Pioneer Bank & Trust
Trust & Investments
Local.

704 7th Ave, PO Box 729
Belle Fourche, SD 57717-0729
Phone (605) 892-3494
Fax (605) 892-2115

2001 W Omaha St, PO Box 9189
Rapid City, SD 57709-9189
Phone (605) 341-2265
Fax (605) 341-7425

140 E Jackson Blvd, PO Box 10
Spearfish, SD 57783-0010
Phone (605) 642-2725
Fax (605) 642-1736

Brexit fallout

July 1—One thing is certain about financial markets—investors hate uncertainty. They hate being surprised. And the biggest surprise of the quarter just ended was the decision by a slim majority of Britons to leave the European Union. The next day Japan's Nikkei dropped 8%; France's CAC fell 10% in two days; and the S&P 500 lost 5% in two days.

But the distress was short-lived, as the stock markets came back quickly. The British pound continued to trade at low levels.

Only time will tell the real economic meaning of Brexit. Before the vote economists were unified in predicting that leaving the EU could only be bad for the British economy, and perhaps for the EU also. When the markets recovered quickly after the initial shock, an alternative vision emerged. Writing on *The Wall Street Journal*'s op-ed page, the CEO of Nasdaq, Robert Greifeld, suggested that the exit could well enhance Britain's prosperity. "An independent U.K. will be free of the fiscal and regulatory costs of the EU and could cut or even eliminate tariffs while developing a new, vastly simplified regulatory approach." Turning lemons into lemonade, he added: "This is an opportunity for the EU and U.K. to set a new global standard. While many observers are focused on the isolationist political views of those who voted in favor of exit, the ultimate result could be the opposite."

On the other hand, Brexit could signal the beginning of the unraveling of the EU itself, which could be very bad for the global economy. Reportedly, there are already calls for French and Italian referenda. Worldwide trade wars were what put the "great" in the Great Depression.

Interest rates

Another great economic thud during the quarter was the May jobs report. The consensus forecast was for 160,000 new jobs, and the reality missed that by a mile, as only 38,000 jobs were added, the worst report since September 2010.

More ominously, the labor force participation rate bottomed at a 35-year low last October. The low participation rate explains why so many Americans don't believe that the economy truly has recovered from the last recession. Improvement in the participation rate since October was almost entirely erased with the May jobs report, as 664,000 people dropped out. There are now over 102 million Americans either unemployed or not looking for work.

Given the weakness in employment, the Federal Reserve Board did not raise interest rates in June, as had been widely predicted earlier in the year. After Brexit and the new economic uncertainties, few expect rates to be lifted during the summer, and the Fed rarely touches interest rates during the peak of an election season. Accordingly, few observers expect another interest rate increase this year.

Oil prices

Although the price of crude fell with the equity markets, based upon fears of a global economic slowdown that would depress demand, it soon bounced back. Brexit is not likely to push oil prices out of the $40 to $50 per barrel range. Europe already has been in a low growth mode, accounting for only 15% of worldwide consumption. Europe's demand for oil peaked in the last decade.

Because of lower prices, oil production has dropped in the U.S., Canada and Colombia. Supplies also have been disrupted in Venezuela and Nigeria. The excess of supply is being worked off. Both shale production and Canadian tar sands are economically viable at current prices. Demand for oil is increasing in India and remains strong in China.

The dollar initially strengthened after Brexit, but then pulled back. Weaker dollars lead to higher oil prices, as demand is stimulated for those who pay in other currencies.

The current economic recovery is now seven years old.