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CURRENCIES & MORE OUR INSIGHT INTO THE WORLD'S LARGEST MARKET

Euro: A brief look-back on the development of sovereign states is helpful to assess the issue in Spain
Krone: Solid fundamentals but a reluctant central bank on FX gains makes it ideal for investment in RCs
Pound: The endless ball play in negotiations has pushed expectations for progress to mid-December

Euro: Catalans call time out

FX news on the Euro these days is dominated by politics as monetary policy has taken a backseat. Once in a while, the ECB is a topic but overall, FX markets focused this year on elections, on how populist parties are doing and now if Catalonia will declare independence from Spain.

The world in 1900



Source: maps.com

With all the current hype around Catalonia's potential secession from Spain, one has to keep in mind that in the past 100 years such developments have been the norm rather than the exception. The concept of sovereign states is basically a historical continuation of multiethnic states like the Assyrian and the Roman Empire. The idea of national states entering the center of politics on our planet was in the 18th century. In 1900, there were 50 sovereign states, 84 in 1950, 192 in 2000 and 195 today. The rea-

sons for the split-off differed from colonial bondage like India, russification in the Baltic States, or genocide in East Timor. Let's face it; Catalonia's situation is far from severe even though its history within the Kingdom has often been difficult. Also, the law of nations is not on the side of Catalonia as it voted overwhelmingly for the new Spanish Constitution in 1978, which recognizes Catalonia's autonomy and language. The law of nations recognizes the right of self-determination but also wants to prevent a destabilization of a region. Yesterday, Catalan President Carles Puigdemont rowed back from an immediate declaration of independence and said he will seek talks with the central government in Madrid. A dialogue is clearly more constructive but Puigdemont will probably not give up so easily. In case these talks turn sour, what would happen to the E.U. if Catalonia became independent and the world had 196 states? We think not much, really. Catalonia's GDP is € 223 billion as of 2016. This corresponds to 1.4 percent of the E.U. GDP of € 16.5 trillion. The big loser would be Catalonia. Large companies are already moving or threatening to move their headquarters out of Catalonia. Furthermore, Catalonia would not have the institutions necessary to run a country. There would be problems in the energy sector, in the telecom sectors, and – of course – in the financial sector. This means Catalonia would not be able to join the E.U. for quite some time as it would not meet the Copenhagen Criteria. Stability of institutions, the rule of law and a functioning market economy are among the criteria that have to be met for an E.U. membership, next to the consent of the E.U. institutions and E.U. member states. The last point makes it even more implausible as E.U. member states clearly do not want to support the idea of European nations splitting up.

Conclusion: Declaring independence would only hurt Catalonia and would hardly have a negative impact on the Euro as the Catalan economy is simply too small.

Krone: Back and forth

The Krone, with its pretty stable exchange rate to the Euro, is ideal for investments in Reverse Convertibles. Norway exhibits solid fundamentals combined with optimal inflation. GDP growth stands at 1.7 percent and Norway exhibits a substantial current account surplus of more than 7 percent of GDP. Norges Bank has removed its easing bias back in June and with CPI at 1.6 percent, a rate hike is only a matter of time. At the same time, Norges Bank tries to prevent the currency from rising too much in order not to jeopardize reaching its inflation target.

€/Nkr in the past 12 months



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: In our series of Trade Alters, we recommended 2 months ago investing Euros in a RC with Krone as alternative currency. We got converted yesterday and recommend reinvesting Krone again versus Euro.

QUICK NEWS HEADLINES (time in CEST)

The following two headlines might have an impact on currency markets today:

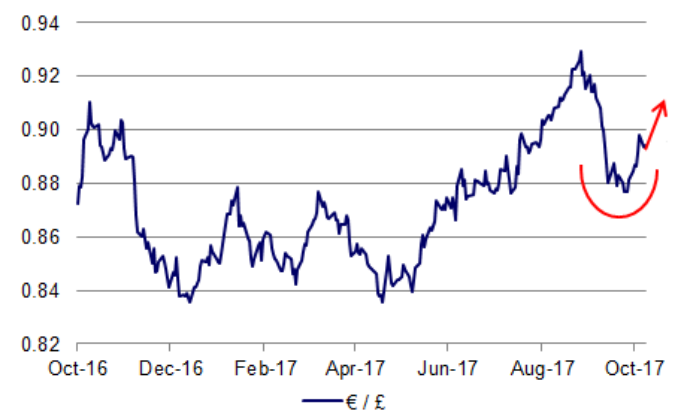
- Turkey: The current account deficit for August is expected at \$ 1.4 billion (09:00).
- Brazil: Retail sales are expected to have risen 4.4% in August y/y (14:00).

Pound: Where’s the ball?

Two simple sentences show the true state of the Brexit negotiations and how they likely evolve during the next couple of months. Prime Minister Theresa May said in her speech to Parliament on Monday that “the ball is in their court,” insinuating that she did what she had to and it was up to the E.U.-27 to move now. Margaritis Schinas, the spokesman for the European Commission, replied that “there is a clear sequencing to these talks and that so far

no solution had been found on step one, which is the divorce proceedings,” and concluded: “So the ball is entirely in the U.K. court for the rest to happen.” This is reminiscent of a tennis game in an endless tie-break. E.U. negotiators said yesterday that they see no breakthrough at the Summit next week and hopes have already shifted to the next meeting in mid-December. With this ongoing uncertainty, the economic situation is likely to continue to deteriorate further and we expect the Pound to remain weak.

€/£ in the past 12 months



Source: Bloomberg Finance L.P., Julius Bär

Conclusion: We still recommend staying short the Pound.

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