NUS INVESTMENT SOCIETY

Global Macro Department –Switzerland

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Basic Information

Real GDP (CHF bn)	741.46 (2023)
Unemployment	2.4%(Mar-24)
CPI	107.1 (Mar-24)
Balance of Trade (CHF bn)	2.8 (Mar-24)
Con. Confidence	-38 (Mar-24)
Currency	Swiss Franc (CHF)

Source: TradingEconomics

Chart info

Figure 1. Switzerland Forecast 24-25

Forecasts Switzerland
Growth rates in % unless otherwise stated

	2024*		2025*	
GDP and components, sport event adjusted**				
GDP	1.1	(1.1)	1.7	(1.7)
Private consumption	1.2	(1.1)	1.3	(1.3)
Government consumption	0.3	(-1.0)	0.7	(-0.6)
Investment in construction	0.5	(0.9)	1.9	(1.9)
Investment in fixed assets and software	-0.7	(1.3)	3.5	(3.1)
Exports	3.0	(2.6)	3.6	(3.8)
Imports	2.5	(2.3)	4.0	(4.0)
Employment in full time equivalents	0.9	(0.6)	1.0	(1.0)
Unemployment rate in %	2.3	(2.3)	2.5	(2.5)
Consumer price index	1.5	(1.9)	1.1	(1.1)
GDP, not adjusted for sport events	1.5	(1.5)	1.3	(1.3)

Source: State Secretariat for Economic Affairs SECO

Overview of Switzerland

- Switzerland, officially called the Swiss Confederation, is a small country in Central Europe made up of glacier-carved Alps, lakes and valleys. Switzerland is the 20th largest economy in the world, with 74% of GDP stemming from the service sector, 25% by industries and agricultural contributing less than 1%. Switzerland is not a part of the European Union (EU) or the European Accessibility Act (EAA), but Swiss nationals retains the same rights to live and work in the UK, similarly to other EAA nationals.

- Switzerland is also notably known for it’s secretive banking sector, Switzerland’s currency is the Swiss franc (CHF), which is subdivided into 100 centimes, emphasizing the nation's strong economic standing and stable financial system.

Tax Heaven

- Switzerland is often referred to as the international tax heaven due to low taxation amount for both foreign corporations and individuals. Switzerland adopts a tax system that reflects its federal structure, with taxes levied across federal, cantonal and communal levels.

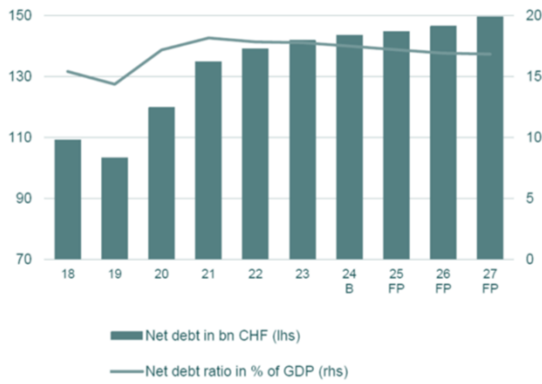
- Switzerland’s tax system reflects its federal structure, with tax liabilities distributed across federal, cantonal, and communal levels (Fig. 3). This multi-tiered approach sees the Federal Treasury collecting approximately 30% of the total tax revenue. The cantons are responsible for 40%, while the communes contribute the remaining 30%. This system underscores the decentralised nature of Swiss governance and its approach to fiscal management.

- Direct taxes, accounting for 70% of the total tax revenue is levied from individuals and businesses. This includes progressive income tax rates, corporate tax ranging from 11.7% to 21.6% and personal wealth tax that is progressive in most cantons.

- Indirect taxes accounts for the remainder 30% of tax revenue. Switzerland boast the lowest Value Added Tax (VAT) in Europe, at 7.7%. Certain items such as accommodation services are taxed at a lower rate of 3.7%, basic necessities and everyday items are taxed at 2.5%, and with essential services such as medical and education are exempted from VAT.

Public Debt

Figure 2: Development of Net Debt



Source: Swiss Federal Finance Administration (FFA)

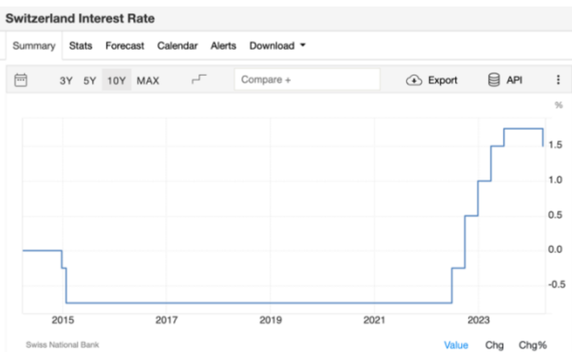
- Compared to most countries around the world, Switzerland has a comparatively low debt burden. In 2003, Switzerland introduced binding rules to prevent public debt from spiralling out of control. The Swiss Debt Brake seeks to ensure that government spending does not overshoot income. In good economic times, the Swiss government must use surplus revenue in repaying debt. This model allows for overspending in fallow economic years and during uncertain periods like wars and pandemics.

- Overall, in recent years, Switzerland racked up over CHF20bn in covid related debts that needs to be paid off by end of 2035. Furthermore, with the cost of housing Ukrainian refugees resulting from the Russia-Ukraine war, it is expected for the Swiss government to incur additional CHF1.25bn per year on spending.

- Given the deficit, net debt for fiscal 2023 rose to CHF141.7bn in fig 2. Debt ratio remained stable at 17.8% of GDP, as the increase in debt was on par with nominal GDP growth.

Interest Rates

Figure 3 : Switzerland's Interest Rates



Source: Trading Economics

- The Swiss National Bank (SNB) lowered rates into negative territory in 2015 to -0.75 with the main intentions of preventing a continuous appreciation of the CHF. The negative rates were held steady for 7 years. The SNB finally raised rates by 75 basis points in 2022. The main reasons for the hike was to combat resurgent inflation.

Corporates and Small-Medium Enterprises (SMEs)

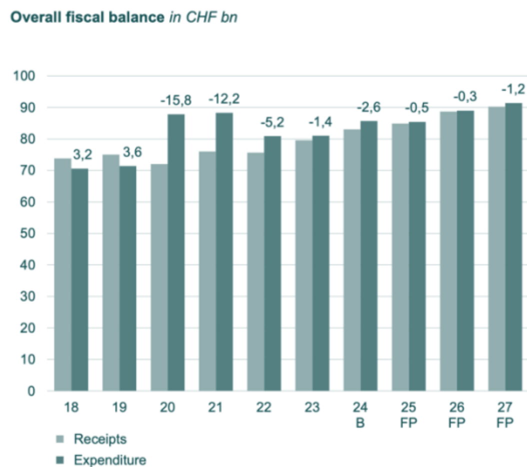
- Small and medium-sized enterprises (SMEs), defined as businesses employing fewer than 250 staff, are integral to the Swiss economy. These enterprises constitute over 99% of all businesses in Switzerland and are responsible for providing approximately two-thirds of the country's employment opportunities. A significant number of these SMEs are family-owned businesses, underscoring their importance in the Swiss economic fabric.

- Switzerland is not only a hub for SMEs, but also hosts several major multinational corporations, particularly prominent pharmaceutical companies. While SMEs form the vast majority of Swiss businesses, these large multinationals employ significant numbers of staff and contribute substantially to the nation's GDP.

Summary of events in the past 6 months

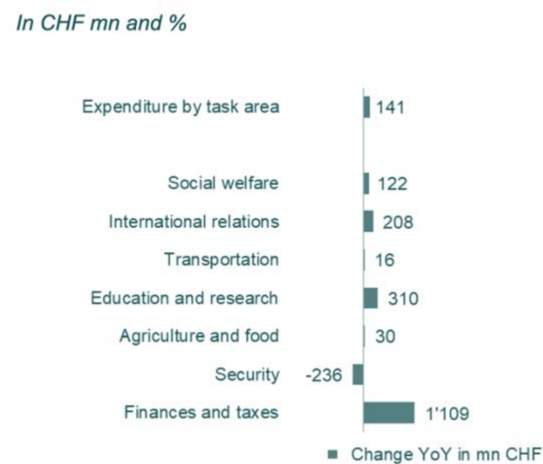
Fiscal Policy

Figure 4: Swiss Overall Fiscal Balance



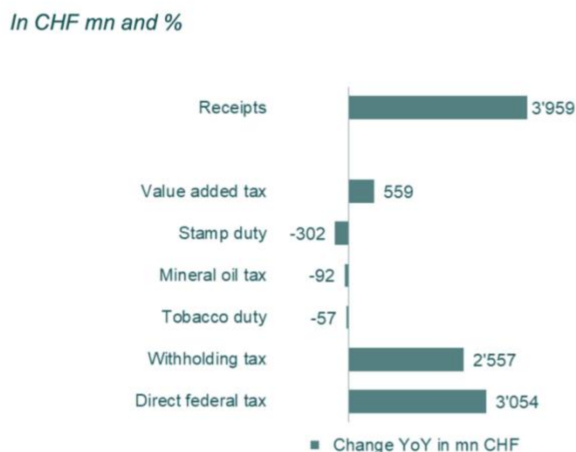
Source: Swiss Federal Finance Administration FFA

Figure 5: Development of selected 2023 expenditure items by task area.



Source: Swiss Federal Finance Administration FFA

Figure 6: Development of selected 2023 receipt items by task area.



Source: Swiss Federal Finance Administration FFA

- The statement of financial performance ended 2023 with an annual surplus of CHF877mil, a slight improvement on the 2023 budget which anticipated a lower surplus. Figures were a big improvement when compared to 2022 numbers. Primarily due to the robust growth of current receipts (+5.1%) compared to current expenditures (+0.2%). Net investments were down slightly at CHF4.8bn compared to 2022.

- The level of self-financing arising from the statements of financial performance was not sufficient to finance the planned net investment. Consequently leading to a high financing deficit (-CHF1.4bn), of which half was attributed to the ordinary financing deficit which was projected in the 2023 budget. Switzerland's GDP remained below potential in 2023, which meant that the debt brake mechanism permitted an ordinary cyclical financing deficit.

- Expenditure remained stable year on year. As nominal GDP grew only slightly, the expenditure ratio fell from 10.4% to 10.2%. Total expenditure amounted to CHF81bn, extraordinary expenditure decreased, while ordinary expenditure grew which was driven by social welfare, finances and taxes, education and research and international relations.

- Receipts of CHF79.6bn were recognized in 2023, a 5.2% growth from 2022. The growth was heavily influenced by considerably higher receipts from direct federal taxes and withholding tax.

Monetary Policy

- The Swiss National Bank surprised markets with a 25 basis point cut to their interest rates in March. This left interest rates at 1.5%. This move arrived after the US Feds and BOE decided to keep rates steady and unchanged, making the SNB the first major economy in the world to cut interest rates. The cut was attributed to the successful decrease of inflation seen in Switzerland, with it being below the SNB's target of 2%.

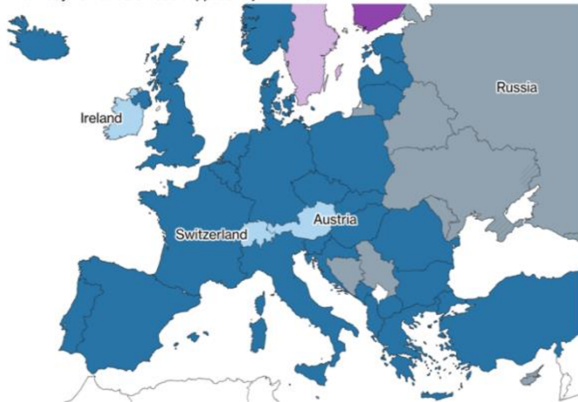
- In March, SNB Chairman Thomas Jordan will step down in September, three years early. This offers an opportunity for the Swiss government to revamp the SNB, opening up the famously conservative institution. However, there is no indication of interest from the Swiss government in this agenda as of recent. Reformation of the SNB would not be proposed, with reiteration from Thomas Aeschi, a senior lawmaker with the Swiss People's Party.

- The SNB posted an annual loss of CHF3bn for 2023, citing reasons due to a interest rate hikes in 2022 that was designed to combat inflation. Additionally, the central bank made a loss of CHF8.5bn in their Franc position, provisional figures shows. This is largely due to the higher interest rates paid to banks which lodge money with SNB.

Geopolitical Events

- The Swiss Federal Council adopted further sanctions against Russia at its January meeting. This is in response to Russia's ongoing military aggression against Ukraine , in doing so, the Council joins the EU, which adopted its 12th package of sanctions in December 2023. New sanctions would be effective as of 1st February 2024. This included the ban on purchase and

Figure 7: Neutrality in Europe



Source: Bloomberg, NATO

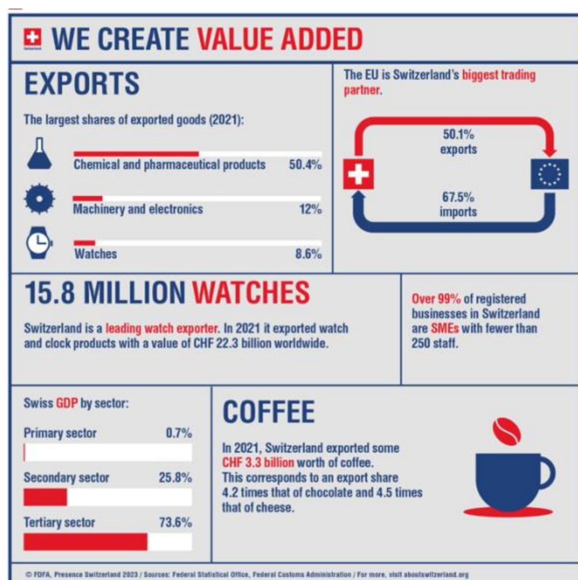
import of Russian diamonds, depriving Russia of this important revenue stream. Further bans of imports include the ban of iron and liquified petroleum gas, and restrictions on exports and sales of crucial industrial materials such as chemicals, lithium batteries and machinery parts.

- The Swiss government has announced in November 2023 that it will introduce a legislation by end February to explicitly ban "Hamas activities or support" from Palestinian groups. In February, a new Federal Act was introduced to ban all Hamas and Hamas related group and activities, hoping to have preventative and repressive impacts on Hamas.

- With the contradictions mentioned above, Switzerland's biggest political party wants to double down on neutrality, with conflicts in Ukraine and the Middle East making the non-aligned stance more difficult to sustain. The party aims to collect 100k signatures to trigger a vote on whether to enshrine "everlasting" neutrality into the constitution, allowing the roll back on sanctions against Russia.

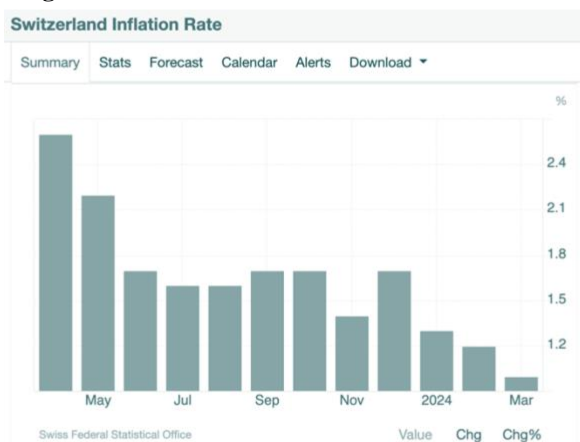
Switzerland's Economy

Figure 8: Breakdown of Swiss GDP



Source: Swiss Federal Finance Administration FFA

Figure 9: Swiss Inflation Rate



Source: Trading Economics

Figure 10: Sectors with the lowest wage growths compared to national average

	Effective wage increases in 2023	Expected wage increase in 2024
Switzerland	**2.3%**	**1.9%**
Textiles	**1.5%**	**1.9%**
Consumer Goods	**2.3%**	**1.8%**
Wholesale Trade	**2.0%**	**1.5%**
Food	**2.0%**	**1.5%**
Media	**2.0%**	**1.0%**

Source: UBS

Switzerland's GDP – Growth Continues to Slow

Approximately 74% of the Swiss GDP is generated from the service sector, with 25% from industries and less than 1% from the agricultural sector. Switzerland imports around 67% of goods from the EU and exports approximately 50% of Swiss exports are to the EU. Making EU the largest trading partner for Switzerland.

Growth of the Swiss economy is expected to gradually recover. This is supported by the gradual recovery in external demand, lower inflation achieving the SNB's 0-2% target and an easing monetary policy with a more dovish SNB. GDP is projected to grow at 1.3% in 2024, and a slightly higher rate of 1.4% in 2025.

As compared to previous forecasts, the expected 1.3% growth for Switzerland's GDP is lower mainly due to the subdued momentum in the eurozone in 2024, likely holding back Swiss exports. Declining capacity utilization is expected to curb investment activities, but private consumption can still be expected to provide support.

Domestic Developments

Inflation

The SNB's target for inflation is in line with other major central banks around the world at 2%. The Swiss inflation rate has been consistently below the SNB's target since 2H2023, with the latest reading at 1% in March 2024 and 1.2% in February 2024.

Previously at the SNB's December 2023 meeting, inflation forecast was expected to average out to 1.9% in 2024 and a more modest 1.6% in 2025. But with the recent lower than expected inflation data, SNB downward revised their forecast to an average of 1.4% in 2024 and 1.2% in 2025, despite the surprise 25 basis point rate cut in March. The downward revision was attributed to a lower-than-expected inflation for certain goods. The rise in value of the CHF over the past year has helped to limit inflation but is now weighing heavily on the competitiveness of Swiss exports.

Unemployment and Wages

The labour market is expected to remain resilient, although unemployment is projected to increase modestly in 2024 to 2.3%, from a historic low of 2%. There are some continued signs of staffing shortage in certain sectors, with aging exacerbating the shortage in the medium term. Continued efforts are required to prepare labour markets for demographic headwinds.

In the annual Compensation Survey by the Chief Investment Office of UBS Global Wealth Management, 389 surveyed companies expects a nominal wage increase of 1.9% in 2024. The expected wage growths is considerably higher than the average of just under 1% for the last 10 years. However, expected rate of wages increases falls short of the wage hike agreements of 2.3% seen in 2023.

Inflation continues to be the dominant driver of this year's wage increases. Showing little deviation between the individual sectors, resulting in a 2% wage increase in 15 out of 22 sectors. The concern is that while most companies are granting wage increase for inflation compensation, they seldom go beyond that which leads to real wages stagnating in 2024.

Coupled with the potential rise in health insurance premiums that are not accounted for in the CPI, purchasing power could effectively erode in 2024.

Swiss National Bank

Dovish Central Bank

With inflation steadily below the SNB's target, there is no incentives left for the SNB to keep rates high for longer. This prompted the surprise rate cuts in March where interest rates were reduced by 25 basis point to 1.50%, from 1.75%. The SNB has justified this rate cut with the sharp fall in inflation observed in Switzerland.

The SNB has stated their intentions on adjusting monetary policies again if necessary to ensure that inflation steadily remains within the range consistent with prices stability over the medium term. The SNB's dovish tone coupled with the downward revision of the forecasted inflation could signal 2 more potential rate cuts for the remainder of 2024. This could potentially occur in the SNB's June or September meeting. But the decision for rate cuts would largely be dependent on ongoing economic data that reflects the performance of the Swiss economy. The SNB noted that unless there is a drastic turn of event that might push for stronger inflationary pressures, it is very unlikely for any more tightening activities from the SNB.

The Franc

In the period between 2022-2023, the SNB actively sought for a stronger nominal Franc to fight inflation. Typically in the past, the SNB has been actively fighting the Franc strength for decades. But in 2022 and 2023, the SNB sold CHF22bn and CHF133bn worth of foreign currencies to generate nominal CHF appreciation. The narrative is expected to change as Q1 2024 FX intervention data is release in June 2024, the SNB is expected to

Looking forward, SNB President, Thomas Jordan acknowledged that the strong Franc has helped dampen inflation, but has also been painful for domestic companies. Taking all these factors into consideration, we expect for more Franc weakness moving forward into the remainder of 2024, with trends persisting into 2025. There are no incentives for the SNB to keep rates high, and being the first major central bank to begin rate cuts, it creates a larger differential between the SNB and other major central banks. With other central banks such as the ECB and the Feds holding rates higher for longer, we can reasonably expect for more Franc weakness.

Trade Idea – Long USD/CHF

Figure 11: Technical Analysis on USD/CHF

Source: Trading View

Narrative

Switzerland's Balance of Trade has been worsening on the back of declining exports in it's largest chemical and pharmaceutical industry. The luxury watch industry, the third largest sector accounting for Swiss exports has been hit with a decline of 3.8% in February, with exports to China decreasing 25% YoY.

Compared to the US, economic growth remains strong with recent NFP data coming in hotter than expected at 303k beating expectations of 200k. Coupled with a strong GDP growth of 3.4% in Q4 2023, and a 3.3% increase in consumer spending for healthcare and financial services amidst the downward revision on goods outlay. Additionally, with rising geopolitical tension pushing oil prices higher, US being a net exporter of oil, benefit from this hike in prices.

Furthermore, with SNB's surprise rate cuts in March, and being the first global central bank to reduce rates, it creates a larger differential between other central banks. Moving forward, we are expecting more rate cuts which would fuel CHF weakness for the remainder of the year.

Catalysts

A potential catalyst would be stronger than expected US economic data, urging the Feds to keep rates consistent in June, while SNB meets with an additional rate cut due to drops in inflation. With the downward revision of the expected inflation, if Swiss economic data released are weaker than expected, it could further substantiate a SNB cut in June and September.

Risk

Potential risks would be moving forward, there is a change in economic data from the US pointing towards a cooling economy. This would prompt for a rate cut by the Feds. Additionally, a recovery from Swiss's largest trading partner, the EU could see demands for CHF to increase for higher imports demand from the EU.

Technical

The USDCHF pair is currently trading at 0.90, with the Bollinger Bands ranging in between the upper and lower bounds. RSI is trending

downwards away from the overbought region of 70, indicating a possible entry period.

Lastly, the MACD looks to potentially cross the signal line, signalling a potential short term bearish change. But prices are trending near the support level of 0.900, we can potentially see if prices rebound from the support before entering the trade.

Entry: 0.901
Take Profit: 0.92
Stop Loss: 0.888
Risk Reward Ratio: 1.50

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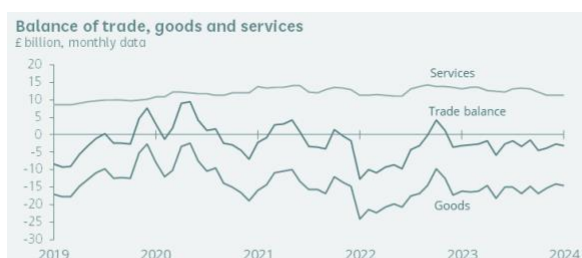
Basic Information

GDP	3.089 Trillion USD
M2	3009816 GBP Million
CPI	132
PPI	135
Con.Confidence	-44 points
Unemployment	3.9%
Currency	Pound Sterling (GBP)

Source: TradingEconomics

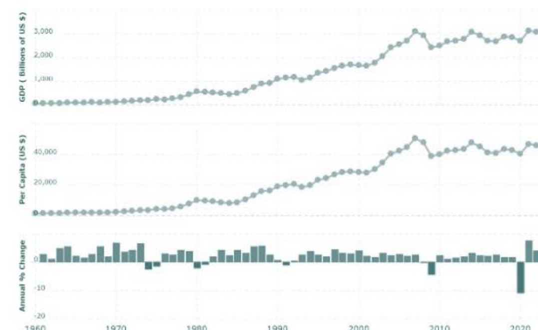
Chart info

Figure 1: UK Balance of Trade



Source: House of Commons Library

Figure 2: UK GDP Change



Source: U.K GDP, Macrotrends

Overview of Sector

- The United Kingdom comprises of England, Scotland, Wales and Northern Ireland, using the pound Sterling as its national currency. As the fifth largest economy in the world with a GDP of 3.186 Trillion USD in 2021, UK is driven mainly by its services sector (71.63%).
- London commands a strong foothold within global financial networks, being the highest exporter of financial services in the world. It is no wonder that the inflections of UK financial woes will have a spill over effect on the world, piercing the global financial membrane.
- Apart from its services sector, a large composition of UK's GDP is in manufacturing, comprising of 17.7% in 2021. This includes commodities such as aluminium, timber products and textiles.
- Trade also has a significant impact on the UK economy, with export and import contributing 27% and 28.25% respectively to its GDP. Within its imports, energy, specifically natural gas, is mainly imported from Europe.
- After UK's departure from the EU, the economy faced a variety of legislative and regulatory issues, primarily in its trade industry.
- Today, UK engages in a precarious balancing act of sustaining its economic policies in light of global macro pressures and tensions. While current policies mandate that UK must adhere to its economic goals and objectives, the current UK government must face a daunting task of ensuring that the economy grows and serves to benefit the people, in order to echo the ardent belief of UK's position as a perpetual economic powerhouse.

Summary of events in the past 6 months

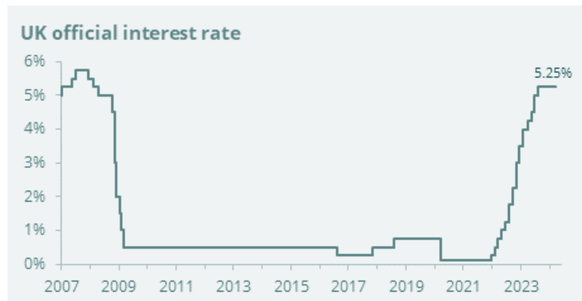
- The U.K. economy sank into a recession in the final six months of 2023, marking it out as one of the weakest performers among developed nations, hit by high inflation and interest rates that stifled household spending. U.K. gross domestic product shrank 0.3% between October and December,
- On an annualized basis, the U.K. economy contracted by 1.2% in the final three months of the year, contrasting sharply with the more than 3% growth in the U.S. economy over the same period on a similar measure.
- Household consumption, a key driver of the U.K. economy, as well as capital investment and weak trade all contributed to falling GDP. Consumers spent less on household goods and services, transport, culture and clothing, though government expenditure, however, crept.

- BOE expects gas prices to keep increasing beyond 2024, while the affordability of people to pay for heat will only keep decreasing. Despite the current government's attempts to enhance the provision of financial aid to the lower income for electricity, reports state that the people's warmth will be short-lived.

- Prime Minister Rishi Sunak must hold a general election within the next tax year

- The latest UK budget announced on 7 March details the objectives and strategies that the new government will focus on. The UK announced continued Oil & Gas Windfall tax while announcing new spending measures such as a reduction in payroll taxes and subsidies and price cap to fuel prices to curb inflation and boost economic growth.

Figure 3: UK Interest Rate Hikes

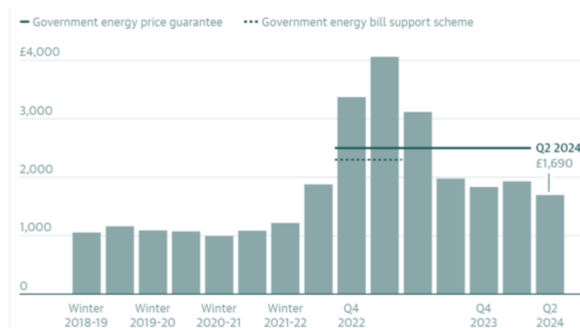


Source: Bank Of England

Figure 4: UK Inflation Rate

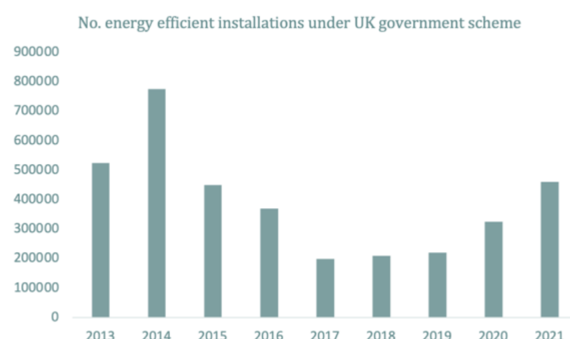
Source: UK Office for National Statistics

Figure 5: UK Energy price Cap



Source: Ofgem

Figure 6: Investments Into Renewable Energy



Inflation – A Cause For Concern

One of the main issues the UK government wants to combat is the poor economic environment brought about by high global inflationary pressures. Thus, as seen in Figure 3, the BOE raised interest rates to record levels in attempt to counter bring down inflation. Indeed, with the global supply chain crisis and spill-over effects from the Covid-19 pandemic, inflationary stresses are exacerbated, and the UK government has no choice but to step in.

Interest Rate Hikes

As seen in Figure 3, to bring down inflationary pressures, the BOE engaged in a series of interest rate hikes to 16 year highs of 5.25%. This has had the negative effect of causing a technical recession as noted above, but this has helped reigned in inflation as seen in figure 4. With UK economy slowing and CPI rising only by 3.5%, BOE Governor Andrew Bailey have signalled they are open to cutting rates to combat slow growth in the UK.

Real Estate Conundrum

Decline In Value Of UK's Commercial Real Estate Market

The Bank of England has raised rates from almost zero to 5.25% over the past two years, pushing up investors' required returns and denting real estate valuations that had reached record levels in the cheap money era. That's pushing some owners to breach so-called loan-to-value rules on their debts. Higher rates are also stretching borrowers' ability to cover interest payments that have risen much faster than rents.

With a significant portion of the £178 billion of loans outstanding needing to be refinanced in the next three years, we expect there to be increase in stress going forward. Alternative lenders that mostly include debt funds reported a default rate of 11.2%. Although banks and insurance companies have cut riskier lending since the financial crisis, their loan books are still under stress, and this is likely to feed in the broader economy.

Further, we expect alternative asset classes such as REITS to decline even further as the lasting impacts of UK interest rate hikes begin to encroach on the UK economy, especially with investors quickly losing faith in the UK real estate market.

Energy Crisis Averted

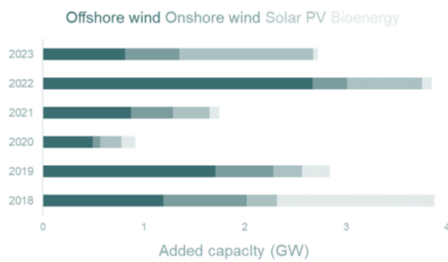
The energy price cap in Great Britain will fall by £238 to £1,690 this spring thanks to a mild winter and lower gas prices, easing pressure on household finances. Set by energy regulator Ofgem, the cap reflects the average annual bill for 29 million households in England, and takes effect from April. It is a 12.3% reduction from £1,928 in the current quarter.

Wholesale gas prices have fallen as a mild winter in Europe reduced demand, helped by plentiful supplies of liquified natural gas in Europe and Asia, leading to a fall in household bills. Some analysts had feared disruption to cargoes in the Red Sea could push prices significantly higher but this has not occurred.

Transitioning to Green Energy

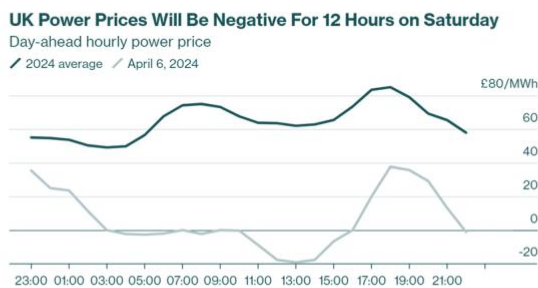
Source: Department for Business, Energy and Industrial Strategy

Figure 7: Added capacity since 2018 for renewable energy



Source: BBC

Figure 8: UK Power Prices



Source: N2EX

At its current levels, the UK economy composes of over 40% in renewable sources of energy in its energy supply, employing over 430,000 people in low carbon businesses. The energy crisis in UK highlighted a fundamental issue that needed to be addressed by the UK government, which is the need to diversify their energy sources to provide a more sustainable, less volatile energy supply to their citizens. To achieve this energy goal, the UK government had invested over 30 billion pounds in the last 18 months into clean energy businesses and plans to have greater investments into nuclear energy by the end of 2050, allowing nuclear energy to comprise of 25% of its energy supply. As seen in Figure 6, UK has continually invested in renewable energy.

This is evident in both the huge growth of renewable energy production and in energy storage system as seen in Figure 7. In the fourth quarter 2023, 0.5 GW of new capacity was installed, almost two thirds of which was accounted for by the final stage of Seagreen Offshore Wind Farm which now stands at 1.1 GW. Although growth in solar PV capacity for the year was strong (9.2 per cent), the new capacity added in the fourth quarter was lower than the preceding three quarters.

This is further supported by NatPower, a UK renewables developer who recently in March 2024 pledged to plough £10bn into what would become the largest portfolio of battery storage projects in the country. The NatPower investment would lead to the construction of two gigaparks which have 60 gigawatt hours of battery storage, with solar and wind projects also in the pipeline.

The huge amount of renewable energy being developed in the aftermath of the Russian Invasion finally coming online has helped kept a lid of prices, pushing the price of power down as seen in Figure 9. This has help lower household bills on power and will help UK's manufacturing sector remain price competitive.

The huge impact of renewable energy on electricity prices can be seen in the fact that UK's. UK's wholesale power prices will drop below zero for 12 hours on Saturday — the second-longest such stint on record — as strong renewable generation means supply will outstrip demand. Day-ahead prices dropped to £6.26 per megawatt-hour, the lowest since December. The hourly rate from 1pm slumped as low as -19.19. Daily generation from solar and wind is forecast to jump to the highest since January. Although, this can be seen as a lack of energy storage to store excess renewable energy being produced, it is submitted that this concern is not too concerning especially with the large amount of energy storage capacity coming online as noted earlier in Figure 7.

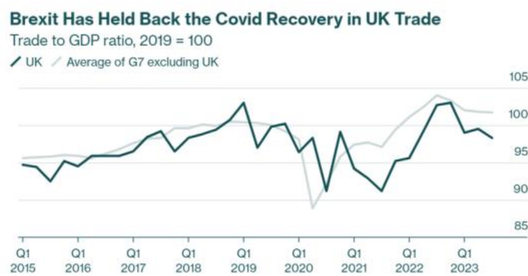
Brexit's Lasting Effects

After departing from the EU single market on 31 January 2020, UK's woes only seemed to grow, causing great stresses to different industries. Masked behind rising inflationary pressures brought about by the Covid-19

Figure 9:Post-Brexit Operational Challenges

Source: KPMG

Figure 10: Brexit's impact on UK trade



Source: Office for Budget Responsibility

pandemic, a post-Covid regime has revealed that the effects from Brexit has only worsened rather than improved.

On a regulatory level, the UK has to rewrite and implement several policies and legislation that were previously utilised by the region under the EU single market. This means material and information flows are slowed down, even impeded, by the gradual movements in legislative implementations. Industries that are affected include chemical and aluminium, amongst the many. This can be seen in Figure 10.

Rewriting Regulation

After departure from the EU, deregulation promises made by the UK were broken, with many industries realising that they had to re-register to conduct certain restrictive business activities in the UK. The chemical industry, for instance, had to re-apply for many permits as they had previously done when under the EU single market, with a projected spending of 500 billion pounds over a period of 10 years just to re-apply alone. The estimated cost to the government is set to be at 2 billion pounds, suggesting the significant headwinds that slow down the development of the UK economy. As seen in Figure 10, cost of administrative burdens remain the biggest hit by Brexit, with additional taxes and duties coming in second at 45%.

We believe that the greatest outcome of the government having to rewrite regulation would be the time lag for trade activities. Trade disruptions will likely pose as the biggest problem for UK after getting out of the pandemic, an issue that the government has yet to come up with solutions fast enough.

Labour Market

In the past year, UK's labour shortages worsened significantly, with industries such as hospitality being hit the hardest due to labour outflows from the region. The removal of free movement enhanced recruitment problems faced by UK employers, with tax and work benefits not enough to enhance the diminished value of working in the UK. Net immigration from the EU, which peaked at over 200,000 a year at the time of the referendum, is now negative. That in turn has had, as predicted, some negative impacts both on specific sectors and the flexibility of the UK labour market as a whole. The scarcity of labor adds to inflationary pressure in the short-term and constrains potential growth further out

Over the period since just before the start of the pandemic, a total of 1.2 million non-EU born foreigners joined the UK workforce, more than making up for a huge fall in UK and EU-born workers, this has partially mitigated the increase in labour costs. However, this influx reflects one-off Pandemic and recruiting to replace EU workers and is likely unsustainable.

Trade

OBR's analysis chimes with that of the Bank of England by showing that a long-term squeeze on the country's economic potential from Brexit is playing out as they feared. The OBR highlighted that trade volumes in the UK have not recovered from the pandemic by as much as other Group of Seven economies. UK trade intensity — exports plus imports as a share of GDP — was 1.7% below pre-pandemic levels by the third quarter of 2023, compared to 1.7% above pre-Covid levels in the rest of the G7. This is reflected in Figure 12, where Brexit has pushed UK trade down, which is likely a structural reason why UK has been facing slower growth and a

tough recovery out of covid. This is compounded by the fact that trade is a major driver of the UK's economy.

A decline in trade intensity lowers productivity because trade, among other channels, fosters competition and allows countries to specialize in activities where they are relatively more efficient. This has caused UK's economic growth to remain significantly lower than its G7 counterparts as noted above.

Figure 11: GBPUSD Daily Chart

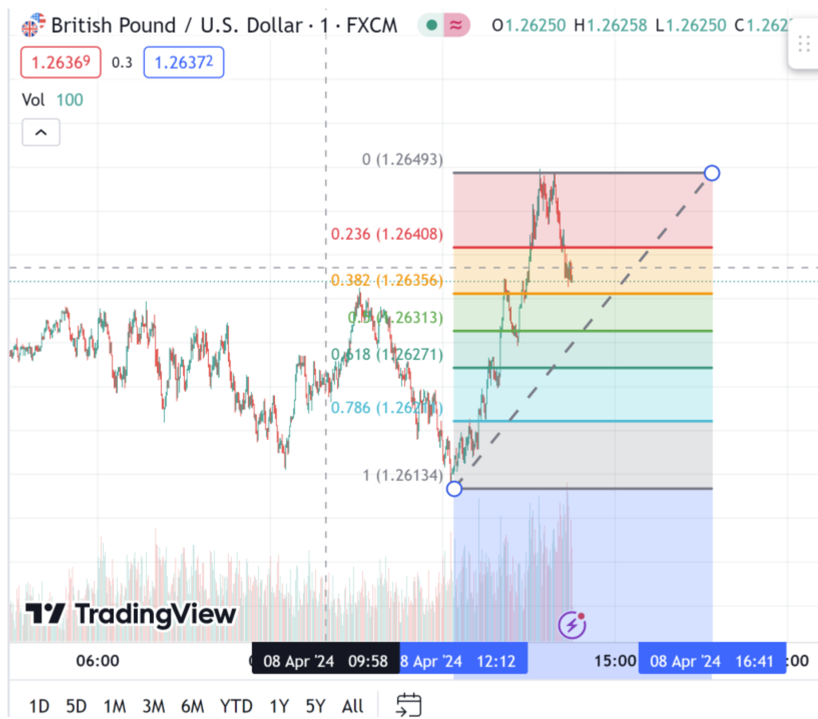
Source: TradingView

Trade Idea: Short GBPUSD

Despite the rally experienced by the GBP in the past months with optimism that UK is heading for a turnaround, we are of the view that near-term macro-outlook for UK continues to be gloomy and it would be difficult for the pound to continue appreciating in the coming weeks.. This is for the following reasons.

1) The continued high interest rates set by the UK to combat inflation will continue to have an contractionary effect on the economy. While UK economy has seen slight growth in 1Q 2024, this is unlikely to continue with rates still as high as 5.25%. It is possible that UK might slip into a technical recession again like in 2023 if the BOE continues to maintain high interest rate.
2) The high interest rates has also led to problems in the the commercial estate

Figure 12: GBPUSD 1H Chart, Fibonacci retracement levels



Source: TradingView

sector, which threatens to spread to the broader UK economy.

3) UK's Brexit's problems are only set to worsen from here on. It would not only be difficult for businesses to trade with EU in the years to come, but also difficult to even operate in their own country, given the lack of proper regulation yet to have been put in place.

All these factors point towards a downward trend of GBPUSD.

Catalyst

A possible catalyst for the trade would be the announcement of an unexpected interest rate cut by the BOE. Although markets currently currently do not expect any cuts by the BOE, the taming of the inflation (with a lowered than expected inflation print in March 2024) with the lowered energy prices and slow economic growth could prompt the BOE to cut interest rates faster than expect. This would

Technicals

On the 1H chart, GBPUSD has risen in the short term. However, many indicators, such as the RSI which has a value of 72.59 suggests that the currency pair is likely overbought. There is also a strong bearish signal from the MACD indicator as the MACD line has fallen below the signal line above the zero line which is strong bearish indicator of the curreny trade.

We would like to initiate a short at 1.26365, with a stop loss at 1.2649 and a take profit at 1.26134. This is because we would like to wait enter the trade in the FFibonacci gold zone.

Entry: 1.26365
Take Profit: 1.26134
Stop Loss: 1.26493
Risk Reward Ratio: 1.80

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