Post-referendum: The economy is doing better than forecast

Given the outcome of the June 23 referendum on the United Kingdom’s withdrawal from the European Union (EU), the U.K.’s economy had been expected to see more trouble. Instead, the situation improved over the summer. In general, the economic indicators are in better shape than the consensus forecast, with the result that the index of economic surprises has been up sharply since the end of the spring. This situation contrasts with the situation prevailing in the euro zone, where the data published has generally been disappointing.

A number of factors have contributed to the improved situation in Britain. The main fact to keep in mind is that Brexit is not yet official, with the government apparently not inclined to get negotiations started quickly. The expected direct impacts of new constraints on trade with the EU have therefore been postponed. Also, immediately after the referendum, a lengthy process to name a new Conservative leader was in the works. Theresa May took office as Prime Minister astonishingly quickly. Moreover, real GDP growth was better than forecast in the spring (before the referendum), suggesting that Britain’s economy was already livelier than anticipated.

The U.K.’s PMI indexes have improved in the last month, particularly in manufacturing, while the Eurozone PMI indexes were going down. Some of the contrast may be due to the pound’s sharp plunge after the referendum. A somewhat weaker currency and a lack of imminent constraints on trade were enough to keep British business confidence up.

Implications: A better situation for Britain’s economy, particularly compared to the difficulties initially feared, should allow the Bank of England to wait before further easing its monetary policy after August’s first round. However, the fears have not vanished altogether and many uncertainties remain and will develop. Sooner or later, the United Kingdom will leave the EU and the negotiations, which could last into 2019 or 2020, will not be easy. We still expect British growth to slow next year. For now, the post-referendum financial and economic situation got some help from the response of the central banks, but there is a limit to this momentum. 

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