Brexit: One Year to the Divorce

The United Kingdom’s official exit from the European Union (EU) is slated for March 29, 2019, just about a year from now. The real consequences of the decision the Brits made in the June 2016 referendum remain unclear, and negotiations between Theresa May’s government and European leaders are far from wrapped up and are fraught with setbacks.

The British economy has decidedly slowed down since the referendum. The fall in the pound sterling has driven up import and consumer prices. Inflation in the United Kingdom has been sitting at around 3% for the past year, in contrast with the low inflation still seen in other advanced nations. This has also affected real household consumption, in addition to forcing the Bank of England to raise its key interest rates. The uncertainty surrounding Brexit is having an impact on business investment as well. Average growth since the referendum has been 1.5%, compared to three times that in the previous two years. Real GDP growth was just 1.7% in 2017, the weakest it has been since 2012. Again, this contrasts with the faster pace of growth observed elsewhere, particularly in the euro zone.

The British economy could nonetheless benefit from the buoyant global economic situation over the next few years. In addition, the effect of the pound’s drop on prices and real disposable income is beginning to fade. However, the situation is still very much tinged with uncertainty, and this is reflected in the mood of economic agents. The Economic Sentiment Indicator that groups consumers and businesses from various sectors dropped in March to its lowest level since October 2016, whereas the same indicator continues to be fairly high in the euro zone (although it has been declining since December’s cyclical peak).

The talks between the British government and the EU offer little clarity. However, there have been positive developments in, for instance, the payments that the British government will have to make when the divorce is finalized and what happens to European citizens in the United Kingdom and to Brits in the EU. Another encouraging aspect is the agreement on the transition period, which will run until December 2020, thus preventing a too abrupt of a break-up in 2019. Unresolved issues include the Irish border and, above all, the trade connection between the United Kingdom and the rest of the continent, which is still not clear to anyone.

It is this last issue that is the major sticking point for Brexit. The economic consequences of the referendum decision will depend on the trade agreement that will unite the two zones. The closer this link is to the current common market, the more modest Brexit’s implications will be for not only Brits and Europeans, but also other trade partners like Canada. An analysis conducted by the U.K. government indicates that the drop in the country’s real GDP (over 15 years) would be much smaller in a customs union (-1.6%) than in a simple free trade agreement situation (-4.8%) or if trading were to be done on the World Trade Organization’s terms (-7.7%). The 21-month transition period leaves a little more time for a trade agreement to be reached, but this timeframe is short nonetheless.

IMPLICATIONS

There is nothing simple about Brexit. There are still many uncertainties about its consequences, and the upcoming quarters will be fraught with political setbacks. Even the option of not going through with it has recently resurfaced. That said, the British economy is expected to continue to grow at a slower pace than most of the other major advanced economies.

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