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Paris, May 26, 2016

A Brexit could cause a major paradigm shift, both in macroeconomic terms and in the financial markets, according to experts at Natixis Asset Management

On 23 June 2016, a referendum will be held on the United Kingdom's continued membership of the European Union. As the Brexit and Bremain campaigns intensify, experts at Natixis Asset Management have examined the macroeconomic impact and the consequences for the financial markets of both options. Their analysis indicates that Brexit would cause a major paradigm shift in Europe from both a political and economic perspective.

A major European challenge

According to Philippe Waechter, Director of Economic Research, the referendum raises many questions about the economic and political consequences for the UK, and also for the entire European Union. "*The referendum will take place against a worrying backdrop for Europe, which is far from returning to the dynamic of growth and expansion that prevailed before the crisis of 2008, resulting in high unemployment, and thus providing a potential risk of social and political instability,"* he explained. Although the electorate's decision is primarily political, it will have a major economic impact.

Brexit would create significant problems for international companies based there. While investments in Britain are mainly linked to a combination of the flexibility of the UK economy and direct access to the single market, Brexit would change the rules by closing, at least for a time, this access to the single market. It may therefore result in a freeze on direct investment in Britain while the progress of negotiations with the European Union is assessed. "However, *the outcome of these negotiations is very uncertain,"* added Philippe Waechter. *If the United Kingdom wishes to limit the impact of Brexit on trade and thus on the economy and employment, it will have to establish a new model, which will take time and will be detrimental to the country's economy."*

The financial sector, which accounts for approximately 10% of UK GDP, would also be greatly affected. The rule change associated with Brexit would limit the UK financial system's ability to access financial structures in the euro area. The City may lose a large part of its euro-denominated trading activity. Furthermore, we can expect a significant outflow of Europeans who have settled in London. This could have a major impact as, besides the strictly banking activity, the population structure will change, penalising the very dynamics of the economy of London and therefore of the UK.

These economy-related elements will have an even greater impact from a political perspective. The United Kingdom will have to negotiate political and strategic issues globally on its own; it will no longer have the support and backing of the EU in negotiations. Its political weight could certainly suffer.

At the same time, a Brexit would be a significant factor of instability for the European Union, since it would remove the perception of irreversibility that has prevailed since the beginning of European integration. "*While one year ago, the possible exclusion of Greece was punitive in nature, in the case of Britain, the interpretation would be in the order of 'I don't want to live with you anymore,'"* added Philippe Waechter. *"It is much stronger and could provide an incentive for other countries to leave the European Union."* Brexit could thus be seen as an opportunity to fundamentally change the shape, scope and dynamics of the European Union. *"That is why a political initiative is crucial, regardless of whether a Brexit takes place. Even if the UK remains in the EU, as the risk of Brexit was so strong, hopefully Europeans will take action to strengthen the dynamic of the European Union. Yet again, the British have been the stimulus required to reinforce European integration*," concluded Philippe Waechter.

Potentially volatile European equity markets

European stock markets appear still somewhat unmoved by the risk of Brexit. "Equity markets appear to be indifferent, and there is no evidence of an overall underperformance of the London financial markets," explained Yves Maillot, Director of European Equities Investment. "Nevertheless, in recent weeks we have observed a clear underperformance of domestic UK companies compared with their internationally focused, export-oriented counterparts, due to the drop in the pound sterling, which has lost about 12% against the euro in the last six months."
According to Maillot, Brexit would cause a particularly difficult situation for British banks, which are very focused on their domestic market, as well as for the financial markets and the financial industry in general. "Indeed, the financial industry would no longer benefit from 'European passports', allowing it to sell its services freely within the Union, despite the fact that 75% of Europe's investment banking and finance business is located in London. "In this case, we will very likely see a transfer of structures. Similarly, some foreign banks whose activity (GDP, volume of loans) is very sensitive in the UK, are in a weak position," added Yves Maillot.
In general terms, if Brexit becomes a reality, equity markets in Europe may experience a shock, the magnitude of which is still difficult to estimate (5% to 10% or more), in view of the likely macroeconomic impact and trade links between the EU and the UK. The much more cautious approach of international investors with regard to Europe (with negative flows on European equity funds in February) is the first materialisation of this risk. "Keeping the UK in the EU would be a genuine relief for the markets," concluded Yves Maillot.

Strong and divergent reactions on the bond market

On the bond markets, Brexit is seen as the greatest threat since the sovereign debt crisis in the Eurozone. "To date, the reaction on the bond markets has been varied: either steadfastly ignoring the risk of exit, as with the Gilt or corporate credit market, or strongly anticipating it (as evidenced by the significant widening of spreads of British banks and sovereign CDS, or the fall in sterling)," explained Philippe Berthelot, Director of Credit Management. However, Brexit would result in a dramatic increase in uncertainty and thereby an increase in volatility and consequently strong risk aversion, which would in turn affect the risk premiums of all asset classes. "The UK, for which some metrics, such as twin deficits, are worse than those of Greece, will have its decisive moment, which will not leave its European neighbours untouched," added Philippe Berthelot. Besides the fall in value of the currency (GBP), there would be repercussions for rates (short and long-term) and for all credit obligations issued by the United Kingdom. "If the Bremain vote is successful, the currency would regain the ground lost in the last six months and British bank bonds would provide excellent opportunities" concluded the expert.

Press Contact

Natixis
Sonia Dilouya
+ 33 (0)1 58 32 01 03
sonia.dilouya@natixis.com

Natixis Asset Management
Fanny Galène Biard
+ 33 (0)1 78 40 84 54
fanny.galene@am.natixis.com

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Natixis Asset Management ranks among the leading European asset managers[1] with €347 billion in assets under management and 712 employees[2]. Natixis Asset Management offers its clients tailored, innovative and efficient solutions organised into six investment divisions:
Fixed income, European equities, Investment and client solutions, Structured products and volatility developed by Seeyond, Global emerging developed by Emerise, and Responsible Investing developed by Mirova.

1 Source: IPE Top 400 Asset Managers 2015 ranked Natixis Asset Management as the 46th largest asset manager based on global assets under management, and by the country of the main headquarters and/or main European domicile, as of 31 December 2014.
2 Source: Natixis Asset Management - Natixis Asset Management Asia Limited as of 31 March 2016.
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About Natixis

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With more than 16,000 employees, Natixis has a number of areas of expertise that are organized into three main business lines: Corporate & Investment Banking, Investment Solutions & Insurance, and Specialized Financial Services.
A global player, Natixis has its own client base of companies, financial institutions and institutional investors as well as the client base of individuals, professionals and small and medium-size businesses of Groupe BPCE's banking networks.
Figures as at March 31, 2016