Across Asia

OCBC Bank

Ripples from the Isles
Brexit and its broader consequences

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- **We trust that you have received tons of analysis on how Brexit would affect the UK economy by now. We'll spare you those nasty details on how much sterling has been pounded and how high the likelihood of a self-inflicted recession is, and focus on the wider global repercussions here.**
- **For Asia, while the direct economic impact is broadly curtailed by limited bilateral trade and investment linkages, our region cannot escape the indirect ones that are playing out in the near term and in the coming months.**
- **Of immediate concerns will be market volatility, made all the worse given the built-in expectation for a diametrically opposite outcome. Beyond these, however, the evident upsurge in anti-establishment sentiment is unlikely to be affecting politics in UK alone. It may yet trump in the US elections soon.**

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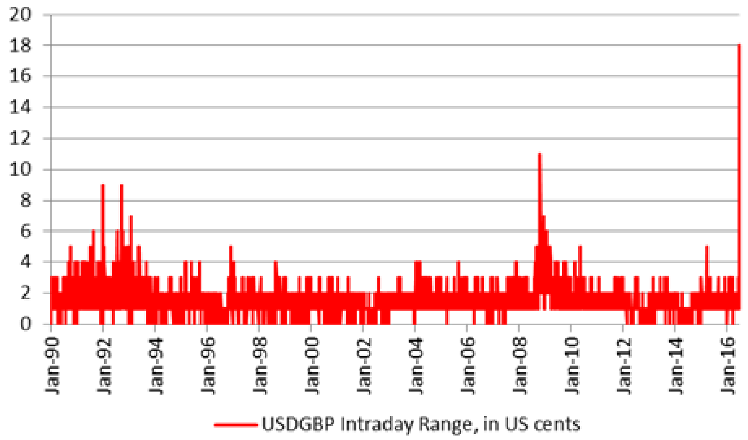
One for History Books

"*Just a flesh wound!"* Fans of British humor might remember this line from Monty Python and the Holy Grail, where a black knight continued to act as if nothing has happened and itching for more blows, even after King Arthur's sword left him armless in an inexplicable fight.

This morning, the cognitive dissonance of our ears hearing shouts of joy from Brexit supporters via live TV even as our eyes were glued to the Bloomberg screens tracking market's negative reaction to the referendum vote counts somehow reminded us of that particular scene. Perhaps, the gravity of what was unfolding somehow left us pining for humor of even the silliest sort.

What a day. As Asia woke up to news flash about poll suggesting a 52%-versus-48% win in favour of the "Remain" camp, there was enough self-assuring relief to see the Sterling appreciating above 1.50 level against USD, for instance. Alas, the day was turning out to be rather different just a few hours later. Reality set in as more and more votes went the 'wrong' way, with fewer and fewer voting areas left to report that could swing things the 'right' way again.



Source: Bloomberg, OCBC.

Unsurprisingly, the British currency took the brunt of damage, dipping all the way down to 1.32 level at some point. Indeed, the 18 points intraday range is the highest gap seen in USDGBP pair is a historic high, exceeding even the September 1992's Black Wednesday. As it turns out, the pollsters were exactly right with the margin of 52-versus-48, but in favor of the opposite camp, of course. All in all, it is a day bound for history books.

From our end, over the longer term, we take heart in the fact that the likely economic fall-out in UK should lead to limited direct impact on Asian economies. As a percentage of GDP, exports to UK range from a low 2-3% for economies such as Hong Kong and Vietnam to even lower 0.2-1% for most of the rest, including Indonesia and Malaysia. The trade impact could be more than flesh wounds, however, if the European economies get affected materially by UK's exit. Countries, including Indonesia, that are more domestically oriented and less tied to exports in general would be better placed to ride this potential secondary effect out, naturally. That is less so for Malaysia, whereby exports to EU account for 6-8% of its GDP.

Before these economic effects play out, however, there are the immediate financial market reactions to contend with. It is a given that market sentiment would remain cautious for a while, and that reactions across different markets and asset classes are going to be amplified by the fact that market expectation for the referendum outcome was all the way at the other end of the spectrum.

To the extent that this event was anticipated at least in terms of timing, however, it did force the major policymakers to prepare for such a scenario beforehand. Whatever arrangements that the major central banks have between them, just in case Brexit does happen, in terms of liquidity support and potential currency market intervention would inadvertently kick in now and should help to smooth the ride out beyond the obvious knee-jerk reactions. In turn, that should limit the magnitude of blows that Asian markets have to suffer through.

Symptom of Something Bigger

Even as we zoom in on the ups and downs of market movement, there is a greater force at work today that warrants our attention. Specifically, the fact that the "Leave" campaign has won the day rather handsomely is itself a symptom of just how fervent the sentiment of anti-establishment has gotten. This is important, because it appears to be prevalent not just in the UK, but also in the other developed economies.

That Donald Trump could seize the Republican party's primaries despite misgivings about his tactics and persona has rested at least in part on the upsurge of a similarly rejectionist sentiment in the US, for instance. At the other side of traditional ideological spectrum, the fact that Bernie Sanders was a serious contender to the Democratic ticket in the primary race there spoke to the same underlying unhappiness among significant segments of the US population.

Indeed, as one veteran US political insider characterized it to us recently, it is no longer about Left versus Right across the traditional political spectrum, it is increasingly about the Up versus Down. As today's Brexit vote outcome shows, the perception that traditional political establishment, including its institutions and politicians who control them, has failed to help the middle class in achieving better lives – even as the rich apparently is getting richer –has opened up a whole new playing field for fresh and untraditional political players. That has to be a risk that global markets would have to contend with. Even if today's events have been shocking in and of its own, it may well be portending more political uncertainties to come across the world.

What can Asia do?

Against this global backdrop, there is not much that Asian economies can do apart from strengthening its own defence and cleaning up its own house. Foreign reserves exchange accumulation would likely remain a key focus for most central banks, since events like today's reinforces the need to pad up insurance coverage.

Meanwhile, it makes it all the more urgent and necessary to undertake structural reforms. On that front, it is interesting to note that, amongst such global uncertainties, Indonesia counts among those economies that are less directly impacted while offering enough momentum on reforms to signal to investors that it is serious about putting its house in order.

While market attention is obviously predominantly focused on Brexit and the immediate ripple effects today and into next week, it pays to note that Indonesia is scheduled to push through the long-awaited tax amnesty law on June 28th. If it goes through as suggested by the Finance Minister, it will be a timely booster shot right just in case the economy's immunity may come to be tested the most.