LETTER FROM EDOUARD CARMIGNAC

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Edouard Carmignac writes on current economic, political and social issues each quarter.

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Dear Investor,

To Brexit or not to Brexit? In the months to come, this Shakespearian dilemma will unquestionably continue to trouble and divide what used to be a United Kingdom.

But is a British EU departure threat really so lethal to financial markets? Discussion of the issue has become so emotional that at this stage it's worth taking a step back – with a cooler head. The innumerable ties that Britain and the European Union have forged over the years make complete severance extremely complicated – and highly unlikely. The UK economy is driven largely by services, primarily financial services, and their future is particularly vulnerable to any unfavourable change in EU regulations.

The novelty, this time round, is that the uncertainty may prove to be a blessing in disguise. The political and economic crisis gripping the UK has already begun to take some of the steam out of the national sovereignty pundits that had recently been gaining ground in continental Europe, first and foremost on its southern rim. Moreover, spreads on Italian and Spanish government bonds over German bunds have shrunk in the past few days to nearly all-time lows. If anything, it looks like the whole ordeal is strengthening the EU in political terms. The first test on this reinforcement awakening will be how Brussels responds to Matteo Renzi's rescue plan for Italian banks, whose shaky health is undermining the Country's economy.

Nor is the fallout limited to Europe alone. Fully aware of how adversely a more fragile EU would affect the already tepid pace of global economic growth, the Fed and the Bank of Japan have repeatedly stressed their determination to do whatever it takes to limit the impact of a possible Brexit. As a result, bond yields have fallen, not only in nominal terms, but also – adding a new factor into the equation – in real terms, thereby creating greater incentives to spend and invest. Another far from trivial benefit is that lower yields worldwide will reduce the risk of a plunge in the yuan, which has already lost 9% against the currencies of China's main trading partners since last November.

So, can we at least look forward to a peaceful summer for the financial markets? In light of the continued high level of uncertainty and recent years' experiences, I wouldn't go so far. And yet, excessive Brexit angst could help make that scenario happen.

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