“Trade and Macroeconomic Implications of BREXIT”

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Roundtable Session

“BREXIT – Implications for EU Agriculture and Agriculture Policy and Beyond”

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Background

- Prior to June 24 referendum, several studies forecast effects of BREXIT – e.g., UK Treasury, OECD, and LSE
- UK Treasury and OECD studies got significant public attention prior to vote – both summarily dismissed as "fearmongering" by "Leave" campaign
- Use similar methodologies to analyze potential UK/EU trading arrangements after BREXIT
- Both focus on potential short-term and long-term economic impacts of BREXIT

UK Treasury Study (May 2016)

- **Study focused on near-term impact of UK leaving EU over two-year period after vote**
- **Evaluated combined effects of *transition* to new trading arrangement, *uncertainty* and feedback from changing *financial conditions***
- **Uncertainty driven by 4 processes:**

  (i) terms of UK withdrawal under Article 50

  (ii) new trading arrangement with EU

  (iii) new trading arrangements with rest of world

  (iv) changing UK regulatory/legislative framework

UK Treasury Study (May 2016)

- Two scenarios: "shock" assuming UK negotiates bilateral agreement with EU, and "severe shock", assuming default to WTO membership
- UK monetary policy: central bank rate held constant
- UK fiscal policy: support for economy through "automatic stabilizers" – with implications for borrowing and public debt
- Global economic conditions: "severe shock" assumes financial contagion with EU – reducing EU GDP by 1%
- Ignores additional downside risks of financial crisis and/or "sudden stop" due to current account deficit

UK Treasury Study (May 2016)

- Conditioned on alternative assumptions about long-term effects of BREXIT in 15-year period after referendum – evaluated by UK Treasury (April, 2016)
- Gravity and CGE models used to forecast UK will be poorer due to permanent reduction in trade, FDI, and productivity (Tables 1, 2)
- Central estimates of long-term reduction in GDP used for “shock” and “severe shock” scenarios
- Use CGE model to estimate transition, uncertainty and financial conditions impact on demand, supply and asset prices (Table 3)

Table 1: BREXIT effect on UK trade/FDI/productivity after 15 years			
	EEA	Bilateral	WTO
Trade (%)	-9	-19	-24
FDI (%)	-10	-20	-26
Productivity (%)	-2.8	-6.0	-7.7

Source: UK Treasury (April, 2016)

Table 2: Annual economic impact of BREXIT on UK after 15 years			
	EEA	Bilateral	WTO
GDP level (%) - central	-3.8	-6.2	-7.5
GDP level (%)	-3.4 to 4.3	-4.6 to -7.8	-5.4 to -9.5
Cost/capita (£)- central	-2,600	-4,300	-5,200

Source: UK Treasury (April, 2016)

Table 2: Immediate impact of BREXIT on UK after 2 years		
	"Shock"	Severe shock"
GDP	-3.6%	-6.0%
Inflation rate (% points)	+2.3	+2.7
Unemployment rate (% points)	+1.6	+2.4
Unemployment (level)	+520,000	+820,000
Average real wages	-2.8%	-4.0%
House prices	-10%	-18%
Sterling exchange rate index	-12%	-15%
Public sector net borrowing (£ billion)	+£24b	+£39b

Source: UK Treasury (May, 2016)