

Expected Macroeconomic Effects of a “Hard” Brexit

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**Panel on: International Affairs, Agriculture, and Article 50:
Brexit’s effects on the UK, the EU, and the World**

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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, CGE and other 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)**

Long-Run Impact of Brexit:

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)

Long –Run Impact of Brexit

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 (%) - range	-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)

*** OECD comparable estimates to 2030**

GDP level (%) -5.1

GDP level (%) -2.7 to -7.7

Cost/capita (£) -1,520 to -5,000

Source: OECD (April, 2016)

Short-Run Impact of Brexit

Table 3: 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
Sterling exchange rate index	-12%	-15%

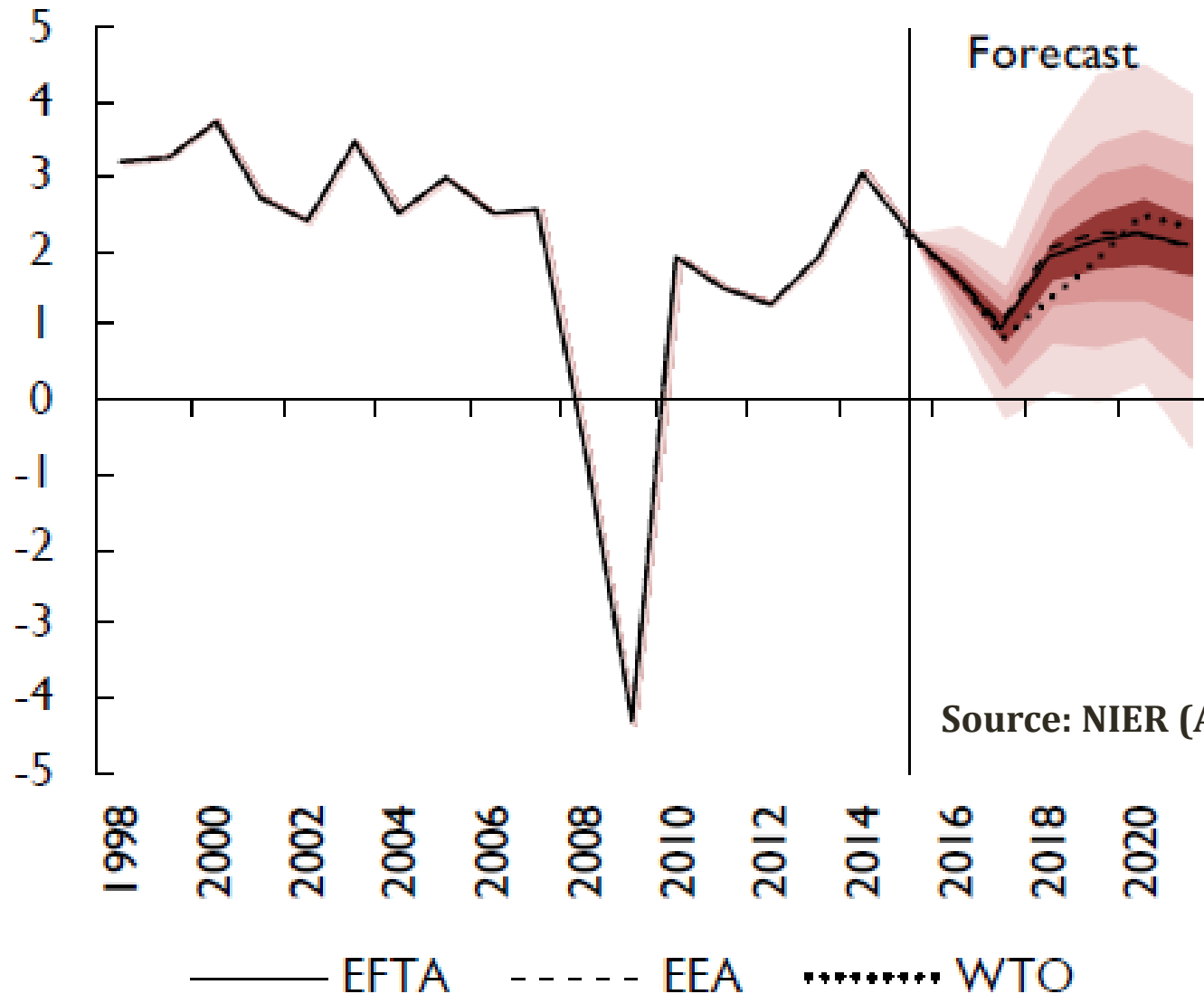
Source: UK Treasury (May, 2016)

*** OECD comparable estimate to 2020**

GDP -3.3%

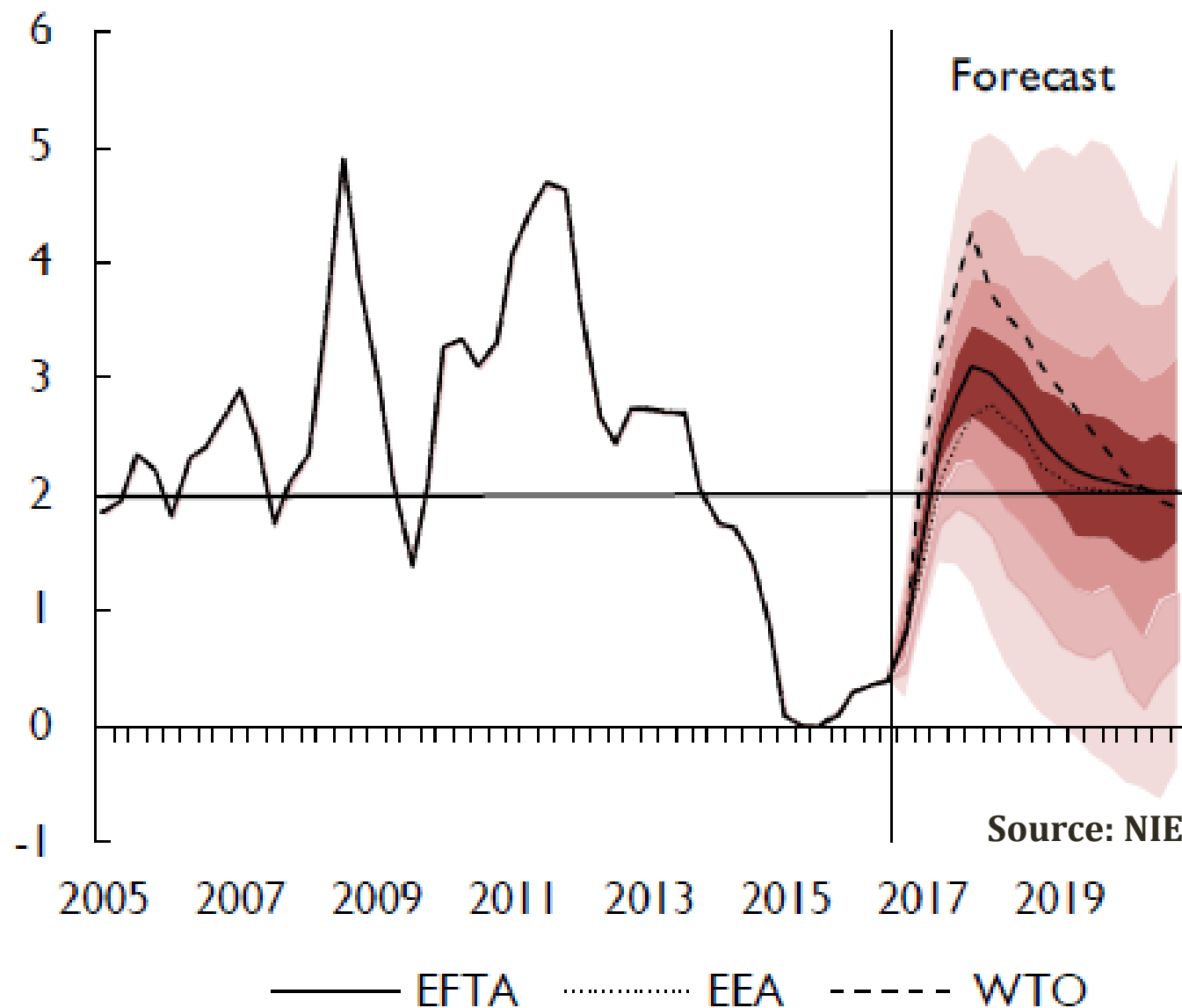
Source: OECD (April, 2016)

Current GDP Forecast (%)

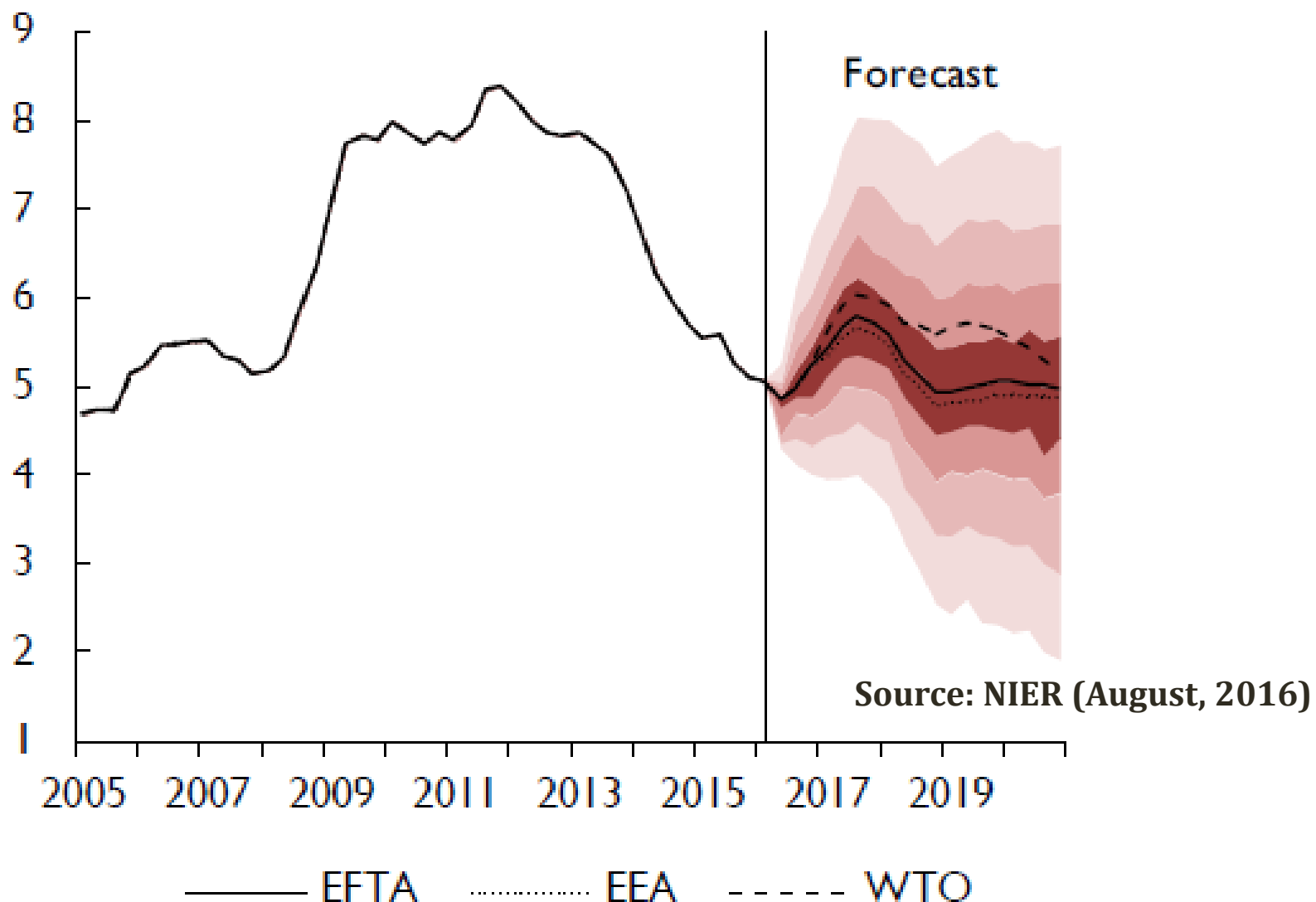


Source: NIER (August, 2016)

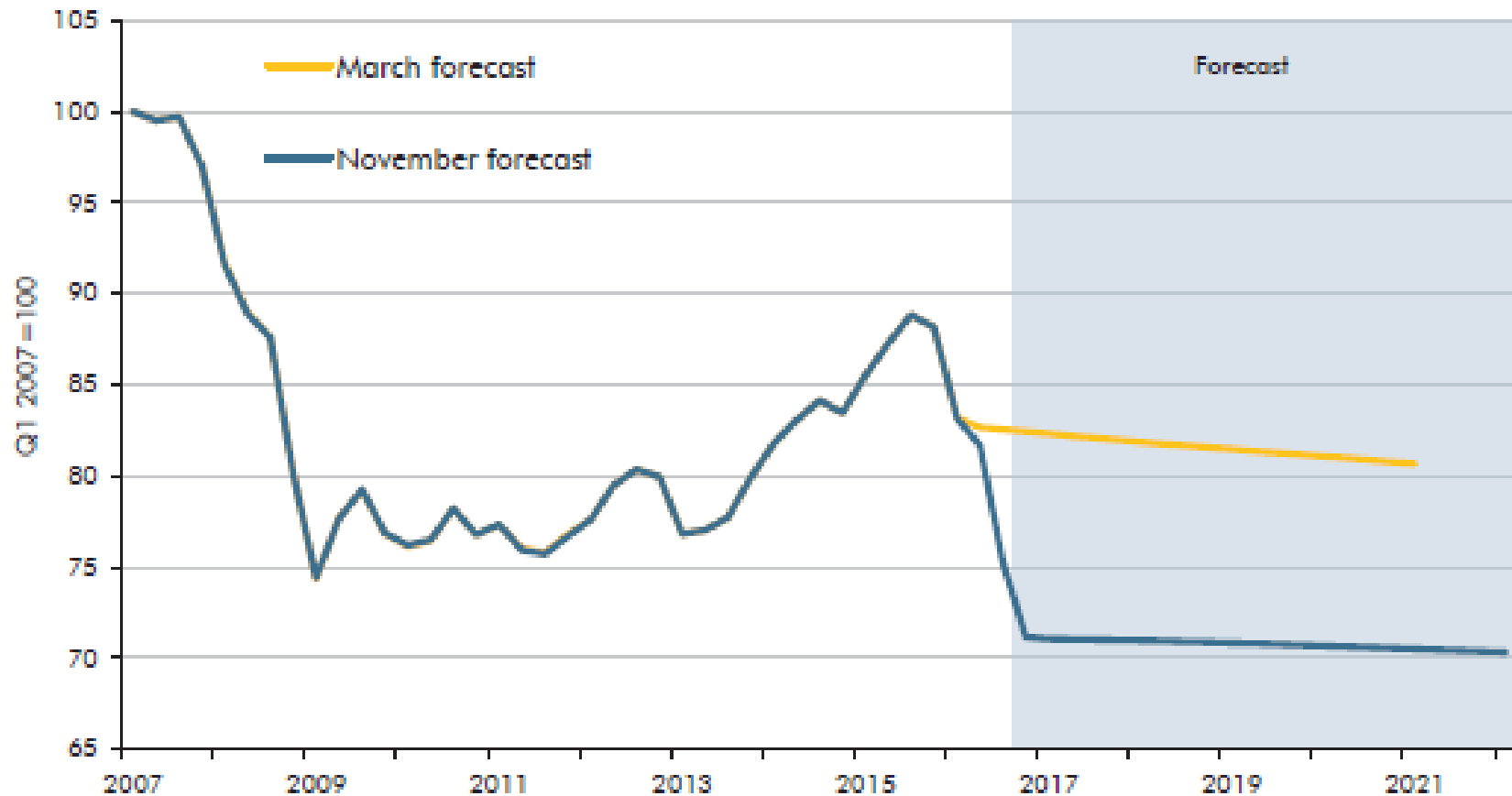
Current Inflation Forecast (%)



Current Unemployment Forecast (%)



Current Sterling Exchange Rate Forecast



Source: OBR (November, 2016)

Impact of Reduction in Immigration

Table 4: Effects of reduction in immigration

<u>Short-run (2020)</u>	Central	Extreme
GDP (%)	-0.6	-0.8
GDP/capita (%)	-0.1	-0.2
Wages (%)	0.1	0.2
<u>Cumulative (2030)</u>	Central	Extreme
GDP (%)	-2.7	-4.4
GDP/capita (%)	-0.9	-1.5
Wages (%)	0.5	0.8

Source: Portes and Forte (December, 2016)