Q&A-Brexit loss to UK GDP projected at 3%; Asian markets to outperform U.S.; Inflation "big concern:" Bronwyn Curtis, JP Morgan Asian Investment Trust

Brexit will result in a 3% loss in UK's GDP over the next five years, but the effect of the coronavirus, which is still undetermined, will overshadowed the ripples from Britain's exit from the European Union, **Bronwyn Curtis, Non-executive director at JP Morgan Asian Investment Trust,** told the Reuters Global Markets Forum on Wednesday, January 13.

"Forecasts are really hard right now, because so much depends on what happens with the vaccine," she said.

Curtis said she expected Asian equities to perform better than U.S. markets, and in turn U.S. stocks to outperform Europe and the UK this year.

"I expect the markets to start worrying about inflation over the next few weeks," Curtis said, adding that fiscal and monetary stimulus the world over are keeping financial assets supported, exacerbating the disconnect between the economy, politics and financial markets.

Following are edited excerpts from the conversation:

Q: What long-term economic fallout for the UK would you expect from the Brexit deal, considering doomsday calls of economic implosions or investment freezes after 2016 didn't really materialise?

A: It isn't doomsday, but the UK will be poorer over the long term. The British think it is worth it to keep their sovereignty. I'm Australian, so I don't agree! Europe will also be poorer over the longer term.

Q: How would you assess the impact in terms of GDP, trade, jobs and wages, say in 10 years, compared to where they would have been if Brexit had never happened?

A: I'm on the Board of the Office of Budget Responsibility and they make all the independent forecasts for the government. Over the next five years they say there will be a GDP loss of 3%. The effect of the virus is overwhelming the Brexit effect for the UK and the rest of the world. There are other big structural issues in the world that I'm more concerned about; changes in trading arrangements, ESG (environmental, social and corporate governance) and policies to mitigate climate change, and political turmoil.

Q: Is this 3% loss due to the virus or Brexit, or both? Or is it too hard to assess the fallout of Brexit itself due to the virus?

A: No, the virus effect is on top of that. Forecasts are really hard right now, because so much depends on what happens with the vaccine. The World Bank's annual forecast was very clear about this. They have four scenarios in which global growth ranges from 5% this year on the upside, to an unspecified below-zero number in their "severe downside" scenario. The primary difference between these scenarios is vaccine progress. If it goes well, we could bounce back quickly and strongly. If not, we will stay in recession.

Q: What areas are you expecting the Department for International Trade to focus on from here? Also, are you expecting a comprehensive trade deal between the UK and EU, and what might that entail?

A: There is a "thin" deal and that's what everyone is using now. But the negotiations will go on for years. The big problem is that there is no agreement on the financial sector and the UK is/was the biggest financial centre in the world. We have already seen euro products traded in London go to be traded in Europe on the first day of the year. A big loss for the UK.

Q: How damaging has Brexit overall and the lack of a clear deal yet for financial services been to London's role as one of the world's most important financial centres?

A: They will be negotiating this for years and that is unproductive for both the UK and the EU. No agreement on financial services is the big issue. Remember the City of London pays about 30% or more of the taxes in the UK.

Q: Does it seem like the financial sector in London will shrink as a proportion of UK's GDP? How desirable is that given the events of the last decade?

A: It is good that it will be a smaller percentage of UK GDP but not because it is shrinking! It would be better if the rest of the UK grew bigger. It is hard to see that happening, but the Chancellor has promised a big deregulation drive to attract money to the UK financial sector. Let's see what happens in the Budget on March 4.

Q: Will the government's 'levelling up' plan aid to that goal too?

A: 'Levelling up' is a good slogan, but the pandemic has made inequality worse, and the government has less money to spend on it. That's the same in the U.S. too. The best way to level-up is to grow the economy and create jobs. I'm pretty optimistic, by the way, about the second half of the year. I think there will be a real bounce back in the U.S. and the UK.

Q: There were talks of China becoming global financial centre -- do you see that happening?

A: Yes, I do see China becoming a big financial centre, probably the main one in Asia. China and Asia have done well during the pandemic, their finances are in better shape than the U.S. and EU and their companies are doing well. They are the place where the biggest investment money flows are going from the West right now. I think Asian equities will do better than U.S. equities and U.S. equites will outperform Europe and the UK this year.

China was the big surprise during the pandemic - the view in the West was that the virus would be China's Chernobyl Moment and it would cause huge problems for them. China comes out of this looking much better than most Western countries. In the West, the population is angry with how the government dealt with the pandemic, either because the government has done too much or too little. In China, there is the feeling that in the two big crises in the past 15 years, the GFC (global financial crisis) in 2008 and now COVID-19, China came out much better than the Western world. It takes trust to build a financial centre though, and that's not there yet.

Q: There is a perception that China underreported COVID-19 numbers. Will the world trust China numbers? Is that not a black box?

A: Yes, there is a belief that China underreported the COVID-19 numbers. But, unlike the West they didn't spend huge amounts of money supporting the economy so financially they are in better shape. Just look at the PMI numbers. To become a real financial centre requires a good "rule of law," so that will take time.

Q: Though modest so far, do you see a significant number of jobs moving out of Britain to EU and the U.S.?

A: Those decisions have already been made. Quite a lot of companies have used their Paris and Amsterdam operations to create jobs in those entities. I'm not worried there will be more losses there. What I am concerned about is that we have had net emigration of EU citizens who do the lower level and trade jobs and they won't be coming back. There will be a shortage of skilled labour in UK.

Q: You mentioned earlier that you expect Asian equities to outperform Europe and UK this year -- what countries would those be? And by how much do you expect them to outperform by?

A: In this uncertain environment it is hard to put numbers on the performances. Here are my thoughts:
Equities to outperform cash and bonds;
China and Asian equities outperform U.S. and U.S. outperforms Europe;
Growth stocks have had their run over the last 10 years;
Tech will not outperform this year. A lot is priced in and it is the main battleground between the U.S. and China;
Value stocks, commodities and EM (emerging markets) will do well this year;
Deal-making will continue as companies use their high stock prices to make acquisitions, but they are paying inordinately high multiples, particularly for growth assets.

Q: How do you see the Bank of England monetary policy and exchange rate policy impacted by Brexit? Also, do you expect the pound to weaken over time, exaggerating Britain's chronic trade deficits long-term?

A: There is little the BoE can do on monetary policy and the exchange rate is likely to fall further over time. They can't really affect that.

Q: What is the risk of hyperinflation?

A: I think inflation is a huge risk now, particularly if the RMB (Chinese yuan) is strong and the USD is weak. China will export inflation to the rest of the world under that scenario. I expect the markets to start worrying about inflation over the next few weeks. The massive amounts of money pumped into the economy are supporting financial assets. Hence the disconnect between the economy, politics and financial markets. I'm more optimistic about recovery with the large amounts of money being pumped in, but my big concern is inflation. Also watch the oil price and the USD!