in the rest of the EU own FDI assets worth 34% of UK GDP (shown on chart 13 as UK liabilities in direct investments). In addition, EU investors own an additional 57% of UK GDP worth of equities and bonds (portfolio investments). Investors in the rest of the world own even more than EU investors, but they too could decide to sell holdings if the outlook for those investments were to change materially.

The impact from international investors selling holdings in UK companies would probably lower their valuations at best, and at worst force the entire shut-down of operations. The former would not have much of an impact on GDP as this would be a transfer of assets, but the latter would cause GDP to fall along with job losses and subsequent negative secondary effects. For portfolio investments, equities being sold would cause prices to fall, although it would only be a transfer of holdings again. The impact on bond markets, however, would be more powerful, as the fall in bond values results in higher interest rates for corporates and the government. The combined impact of selling across both direct and portfolio assets would also result in net selling of sterling, which is why we have already seen sterling underperform in recent months.

Migration – the UK’s non-crisis

When the pollsters asked the public “*what would you like to see David Cameron seek to change in the UK’s relationship with the EU?*”, 52% of respondents said “*Greater control of borders and immigration from EU*” followed by 46% “*Limits on benefits EU migrants are eligible for*”.¹ In 2010, the current government had promised to lower net immigration to “*...the order of tens of thousands each year, not the hundreds of thousands every year that we have seen over the last decade*”. However, the UK saw a record number of migrants arrive in 2015, despite the government clamping-down on bogus student entry and restricting visa access.

Migration has always been top of the agenda for euro-sceptics who argue that the UK cannot control the number of migrants while it is part of the EU’s free movement of labour. In theory, this is correct. If the entire population of Italy, Spain or any other country decided to relocate to the UK, they would be free to do so. In reality, despite the government’s promise to lower immigration, the data suggests it has not been very successful.

Chart 14 highlights that while the EU is a significant source of inward migration, non-EU migration is the largest source, and has been in every year for at least the past decade. The government could therefore have cut migration by more than half if it really wanted to (chart 15). Indeed since 2005, there have been 2.1 million net immigrants to the UK from non-EU countries compared to just 1.2 million from the EU.

¹ YouGov poll, 20 – 24 November 2015.

...however, EU migration flows have been less of an issue than non-EU migration flows

Chart 14: Migration (EU vs. non-EU)

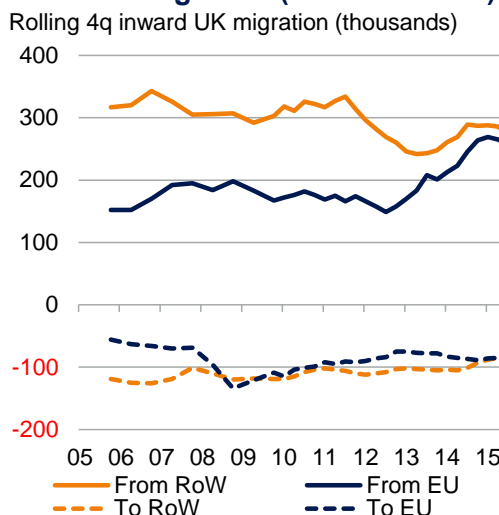
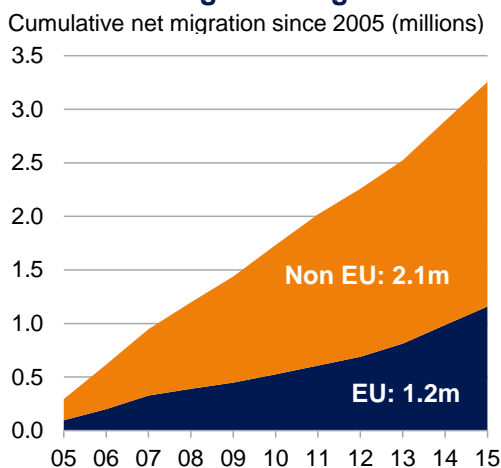


Chart 15: Long-term migration



Source: ONS, Schrodgers Economics Group. 24 March 2016.

EU migration is the UK's big non-crisis. It has contributed to a perceived problem which politicians have attempted to capitalise on, but is in fact not a major concern and from an economic standpoint is not a problem at all. Especially as these migrants tend to arrive to work, pay taxes, and ease the burden of an ageing population.

Membership costs – big savings?

The subscription cost to being an EU member has been a hotly-debated topic, and is the second most important factor for leaving behind migration according to pollsters. Euro-sceptics argue that the UK could spend the money sent to the EU better at home on public services. Europhiles argue that the cost is small, and is easily recovered by the benefits received from EU membership.

The cost of membership is another area of contention...

Based on national contributions data published by the European Commission for 2014, the UK made a total gross contribution of €20.4bn (approximately £16.5bn), but deducting the UK rebate and the justice and home affairs (JHA) adjustment (€6.1bn), took the UK government's contribution to €14.3bn (£11.5bn). However, the UK then received payments for agriculture, regional development, R&D investment etc. worth €9.1bn, taking the UK's net contribution to €4.9bn (£4bn or £61.92p per capita).²

The net cost to the UK has been rising in recent years as illustrated by chart 16, where the contribution used to range between 0.1% – 0.2% of gross national income (GNI), but has recently risen to range from 0.3% – 0.4%, with 2014 showing an unusual decline. In any case, the scale of these costs is hardly going to result in a significant saving for the UK economy (note, the cost savings to the exchequer would be larger, but only at the expense of the private sector firms in receipt of EU payments).

² Note, the OBR's published figures of £13.4bn gross contribution and £8.7bn net contribution differs as it excludes EU payments to the UK's private sector, and is calculated for the financial year 2014/15, rather than just 2014.

...but at just 0.3 – 0.4% of UK GNI, it is hardly a game changer.

Chart 16: UK net operating budget position with the EU

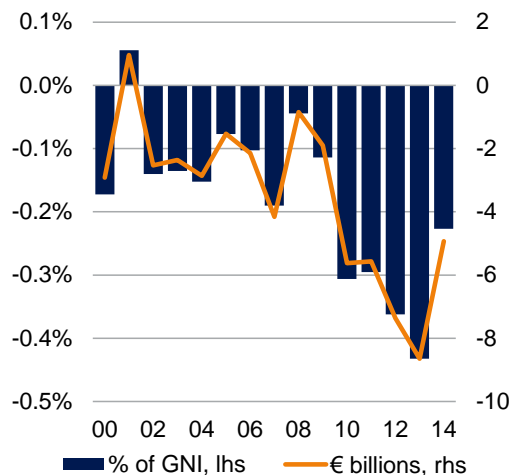
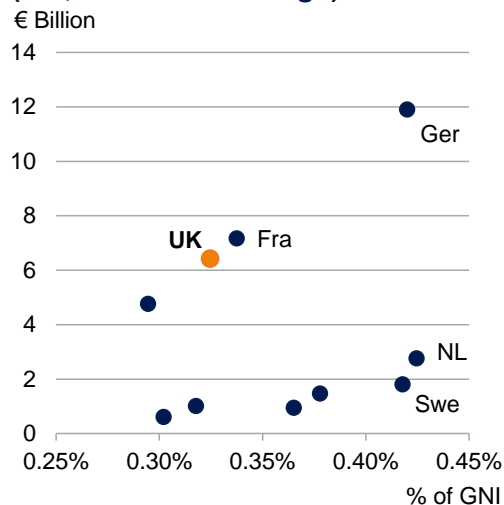


Chart 17: Comparison of contributors to EU budget (net, 2010 – 14 average)



Source: European Commission, Schroders Economics Group. 24 March 2016.

Compared to other member states, the UK was the third highest contributor in cash terms on average between 2010 –14; however, as a share of GNI it was only the seventh highest, well behind the top three of Germany, the Netherlands and Sweden. This makes it difficult for the UK to argue that it should pay even less towards the cost of the EU if it wants to maintain its access to the single market.

Assessing the economic impact

Numerous studies have recently been published on the potential impact of Brexit on the UK economy. To begin with, we will focus on the short-term impact (2016 and 2017), before considering the long-term impact.

In the near-term, if the UK votes to leave the EU in June, a negotiation will begin between the EU and UK as to the terms of its exit. These negotiations will last at least two years, but more likely take even longer, especially as both France and Germany have major elections in 2017. During this period of uncertainty, we expect the Brexit vote will have an impact on three areas which we have modelled and compared to our baseline forecast which assumes a ‘remain’ result:

1. Uncertainty over the UK’s access to the single market is likely to reduce net FDI inflows and slow domestic investment.
2. Households are likely to raise precautionary savings as reports of potential job losses start to escalate. We assume this will slow household consumption in real terms.
3. We assume sterling will fall by 12% on a trade-weighted basis, with a larger fall against the US dollar than the euro.

All three modelled shocks cause growth to slow as shown in chart 18. The biggest drag comes from growth in investment, which also causes a slowdown in employment and wage growth compared to our baseline forecast. Household consumption not only slows due to a higher savings rate, but also due to lower real disposable income caused by slower employment and wage growth. In addition, higher inflation due to the depreciation in sterling causes a loss in purchasing power in real terms.

Due to the government’s self-imposed fiscal targets, we assume the government will have to trim government consumption slightly to counter the impact of weaker tax revenues. Finally, we do not assume any first round effects from a vote to leave the EU on UK net exports as the UK would not actually leave for at least two years. However, we do assume a second order effect. The assumed depreciation in sterling should cheapen UK exports to foreign markets, and therefore boost demand and exports. Conversely, the fall in the UK’s purchasing power would lower UK demand for imports compared to domestically produced goods. Therefore net trade is forecast to slightly offset the negative impact from slower investment, consumption and government spending.

In the near-term, we forecast lower growth and higher inflation in a Brexit scenario

Overall, we forecast that in the event of a vote in favour of leaving the EU, UK GDP would be 0.9% lower than our baseline forecast by the end of 2017 (chart 18). We also forecast inflation to rise to over 3% (CPI measure) before falling back as base effects reverse (chart 19). During this period, the Bank of England is unlikely to raise interest rates. Slowing growth should leave the bank more concerned about domestic deflationary pressures building over the medium-term than the short-term shock from higher import prices.

Chart 18: UK GDP forecast

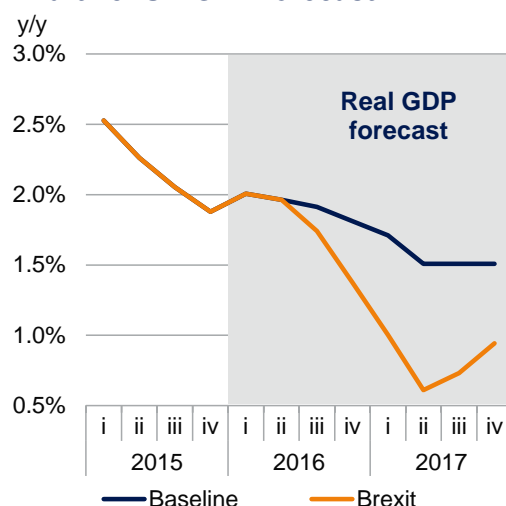
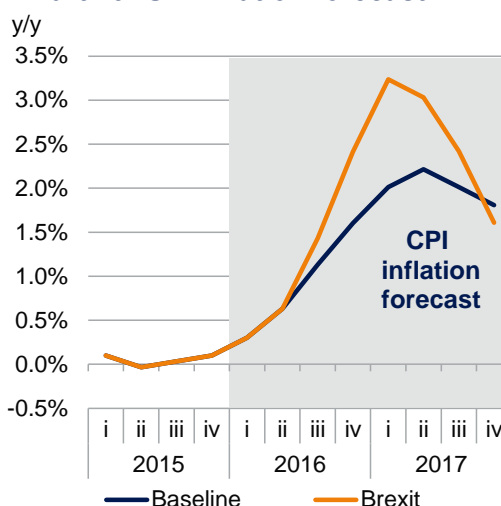


Chart 19: UK inflation forecast



Source: Thomson Datastream, Schroders Economics Group. 24 March 2016. Please note the forecast warning at the back of the document.

Of course, this type of analysis is highly uncertain and while the magnitude of the shocks we have outlined can be questioned, we are confident in the direction and impact of these shocks compared to our baseline forecast.

Life after Europe – the long-term impact of Brexit

The long-term outlook in the event of Brexit is far more uncertain than the immediate negotiating period. There are so many factors to take into account that modelling a most likely single scenario would be impossible. Many studies published already avoid this by offering a range of scenarios, which in turn result in a range of estimates for the impact on GDP. These studies on the whole have a median estimate that is negative for growth, but the ranges do include the possibility of some positive outcomes (see box 1).

The long-term impact of Brexit is more difficult to predict, but most studies expect slower GDP growth

Box 1: A summary of studies on the impact of Brexit

The following is a summary of the headline results from a number of influential studies on the impact of Brexit on UK GDP:

- The National Institute for Economic and Social Research (2004) estimates that Brexit would cause GDP to fall by 2.25%
- The Centre for European Policy Research (2013) has a range between -1.8% and -1.2% to GDP
- Institute of Economics Affairs (IEA) forecasts a gain of 0.1% in GDP (2014)
- Open EU (2015) estimates the impact to be between -2.2% to +1.6% impact by 2030. However, the study suggests that politically acceptable scenarios narrow the range to -0.8% to +0.6%
- Oxford Economics (2016) estimates the impact to range from -3.9% to -0.1% by 2030 in absolute terms. The impact on GDP per capita is estimated to be between -2.8% to +0.1%
- A PwC report sponsored by the Confederation for British Industry (2016) estimates the impact to be between -5.4% to -3% by 2020. In the more optimistic scenario, per capita GDP would still be 0.8% lower compared to remaining in the EU
- The Centre for Economic Performance (2016) estimates the long-run impact to be between -9.5% to -6.3% to GDP

Beyond studies on Brexit, the Confederation of British Industry estimated in 2003 that EU membership had added 4-5% to UK GDP since it joined. Also, both the Centre for Economic and Business Research and the National Institute for Economic and Social Research estimate that between 3.3 – 4 million jobs rely on exports to the EU. These are not dependent on membership, but would likely be impacted by Brexit.

The impact on the UK is likely to depend on trade, migration and EU subscription costs

The impact on the UK is likely to depend on three key factors:

1. **The degree of EU market access the UK is able to retain along with how many of the 50+ trade agreements with other parts of the world would remain.** Tariff and non-tariff barriers could be applied which would make UK goods less attractive to the rest of the EU. Moreover, access to the services market would also need to be negotiated, especially as it is a large portion of UK exports. A scenario where the trade relationship remains as close as possible to the current situation would not only safeguard current trade patterns, but also foreign direct investment that relies on the UK having access to the single market.
2. **Whether the UK government decides to take a liberal or populist approach to the deal offered by the EU.** If the UK reciprocates with counter tariffs and barriers to trade, then it would simply be increasing the cost on UK consumers, and businesses that rely on EU imports. This may appear to be attractive from the perspective of tilting competition in favour of UK manufacturers, but it ultimately raises costs on end users. A liberal government would not only minimise trade barriers, but it would also not seek to limit immigration – another long-term contributor to UK growth, whereas a populist government may seek to limit migration numbers.
3. **The EU's influence on the UK through regulation and subscription costs.** Being outside the EU does not necessarily mean no associated costs. Many countries still pay subscription costs (albeit less than EU members), and are subject to EU rules and regulations. Minimising these would be beneficial, assuming the UK government does not replace those

regulations with even more burdensome ones.

Alternative models to EU membership

A starting point for most research on this topic is to look at how other affiliations/memberships work, and consider the advantages and disadvantages as a model for the UK.

Alternative models for the UK include the EEA, EFTA or a customs union...

Starting with the European Economic Area (EEA) which includes Norway, Iceland and Liechtenstein (along with the EU). EEA members enjoy full access to the single market, along with free movement of capital and persons. However, EEA members are outside of the customs union, meaning that all trade in goods is subject to customs procedures, with companies having to prove the origin of the components of their exports. Compared to the UK's current arrangement, this would substantially raise the cost of exporting to the EU. EEA members are bound by existing EU rules and must implement any new regulations related to employment, health and safety, transport, the environment, along with any other product-related edicts. Moreover, EEA members have almost no influence or say in the creation of EU legislation. Finally, EEA members still pay a fee (approximately 90% of the UK's current contribution per head).

An alternative would be a looser arrangement in the form of membership of the European Free Trade Association (EFTA) – which is dubbed the “Swiss option”. EFTA which originated in the 1960s as an alternative to the deeper European Communities eventually evolved to become the EEA, but Switzerland decided not to follow the likes of Norway and Iceland, leaving it as the last EFTA-only member. Rather than the dynamic (or automatic) status of EEA members which evolves with the EU in terms of trade access and rules, the Swiss option is static, whereby changes on either side require bi-lateral negotiations. Switzerland has no right to the single market and is also outside of the customs union, but has managed to negotiate over 100 individual trade agreements with the EU, giving it only partial access to goods markets, and limited access for services. This option may appear attractive, but it is not without its costs. Switzerland pays less in fees than EEA members (approximately 40% of the UK's current contribution), but is still subject to many EU rules based on desired market access. There is no free movement of capital, but free movement of labour is a requirement. It is worth adding that the Swiss situation is always evolving and is not necessarily stable. For example, a majority of Swiss voted “against mass immigration” in a referendum in February 2014, going against the bi-lateral agreement with the EU. The European Commission says it is studying the exact outcome but European Commission Vice-President Viviane Reding states that the result of the referendum could jeopardise Switzerland's access to the single market.

...however all of these options have drawbacks...

A more recently developed relationship exists between Turkey and the EU in the form of a customs union, originally designed to motivate Turkey to reform itself and eventually seek accession to the European Union. The agreement gives Turkey partial access to the single markets for industrial goods and process agricultural goods, without the need for customs checks. However, many other goods are not covered, and services are excluded. As a member of the customs union, Turkey must align its external tariffs with those of the EU, limiting its ability to negotiate with non-EU countries. Turkey also faces some EU regulation for the markets it has access to, although Turkey pays negligible fees for the access it receives. In reality, those fees will be more than offset by EU funds in the future as Turkey moves closer to EU membership. Turkey has no free movement of capital, and very limited movement of persons.

Looking at the three available options so far, all have drawbacks for euro sceptics. One of the main arguments for voting for Brexit is the return of sovereign powers, which would make the EEA option almost impossible. Under EEA, the UK would lose a huge amount of influence and power in exchange for a limited reduction in the cost of membership. The EFTA option offers more

flexibility, but seems too costly once the burden of bi-lateral negotiations are considered along with the long-term uncertainty the process would create. Meanwhile, the customs union is most appealing from a trade perspective, although services would still be excluded, and freedom to establish third party agreements would not be allowed.

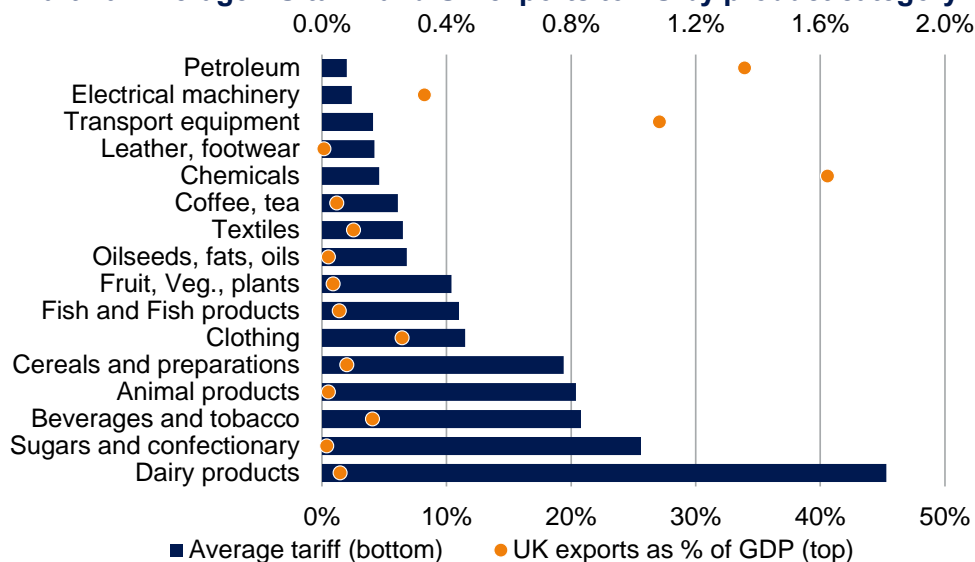
...which suggest the UK could seek to forge its own path

Of course, the UK does not have to follow the template for any of the above and could establish its own relationship. The starting point for negotiations could be a customs union, ideally with wider access to goods and service markets. Some EU regulation to exporting firms (as oppose to all firms) would be acceptable, along with a small subscription cost. On migration, perhaps preferential treatment for EU citizens in a points-based system could be agreed, which could still be very generous given the UK's need for skilled workers.

If after the negotiation period the UK does not accept the offer made by the EU, then a unilateral withdrawal would occur, and a definite break in relations. The UK would probably be subject to World Trade Organisation (WTO) minimum thresholds, with tariffs and quotas applied. EU Tariffs can be as high as 45% on dairy products, or 21% on beverages and tobacco. Chart 20 illustrates the average tariff applied to a range of product categories along with the value of UK exports of these products to the EU as a share of UK GDP. For example, the chemicals industry which exports just over 1.6% of GDP to the EU would face average tariffs of 5%.

Chart 20: Average EU tariff and UK exports to EU by product category

Unilateral withdrawal and being subject to full WTO tariffs and quotas would be a very painful option, but will probably not be the final destination



Source: WTO, ONS, Schrodgers Economics Group. 24 March 2016.

Agricultural tariffs are very taxing. More than 90% of UK beef and lamb exports go to the EU, worth £80 million annually. Car exports would face a 10% tariff, which would be applied to the UK's £10.2 billion worth of exports to the EU (2015).

The initial move to a WTO relationship would be a significant macro shock, but it does not have to be a permanent outcome. Canada has negotiated one of the most far-reaching trade agreements with the EU, giving it access to many industrial and product goods markets, with many tariffs being phased out over time. There is no reason to believe that the UK could not agree something similar (or better). The problem is the time it might take to reach such an agreement. Canada took seven years to conclude its negotiations, although given that most UK exporters already adhere to EU rules and regulations, it should be a quicker process. Although still being outside the single market (with single product regulations) and not in a customs union is an inferior outcome to the UK's present situation.

Voting for Brexit will probably lower growth and raise inflation in the near-term, while the long-term impact will probably also be negative for GDP

The wider implications include the future of the EU, the stability of the UK government, and whether Scotland remains part of the UK

Conclusions and wider implications

The close economic links forged over decades of co-operation and commerce will be painful to unravel if the UK votes for Brexit, and the government at the time decides to trade off access to the single market for greater sovereignty. In the near-term, we forecast a stagflationary outcome in a Brexit scenario with real GDP 0.9% lower, but CPI 0.6% higher by the end of 2017. Without greater clarity over what Brexit means, it is too difficult to forecast the long-term impact on the UK economy post-Brexit, but studies that have been published lean towards a negative outcome compared to remaining in the EU. Limiting immigration would lower trend GDP growth, although per capita growth may not be affected to the same extent. Meanwhile, the loss in FDI would reduce long-term investment and would adversely impact productivity growth and therefore standards of living.

The UK is an important trade partner and investment destination for the rest of the EU and so Brexit would also have a negative impact on Europe, albeit far smaller than the impact on the UK. A bigger worry would be the loss of a large member state with liberal free-market tendencies. Protectionists and those that support state interventionist measures would not only gain ground if the UK leaves, but may even take control at a time when Europe crucially needs liberal structural reforms if it is to survive as a political and economic project. Many in Europe fear that the UK would not be the last member state to depart once a path out of the union is established. This may incentivise the rest of the EU to take a tough negotiating stance with the UK in order to set an example.

Politically for the UK, not only would Prime Minister David Cameron be at risk of losing his job, but the Scottish question would almost certainly return. The government in Scotland is promising to push for another independence vote if Scots vote to remain, but the rest of the UK forces the union to leave the EU. Whether Scottish independence is even economically viable given the fall in global oil prices is a topic for another day, but it is certainly another factor investors are thinking about.

For investors, many have already started to hedge the risk in their portfolios by selling sterling, which we believe still faces downside risks if the UK votes to leave. According to the Investment Association (UK trade body), UK investment funds suffered net outflows of £862 million in January and February, with property funds seeing their largest monthly outflow since November 2008 (although this has to be considered against a backdrop of wider market volatility). We expect domestically focused and heavily EU-exposed stocks to underperform in a Brexit scenario, but more international stocks to outperform as international earnings are lifted by weaker sterling. As for bonds, credit spreads may widen as investors seek a larger credit-risk premium, but government bonds may underperform at the 10-year maturity – the most popular point in the curve for international investors. Domestic investors may choose to hold more gilts as a safe haven asset, and so we expect curve steepening, which would also be consistent with higher inflation from the expected depreciation in sterling.

Emerging markets: time to buy?

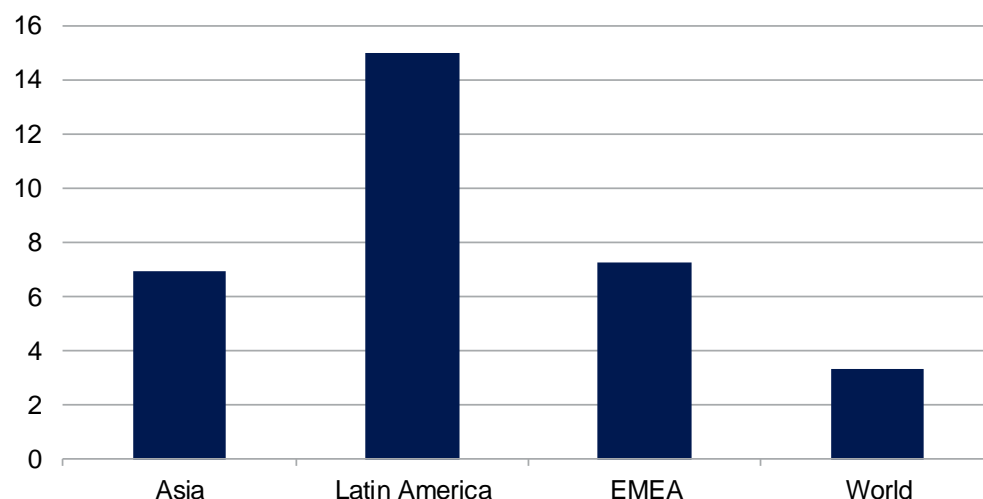
Recent outperformance has excited investors

Emerging market equities have posted a strong performance this year, with the MSCI EM index rallying around 18% since the lows touched in January. The bulk of this rally came in March, and has coincided with stronger emerging market currency performance as well. An inevitable question then is whether this marks the turning point for emerging markets, or will instead prove to be yet another false dawn.

Chart 21: EM equity easily outperformed developed markets

MSCI equity market price-returns in 01/03/16 to 29/03/16 (%)

March rally has seen EM outperform, particularly LatAm



Source: Thomson Datastream, Schroders Economics Group. 29 March 2016. MSCI World is a DM only equity index. All returns are in US dollar terms.

Looking at equity markets by region (chart 21) shows much of the performance has been driven by Latin America, though all regions outperformed the developed market aggregate. This suggests an idiosyncratic driver in Latin America that would cause it to outperform emerging markets as a whole. Given what we know about the region, the first place we would typically look is commodities. But we have written about Brazil's situation often in recent months, so it is hard to ignore the elephant in the room. It turns out that Brazil's equity market is by far the strongest regional performer, with twice the returns of any other Latin American market, which are generally closer to the performance of Asia and EMEA than of Brazil. In Brazil's case, outperformance rests on political factors (namely, hopes that current President Dilma Rousseff will be ejected) above anything else.

If all other markets are up by similar amounts, what else could be at play? There will be some inflows to global emerging market indices in pursuit of the Brazil story, but that seems insufficient on its own.

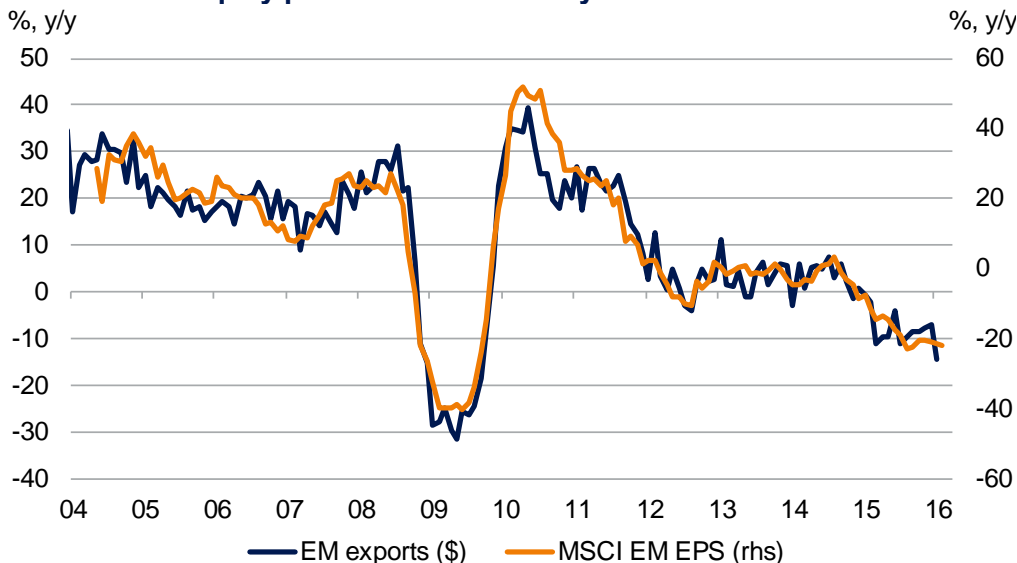
Trade is still soft

Without trade growth, earnings growth will be limited

One of the key fundamental drivers of emerging market equity performance is export performance in US dollar terms. This matters because it impacts nominal dollar GDP growth, and hence the earnings potential in emerging markets (chart 22). Intuitively this makes sense; international investors are more interested in what dividends are available in hard currency, rather than local currency, and the equity indices are typically skewed towards exporters. Consequently, the behaviour of trade will do much to determine the behaviour of emerging market equities, in aggregate (we focus on a top-down approach here,

as economists; there will likely always be individual stocks that flourish despite trade weakness).

Chart 22: EM equity performance driven by trade



Source: Thomson Datastream, Schroders Economics Group. 29 March 2016.

We do not yet have a full set of February trade data for emerging markets; roughly half the countries we monitor have reported. Of these, most reported improved export figures in February, compared to January (the glaring exception is China). While this is encouraging, we would be very reluctant to read too much into one month's data, especially given the volatility of the series. The trend so far has been decidedly negative for the emerging market outlook, as is evident in chart 22.

Trade now looks structurally weaker

The trend referred to clearly begins in late 2014, and is largely commodity price driven. That is not to say the impact has been limited to commodity exporters; commodity importers have also seen a fall in export values of a near identical magnitude. This points to a lack of pricing power (so falling costs are passed on), reflecting a weak demand situation. This is illustrated clearly when we consider global trade in volume terms (charts 23 & 24). Trade volumes are expanding at a much slower pace today than historically, on a global basis. If this is a “new normal”, then even when price effects unwind, as they should do this year, emerging market trade values are unlikely to grow much faster than for the 2012-14 period, with similarly uninspiring consequences for earnings once the initial recovery phase is done.

Charts 23 & 24: Trade volumes and the trade multiplier



Source: Thomson Datastream, Schroders Economics Group. 29 March 2016.

Lower trade multiplier reduces beta of EM to global growth

As to whether or not this is a “new normal”, consider the trade multiplier shown above. This is a fairly simple measure, we use the ratio of growth in trade volumes to growth in global real GDP, but it tells you whether the rate of growth in trade we see today is purely a result of slower growth, or if something has changed in the trade intensity of world growth. The trade multiplier exhibits a clear downward trend over the period (the global financial crisis distorted the measure), which tells us that for this level of GDP growth, we should have nearly two-to-three times the amount of trade growth. So this is not a problem we can easily “grow out of”; we would need global growth of over 6% to see trade grow at its pre-crisis rate. Global GDP pre-crisis typically grew around 4%.

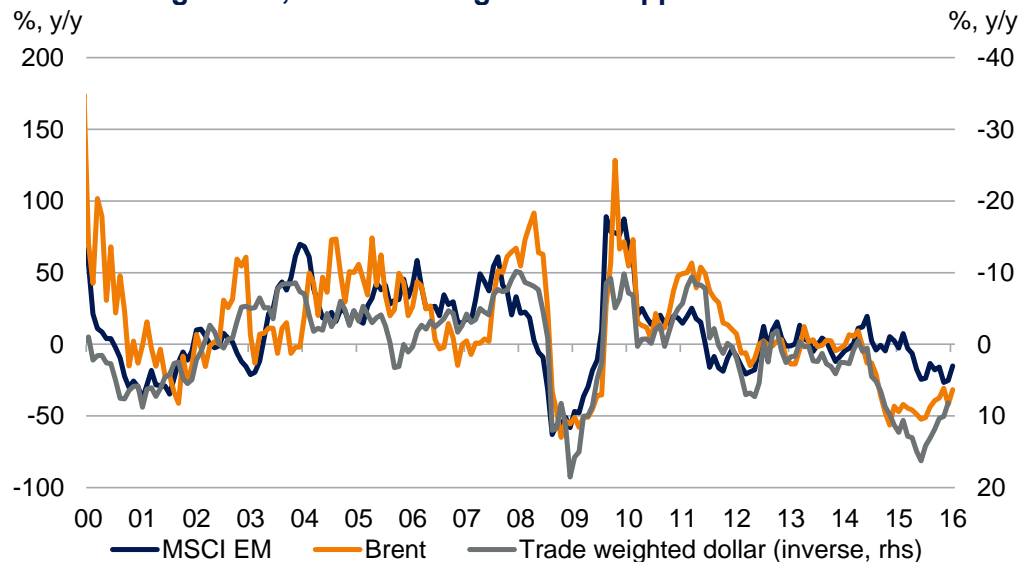
The fundamental support for emerging market equities, then, looks weak. Trade looks to be structurally weaker and we do not see any immediate or even near-term catalysts for that to change. One short-term positive for emerging market assets should be the unwinding of commodity-related price effects on trade values. Assuming a relatively flat profile for commodity prices from here would imply this occurs in H2 of 2016. As these price effects unwind, nominal dollar earnings will be boosted which should aid equity performance in the short term. But ultimately we will return to the stale export growth profile of 2012 – 14, unless we see a serious boost to global growth. Of course, there is also a downside risk here: even if values recover, it may be that at these commodity price levels, some commodity exporters are unprofitable, rendering the longer term outlook rather bleak, particularly with credit tightening. Lacking that fundamental support, how to explain the emerging market equity rally?

Risk on, risk off

EM, oil and the trade weighted dollar are all ways to play global risk

We have already mentioned earlier in this month’s Viewpoint the improvement in global risk sentiment since January, aided by ebbing concerns over China. This change to the global risk environment is reflected clearly in the behaviour of oil and the trade-weighted dollar. As chart 25 shows, it is also reflected in the behaviour of emerging market equities.

Chart 25: Right now, it’s all about global risk appetite



Source: Thomson Datastream, Schroders Economics Group. 30 March 2016.

There is a misconception we should address here, which is that emerging markets are “all about commodities”. But the region is much less dependent on commodities for growth than is commonly assumed; consider that the bulk of emerging markets GDP is manufacturing orientated (Asia and Europe). Not only that, over 70% of equity market capitalisation in emerging markets is in net commodity importers ; one would expect rising commodity prices to be bad for

**Not time to buy
just yet, but 2016
could still be the
year**

emerging markets as a whole. This reinforces our view that chart 24 is showing you three series highly correlated with global risk.

So really, that looks to be it. There is at best only a weak fundamental story; most of the recent move in emerging markets looks to have been driven by sentiment alone (including the political story in Brazil), with the improvement in risk appetite coming at a time when aggregate emerging market valuations look attractive and investors have been waiting for an opportunity to re-enter the asset class. On this point, our view would be that the apparent cheapness in emerging market equities emanates from areas like commodities and Chinese financials, which all have potentially serious balance sheet issues, so the scope for rerating is limited. Arguably, anything you want to buy in EM already looks fair value, if not expensive. So, answering the question of whether you should be buying emerging markets right now, the answer is: only if you're positive about the direction of risk appetite. We have already laid out our view in the global section of this Viewpoint: at this stage it is difficult to make the case for an acceleration beyond the current pick-up, and building expectations of Federal Reserve rate hikes (we expect two this year, in a more hawkish tilt than the market) will likely see US dollar appreciation.

So, if now is not a good time to re-enter emerging markets, when would be? Returning to our earlier point on the importance of trade, a revival in emerging market exports would be one key trigger. But as we discussed, a significant long term revival seems unlikely given the structural change in trade. Volumes will likely remain muted given this structural change and our expectations on global growth. Trade values, on the other hand, should stage a short recovery later this year: around H2 assuming a flat commodity price profile, as base effects drop out of the comparison. Were commodity prices to pick up before then, we should see a more rapid pick-up in EM performance. Again, given our views on China, we think this is fairly unlikely. Summarising then, when do we buy EM? Soon, but not yet.

Schroder Economics Group: Views at a glance

Macro summary – April 2016

Key points

Baseline

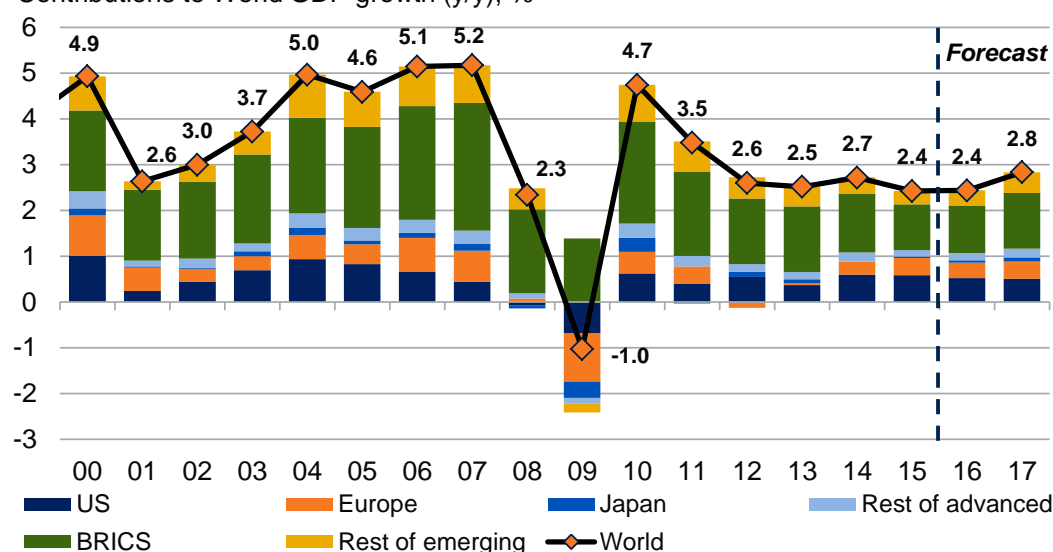
- We trimmed our global growth forecast in February to 2.4% for 2016 led by downgrades to the US, Japan and emerging markets. The inflation forecast for 2016 was also reduced for the advanced economies to reflect the lower oil price profile. Emerging market inflation is, however, higher as a result of currency depreciation and administered price hikes. For 2017, our forecasts were little changed, with growth strengthening modestly as a result of more stable emerging market activity.
- The US Fed is expected to raise rates in June and December by 25 bps, so taking fed funds to 1% by end year. Further increases in 2017 to 1.5% by end year, but this is a flatter profile than before to reflect lower inflation and concerns about global activity.
- UK recovery to continue, but to moderate as a result of Brexit uncertainty and the resumption of austerity. Interest rate normalisation to begin with first rate rise in November 2016. BoE to move cautiously, hiking 25 bps in November, peaking at around 1% in February 2017 when weaker activity will force a pause.
- Eurozone recovery continues in 2016, but does not accelerate as tailwinds fade and the external environment drags on growth. Inflation to turn positive again in 2016 and rise modestly into 2017. ECB to cut rates further with the deposit rate falling to -0.5% by the end of the year where it stays through 2017.
- Japanese growth now forecast at 0.8% this year (previously 1.1%) and inflation reduced to 0.4%. The BoJ responds with further rate cuts, taking policy rates to -0.25% by end 2016.
- Emerging economies benefit from modest advanced economy growth, but tighter US monetary policy weighs on activity, while commodity weakness will continue to hinder big producers. Concerns over China's growth to persist, further fiscal support and easing from the PBoC is expected.

Risks

- Risks skewed towards deflation on fears of China hard landing, currency wars and a US recession. The risk that Fed rate hikes lead to widespread EM defaults would also push the world economy in a deflationary direction. Inflationary risks stem from a significant wage acceleration in the US, or a global push toward reflation by policymakers. Finally, an agreement between Saudi Arabia and Russia could limit oil supply, leading to a jump in inflation and a hit to consumer spending.

Chart: World GDP forecast

Contributions to World GDP growth (y/y), %



Source: Thomson Datastream, Schroders Economics Group, February 2016 forecast. Please note the forecast warning at the back of the document.

Schroders Baseline Forecast

Real GDP

y/y%	Wt (%)	2015	2016	Prev.	Consensus	2017	Prev.	Consensus
World	100	2.4	2.4	↓ (2.6)	2.4	2.8	(2.8)	2.9
Advanced*	62.4	1.8	1.7	↓ (1.9)	1.8	1.9	(1.9)	1.9
US	24.7	2.4	2.1	↓ (2.4)	2.1	2.1	(2.1)	2.4
Eurozone	19.0	1.5	1.4	↓ (1.5)	1.5	1.6	(1.6)	1.7
Germany	5.5	1.4	1.6	↓ (1.7)	1.6	2.1	(2.1)	1.5
UK	4.2	2.2	1.9	(1.9)	2.0	1.6	(1.6)	2.2
Japan	6.5	0.5	0.8	↓ (1.1)	0.7	1.4	↓ (1.5)	0.6
Total Emerging**	37.6	3.4	3.6	↓ (3.9)	3.5	4.4	↑ (4.2)	4.3
BRICs	23.6	4.2	4.4	↓ (4.6)	4.3	5.2	(5.2)	5.0
China	14.7	6.9	6.3	(6.3)	6.4	6.2	(6.2)	6.2

Inflation CPI

y/y%	Wt (%)	2015	2016	Prev.	Consensus	2017	Prev.	Consensus
World	100	3.0	3.9	↑ (3.7)	4.2	3.7	↓ (3.9)	3.6
Advanced*	62.4	0.2	1.0	↓ (1.4)	0.8	2.0	↑ (1.9)	1.8
US	24.7	0.1	1.2	↓ (1.6)	1.3	2.3	↑ (2.1)	2.2
Eurozone	19.0	0.0	0.7	↓ (1.3)	0.3	1.6	(1.6)	1.4
Germany	5.5	0.1	0.9	↓ (1.5)	0.5	1.8	↑ (1.6)	1.6
UK	4.2	0.1	0.8	↓ (1.3)	0.7	2.0	↓ (2.2)	1.8
Japan	6.5	0.8	0.4	↓ (1.0)	0.0	1.8	(1.8)	1.6
Total Emerging**	37.6	7.6	8.7	↑ (7.4)	9.7	6.7	↓ (7.3)	6.7
BRICs	23.6	4.5	3.8	↑ (3.6)	3.5	3.5	↑ (3.4)	3.2
China	14.7	1.5	1.9	(1.9)	1.5	2.1	(2.1)	1.7

Interest rates

% (Month of Dec)	Current	2015	2016	Prev.	Market	2017	Prev.	Market
US	0.50	0.50	1.00	↓ (1.25)	0.83	1.50	↓ (2.00)	1.07
UK	0.50	0.50	0.75	↓ (1.00)	0.65	1.00	↓ (1.25)	0.83
Eurozone (Refi)	0.00	0.05	0.05	(0.05)	-0.30	0.05	↓ (0.25)	0.83
Eurozone (Depo)	-0.40	-0.30	-0.50	-		-0.50		
Japan	-0.10	0.10	-0.25	↓ (0.10)	0.01	-0.50	↓ (0.10)	0.01
China	4.35	4.35	3.50	(3.50)	-	3.00	(3.00)	-

Other monetary policy

(Over year or by Dec)	Current	2015	2016	Prev.	2017	Prev.
US QE (\$Bn)	4487	4487	4505	↓ (4507)	4523	↓ (4525)
EZ QE (€Bn)	159	652	1372	↑ (1369)	1732	↑ (1369)
UK QE (£Bn)	375	375	375	(375)	375	(375)
JP QE (¥Tn)	383	383	400	↓ (404)	400	↓ (404)
China RRR (%)	17.50	17.50	15.00	15.00	13.00	13.00

Key variables

FX (Month of Dec)	Current	2015	2016	Prev.	YY(%)	2017	Prev.	YY(%)
USD/GBP	1.44	1.47	1.43	↓ (1.50)	-3.0	1.40	↓ (1.50)	-2.1
USD/EUR	1.14	1.09	1.08	↑ (1.02)	-0.6	1.04	↑ (1.02)	-3.7
JPY/USD	112.5	120.3	115	↓ (120)	-4.4	120	↑ (115)	4.3
GBP/EUR	0.79	0.74	0.76	↑ (0.68)	2.5	0.74	↑ (0.68)	-1.6
RMB/USD	6.48	6.49	6.80	↑ (6.60)	4.7	7.00	↑ (6.80)	2.9
Commodities (over year)								
Brent Crude	39.8	52.7	35.7	↓ (48)	-32.3	41.9	↓ (43)	17.6

Source: Schroders, Thomson Datastream, Consensus Economics, March 2016

Consensus inflation numbers for Emerging Markets is for end of period, and is not directly comparable.

Market data as at 30/03/2016

Previous forecast refers to November 2015

* **Advanced markets:** Australia, Canada, Denmark, Euro area, Israel, Japan, New Zealand, Singapore, Sweden, Switzerland, United Kingdom, United States.

** **Emerging markets:** Argentina, Brazil, Chile, Colombia, Mexico, Peru, Venezuela, China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, South Africa, Russia, Czech Rep., Hungary, Poland, Romania, Turkey, Ukraine, Bulgaria, Croatia, Latvia, Lithuania.

Updated forecast charts – Consensus Economics

For the EM, EM Asia and Pacific ex Japan, growth and inflation forecasts are GDP weighted and calculated using Consensus Economics forecasts of individual countries.

Chart A: GDP consensus forecasts

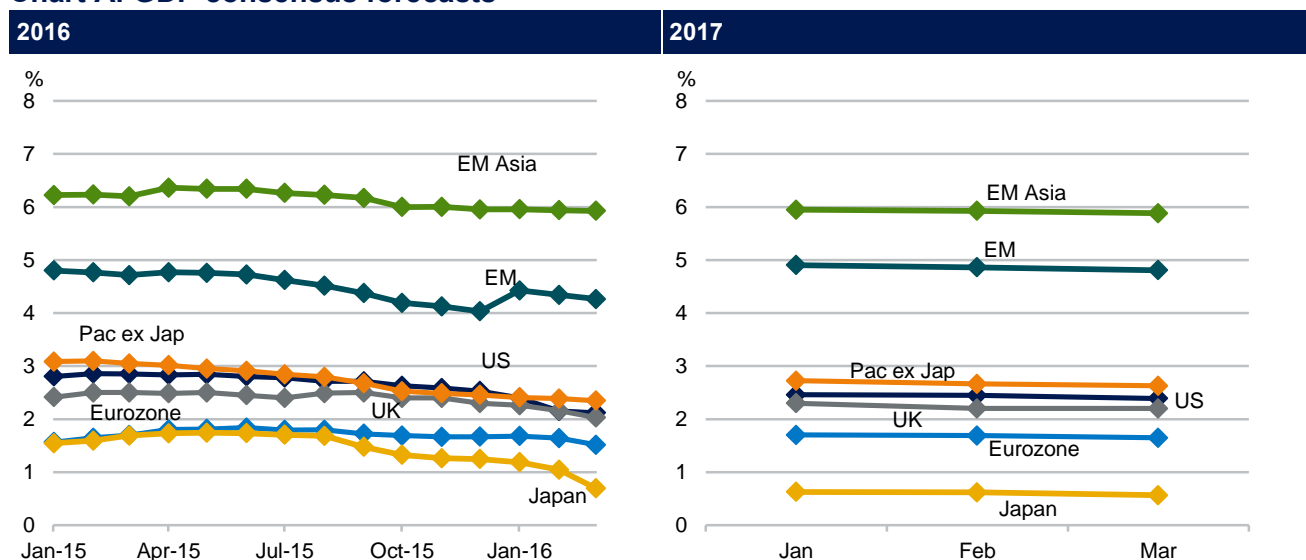
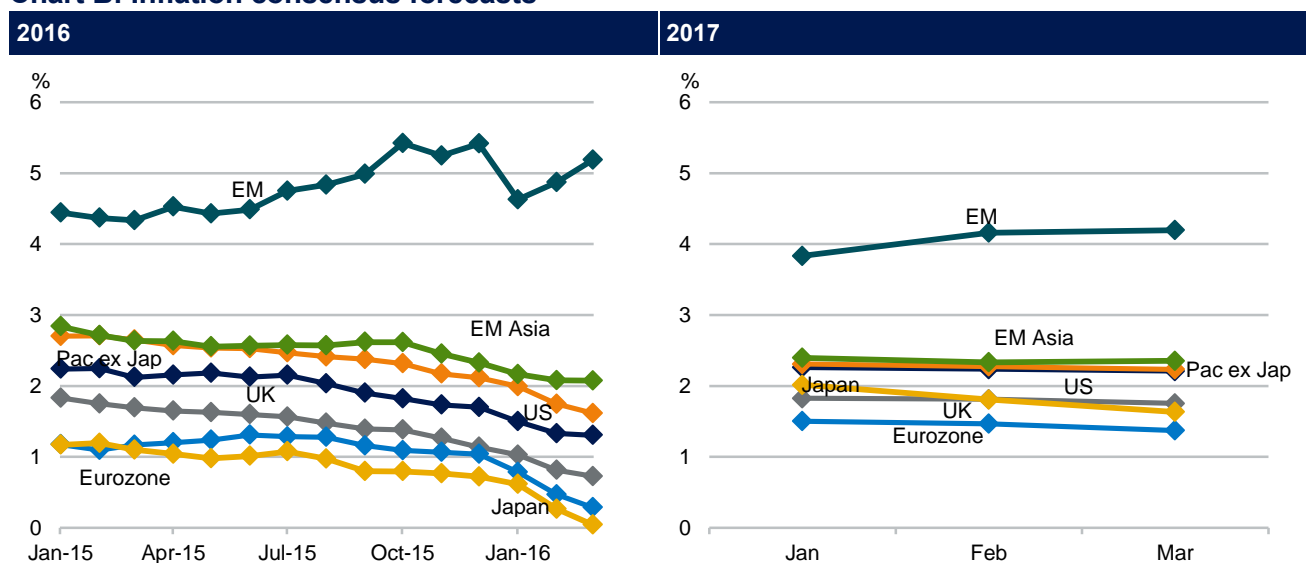


Chart B: Inflation consensus forecasts



Source: Consensus Economics (March 2016), Schroders

Pacific ex. Japan: Australia, Hong Kong, New Zealand, Singapore

Emerging Asia: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand

Emerging markets: China, India, Indonesia, Malaysia, Philippines, South Korea, Taiwan, Thailand, Argentina, Brazil, Colombia, Chile, Mexico, Peru, Venezuela, South Africa, Czech Republic, Hungary, Poland, Romania, Russia, Turkey, Ukraine, Bulgaria, Croatia, Estonia, Latvia, Lithuania.

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