

Brexit Countdown – Scenarios and Consequences

Wednesday 6th March 2019

9.00-10.00am

Chair: Ben Chu, *Economics Editor, Newsnight*

09.05 Panel Session with:

Jagjit Chadha, Director, *NIESR*

Thomas Sampson, Associate Professor, *LSE*

Gemma Tetlow, Chief Economist, *Institute of Government*

09.40 Q&A



#BrexitCountdown



Brexit Countdown: Scenarios and Consequences

Political Cacophony and the Spring Statement

Professor Jagjit Chadha

Director

NIESR



6th March 2019



National Institute of Economic and Social Research

Politics and Economics without Philosophy

- Political deadlock and constitutional crisis does not necessarily spell economic doom
 - An economy at full employment and in need to supply-enhancing capacity-building waits for the outcome of the a tortuous EU Exit process
 - Output is now some 2% lower than otherwise as a result of the EU referendum result for precisely the reasons outlined by reputable economic analysis:
 - Demand and supply are driven down by an expected deterioration in prospects and
 - The fog of uncertainty about those prospects
 - No-one can be quite sure what will happen in terms the EU and our future trading relationships
 - How to approach fiscal policy at this time?
-



Impact of EU Exit

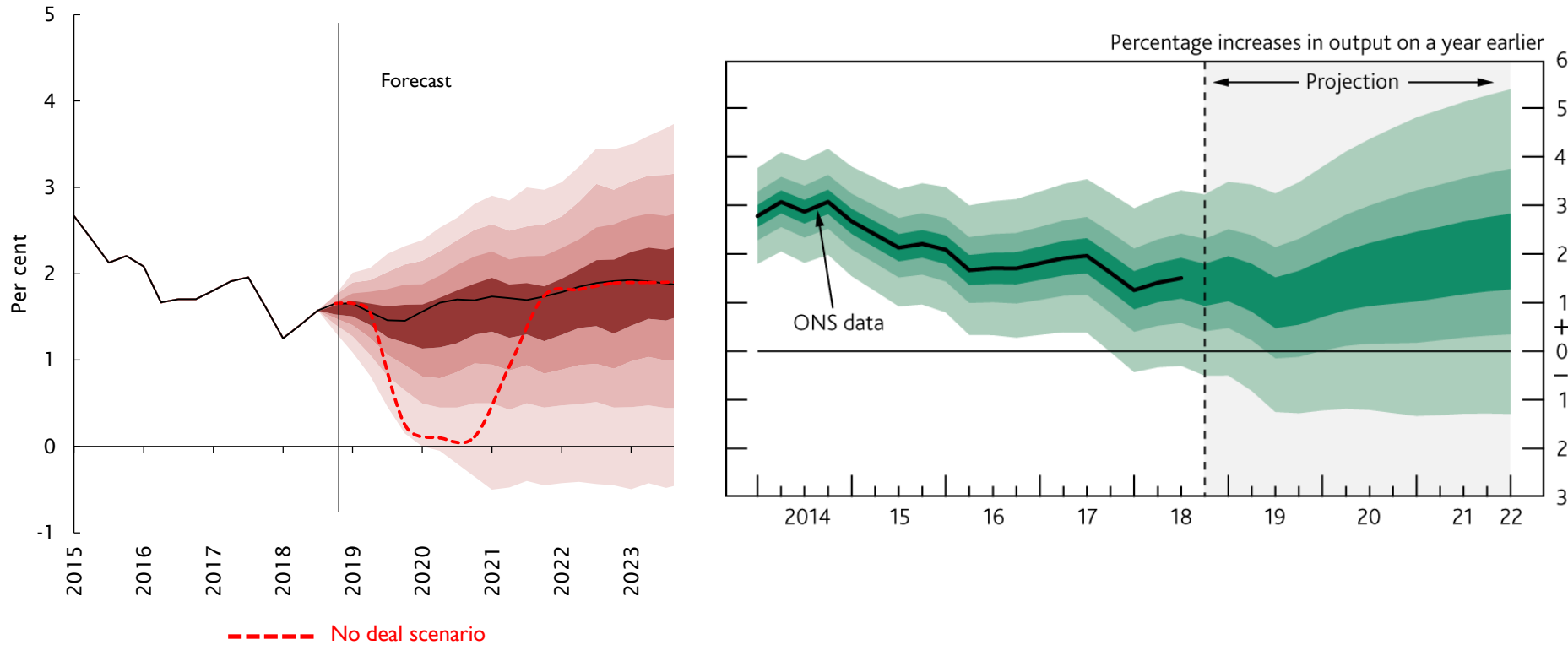
Table 1: Comparison of EU Exit Deal impact studies

		Close relationship	FTA	Orderly no-deal
<i>Long run</i>				
NIESR	% GDP	-2.8%	-3.9%	-5.5%
	% GDP per capita	-1.9%	-3.0%	-3.7%
UK in a Changing Europe	% GDP	n/a	n/a	n/a
	% GDP per capita	-5.5%		-8.7%
HM Government	% GDP	-2.1% to -3.9%	-4.9% to -6.7%	-7.7% to -9.3%
	% GDP per capita	-2.1% to -2.7%	-4.9% to -5.4%	-7.6% to -8.1%
<i>Medium run (2023)</i>				
NIESR	% GDP	-2.6%	-2.0%	-3.2%
Bank of England	% GDP	-1.25% to -3.75%		-7.75%

Notes: 'Close relationship' encompasses comparable scenarios with stronger regulatory convergence compared to a free trade agreement but characterised by non-tariff barriers in particular to services trade. This includes NIESR's 'Deal + Backstop' scenario and the scenario by HM Government called 'White Paper w/ 50% NTB sensitivity'.



Output Forecasts



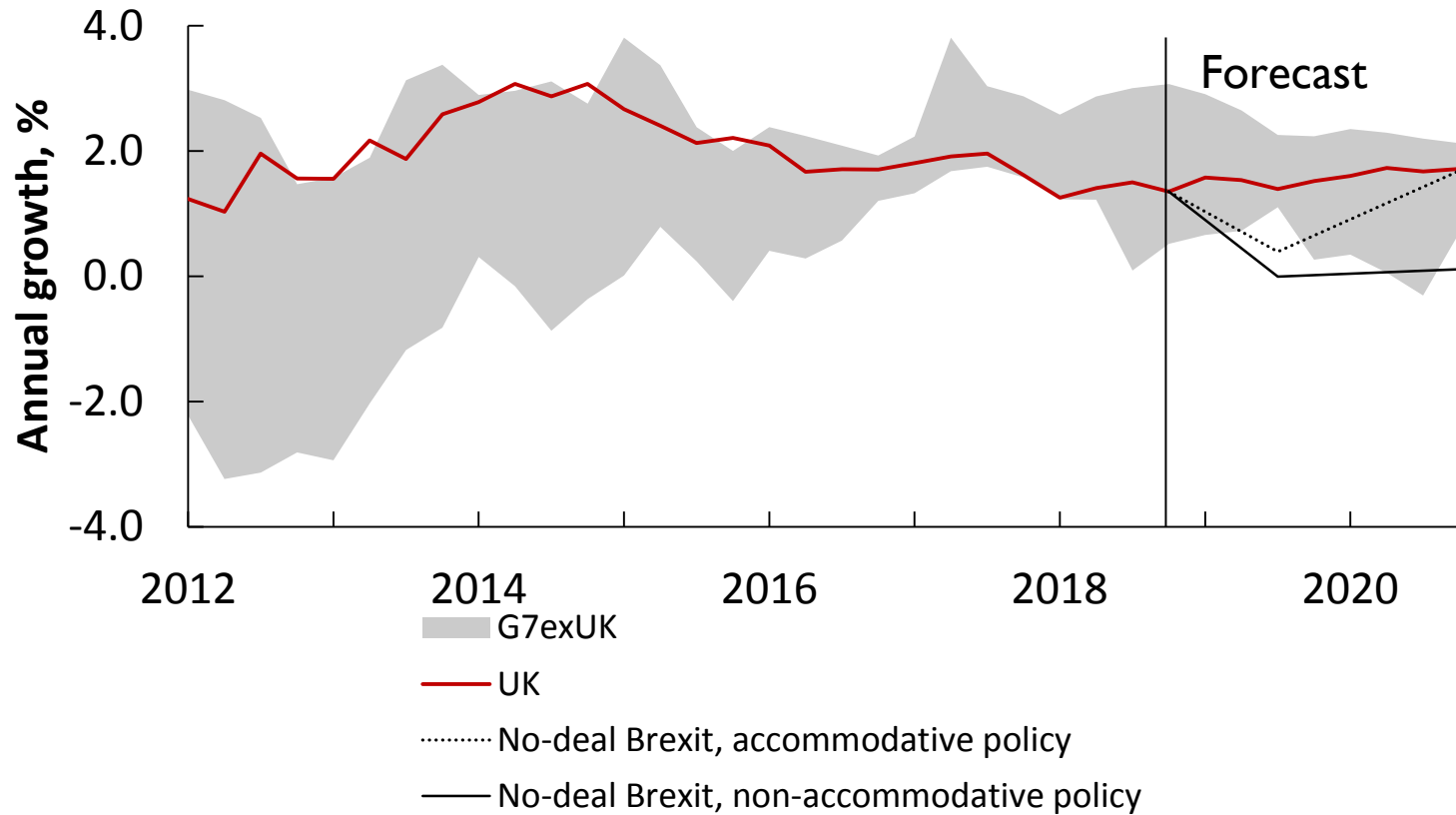
- A pea-souper of a fog of uncertainty



Source: NiGEM Stochastic simulation

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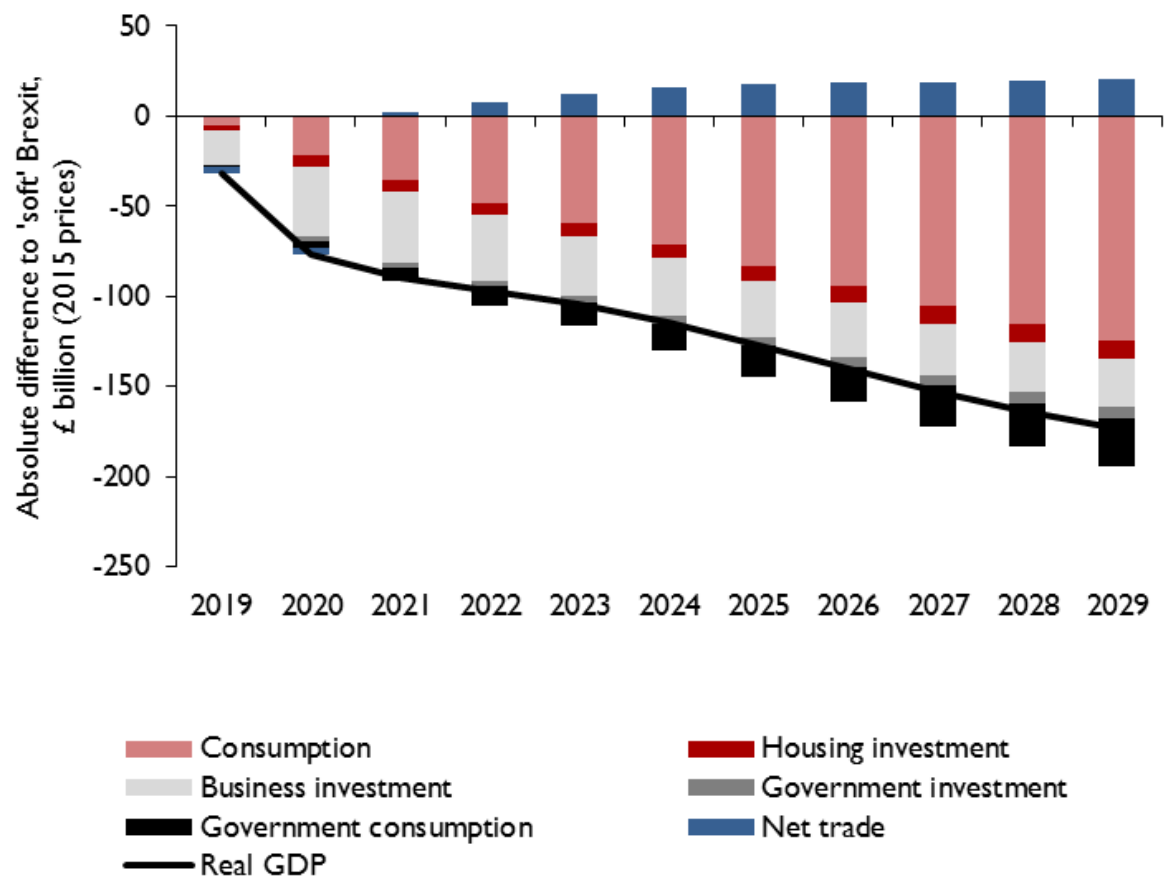
Output Forecasts vs G7



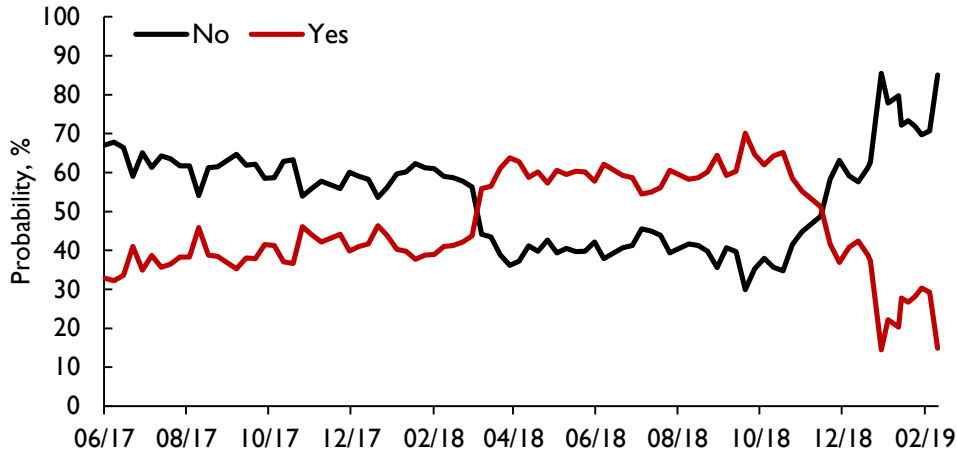
- A choice about riding with the pack or falling behind



Accounting for a “near-worst” case exit

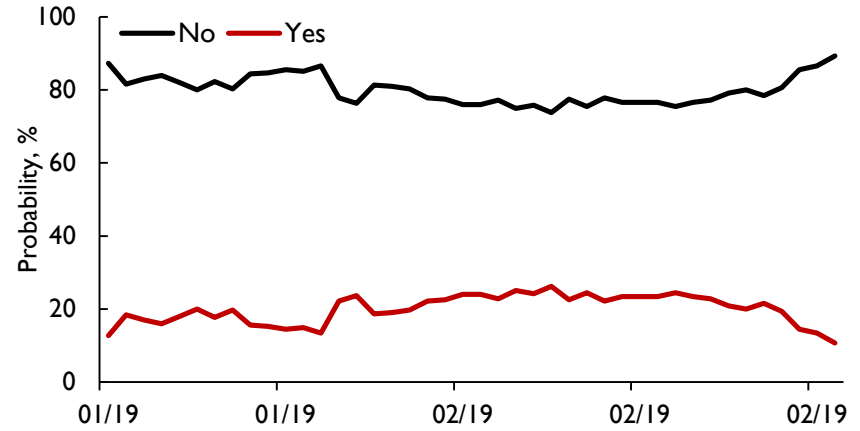


Will the UK leave the EU on the 31st March 2019?



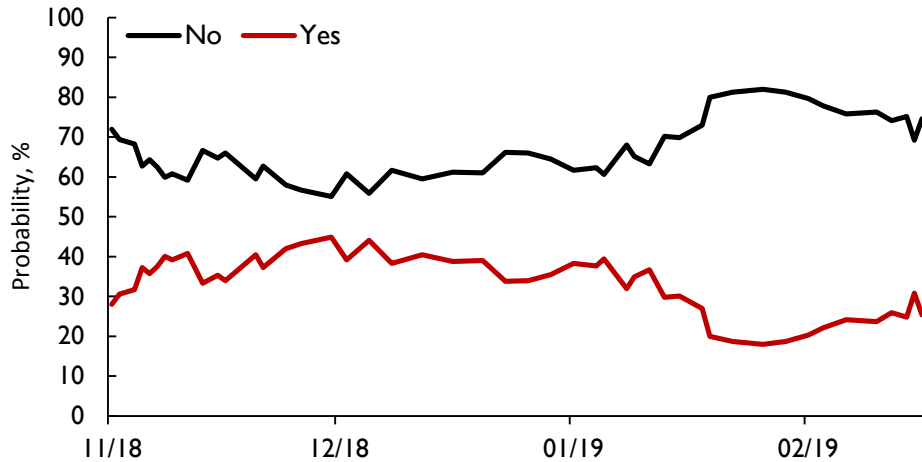
Source: Betfair, NIESR

Will there be no deal?



Source: Betfair, NIESR

Will there be a second referendum before 2020?



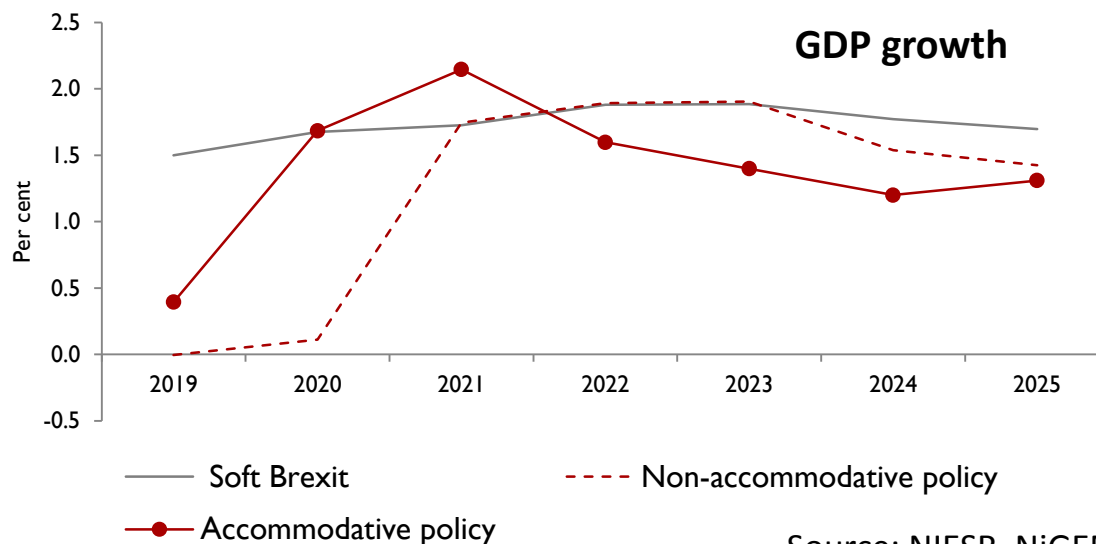
Source: Betfair, NIESR

- Delayed Exit
- With a Deal
- Without a second referendum

Some Betting Odds – “Political Flu”

How should policy respond to a no-deal Brexit?

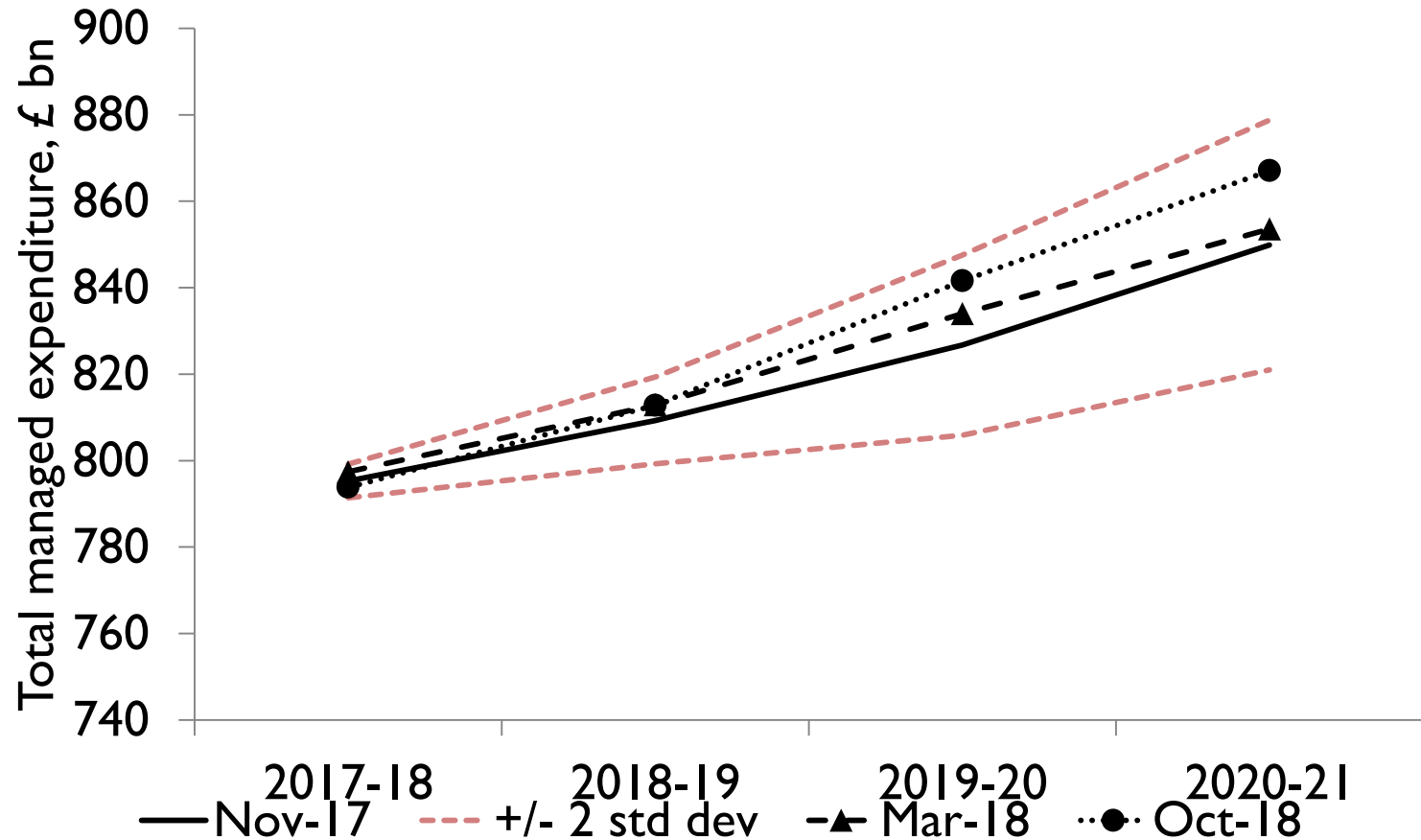
- **Supply shock:**
 - Contingency measures implemented by EU and the UK e.g. liquidity injection, FX swap lines, rights of UK/EU citizens, financial services (equivalence), air transport, road haulage etc. (See BOX A)
 - Important to note that these are temporary and limited in scope
 - Does not cover FTA with non-EU countries
- **Demand shock:**
 - triggered by confidence effects and a loss in income because of trade barriers. Monetary and fiscal policy can help



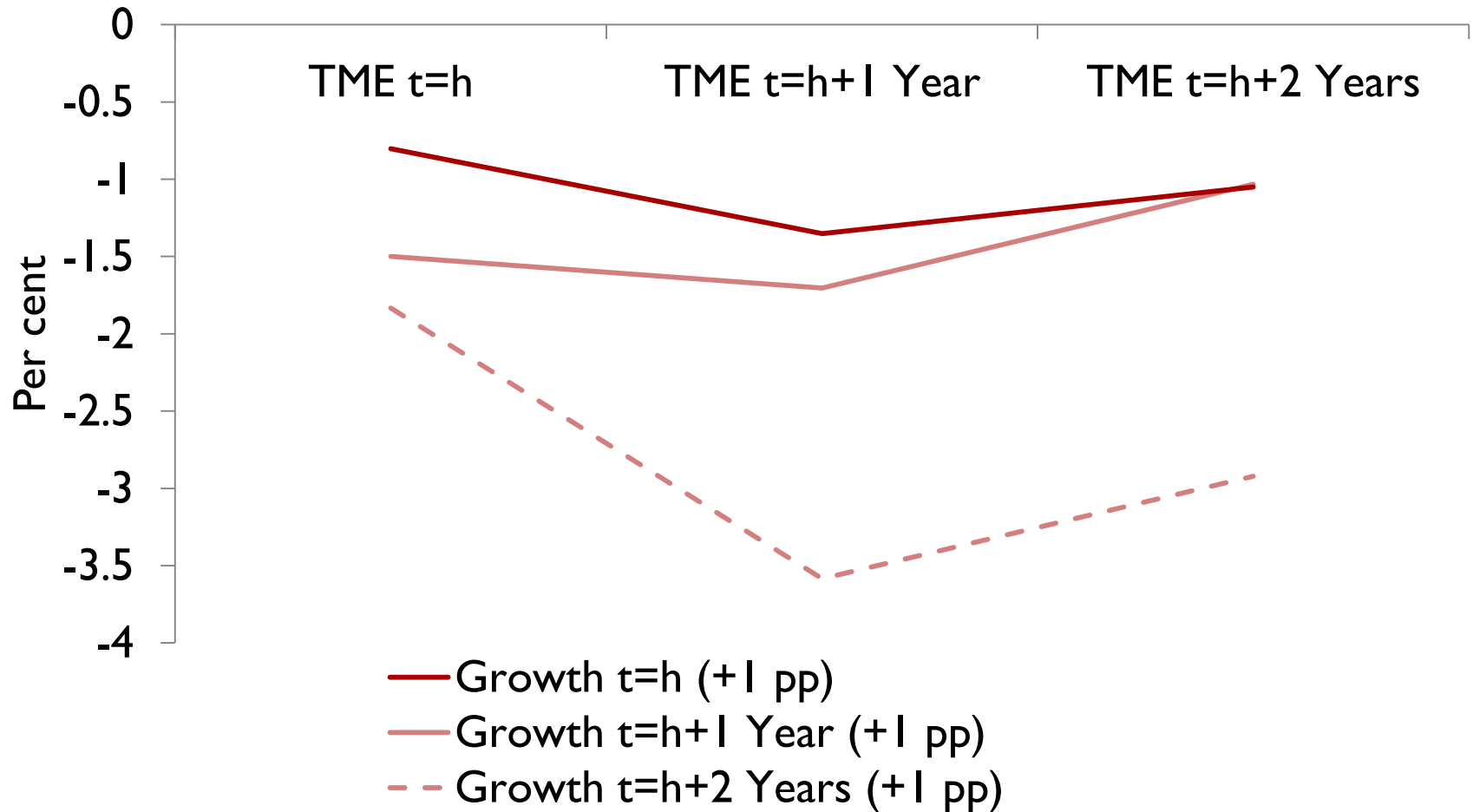
Source: NIESR, NiGEM simulation



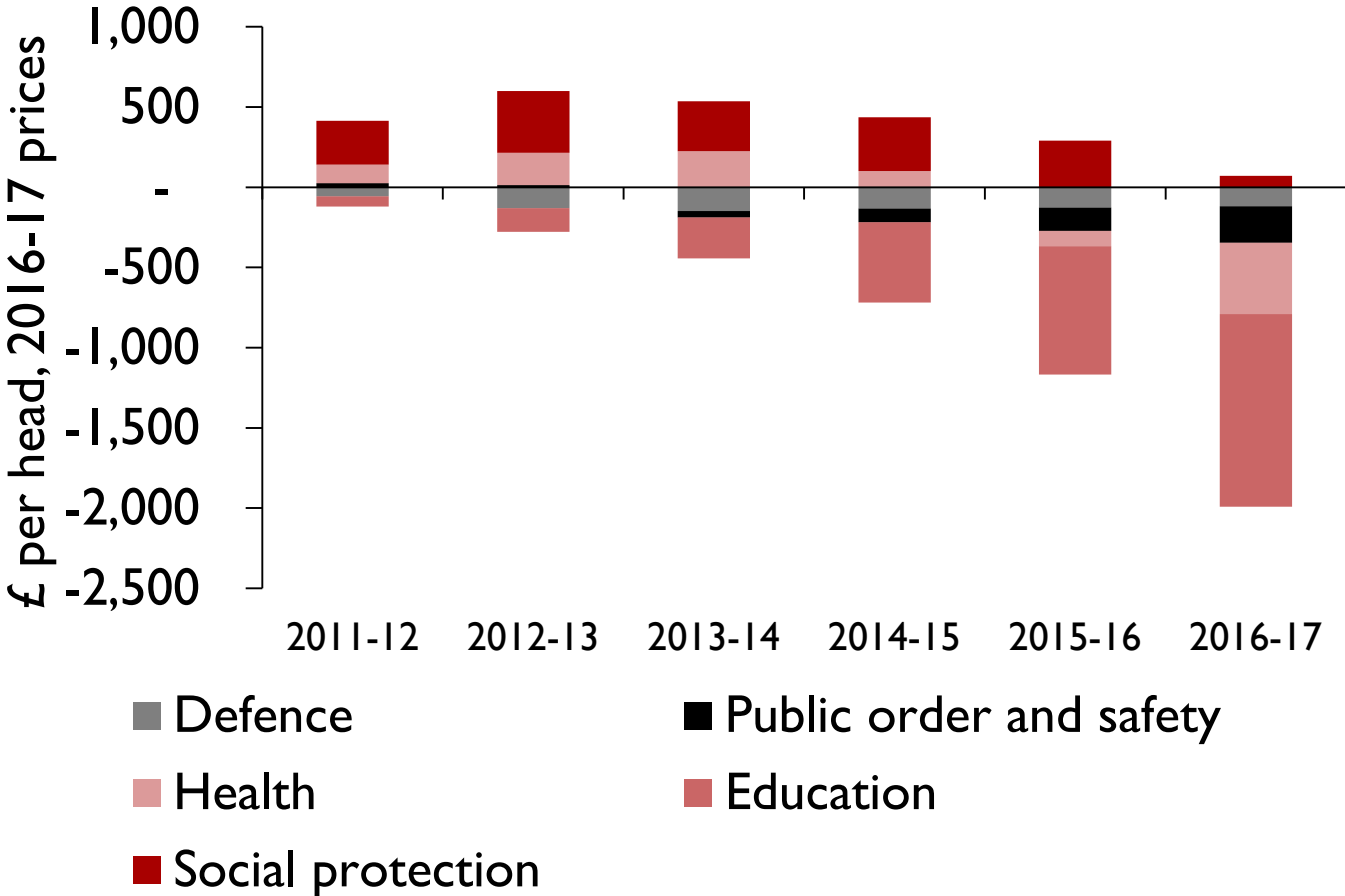
Risk around Expenditure Paths – Historic



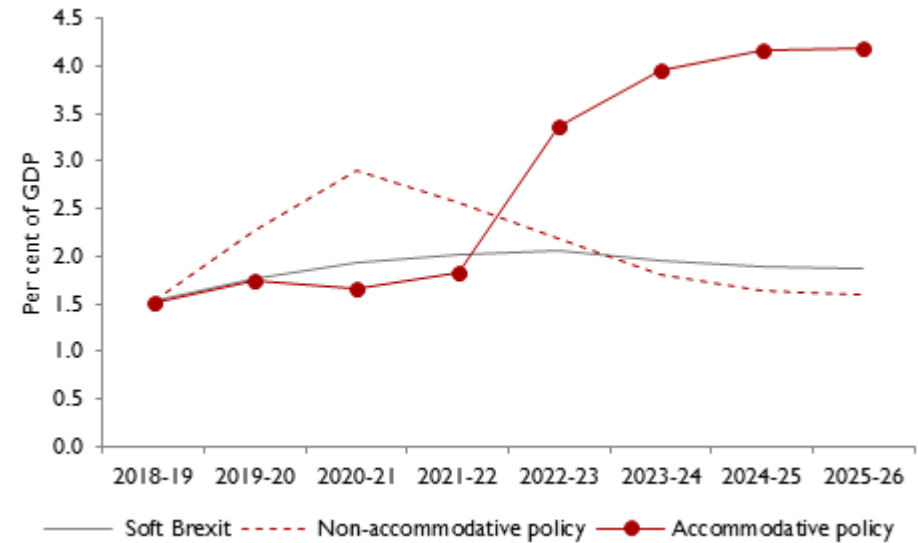
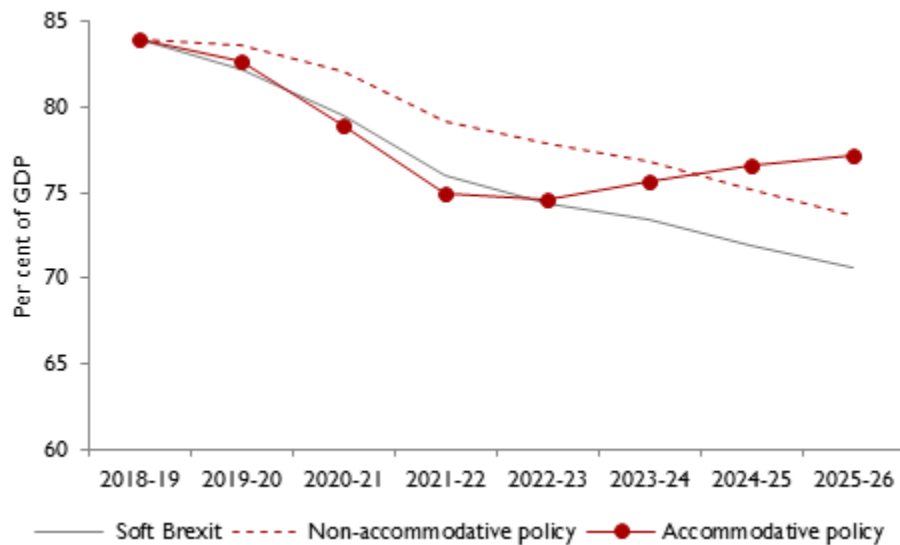
Positive revisions to growth expectations lower expenditure paths



Difference actual and warranted spending (selected functions)



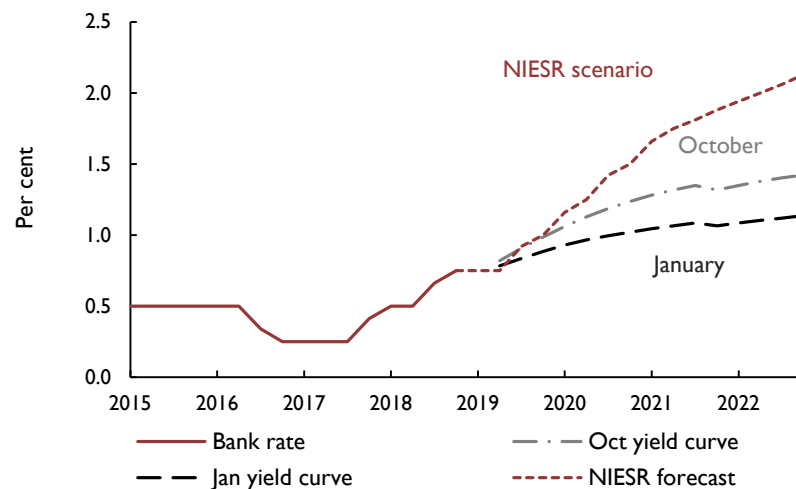
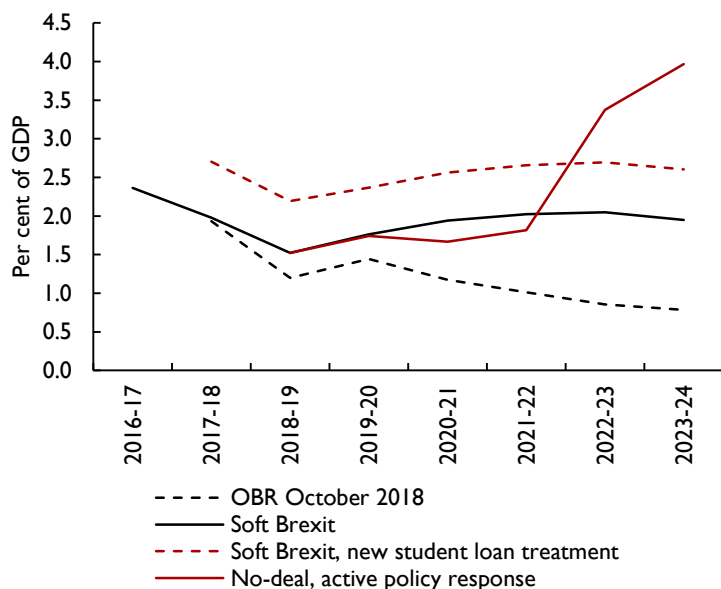
Debt and Deficits



- Fiscal Policy need not be constrained by an arbitrary fiscal rule, even though public debt levels do matter



Deficits and Bank Rate Expectations



- Markets do not see much scope for interest rate normalisation even in the presence of fiscal loosening but they correspond to an average outcome not a particular scenario



The Cacophony of Spring

- An exit on near frictionless terms still seems most likely but possibly with a short delay
- Not at all clear – so policy has to flesh out responses in alternate scenarios to reduce concerns
- Even though the cyclical impact of the referendum was well anticipated by economists, there was no strong case for a further fiscal policy response given the large exchange rate depreciation and the loosening of monetary policy
- There is room for monetary policy to respond but also the financial sector seems ready to absorb shocks
- There are though issues for fiscal policy:
 - Under-investment or public good capacity in key areas;
 - Need to offset shortfall in investment, FDI and R&D at national/regional levels
 - A question-mark over the tax regime
 - And the fiscal rules



References

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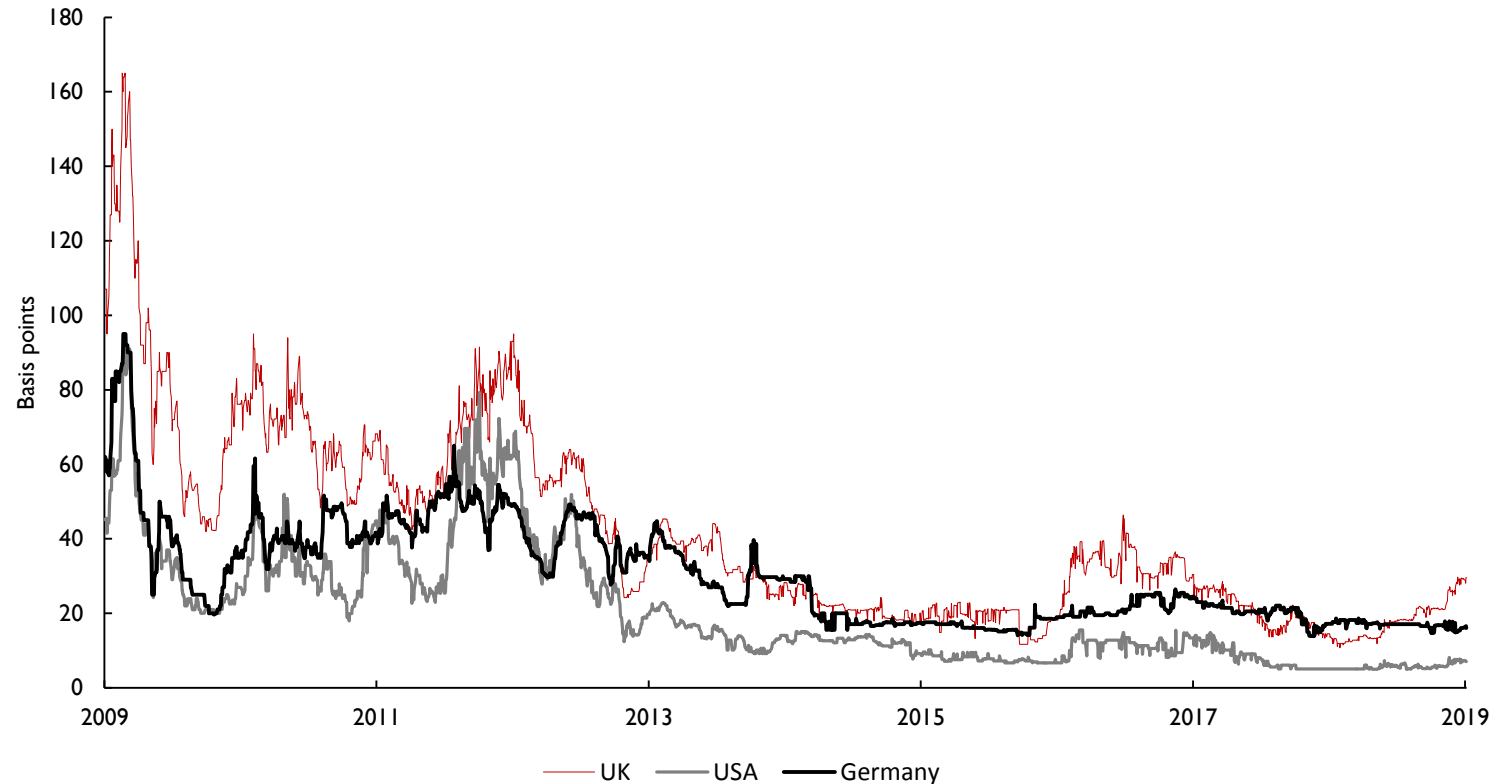
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Appendix Chart – CDS Spreads for UK, USA and Germany



Brexit & UK Outward FDI

Thomas Sampson

London School of Economics

NIESR, 6 March 2019

Brexit & Outward FDI

- Has the Brexit vote affected outward investment by UK firms into the EU?
 - Are firms looking to move production to EU to avoid future trade barriers?
 - Bad news for UK economy if leads to lower domestic investment

Brexit & Outward FDI

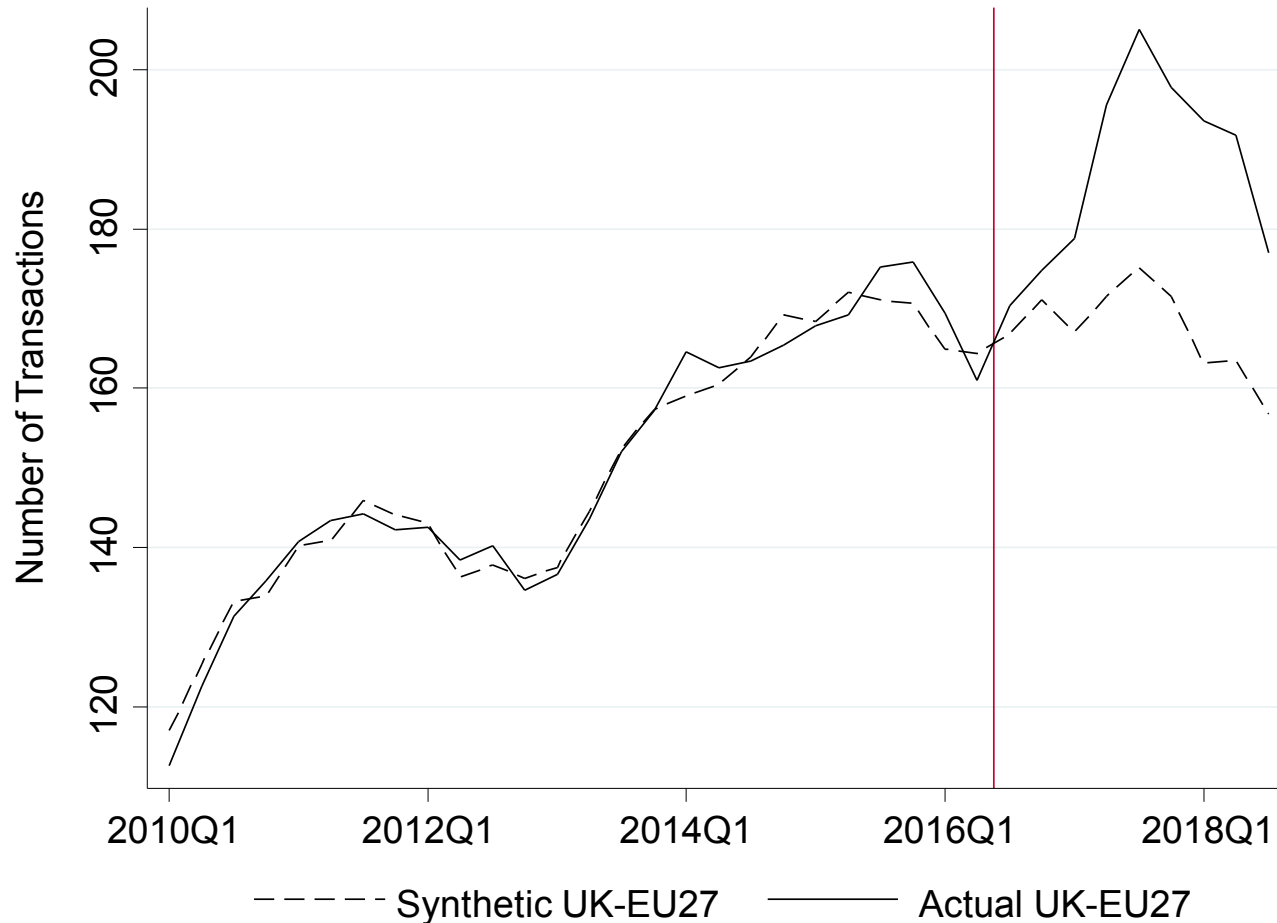
- Has the Brexit vote affected outward investment by UK firms into the EU?
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- Data: announcements of new foreign investment projects – greenfield and M&A

Brexit & Outward FDI

- Has the Brexit vote affected outward investment by UK firms into the EU?
 - Are firms looking to move production to EU to avoid future trade barriers?
 - Bad news for UK economy if leads to lower domestic investment
- Data: announcements of new foreign investment projects – greenfield and M&A
- Method: compare UK investment to “synthetic counterfactual” comprising investment flows between other developed economies

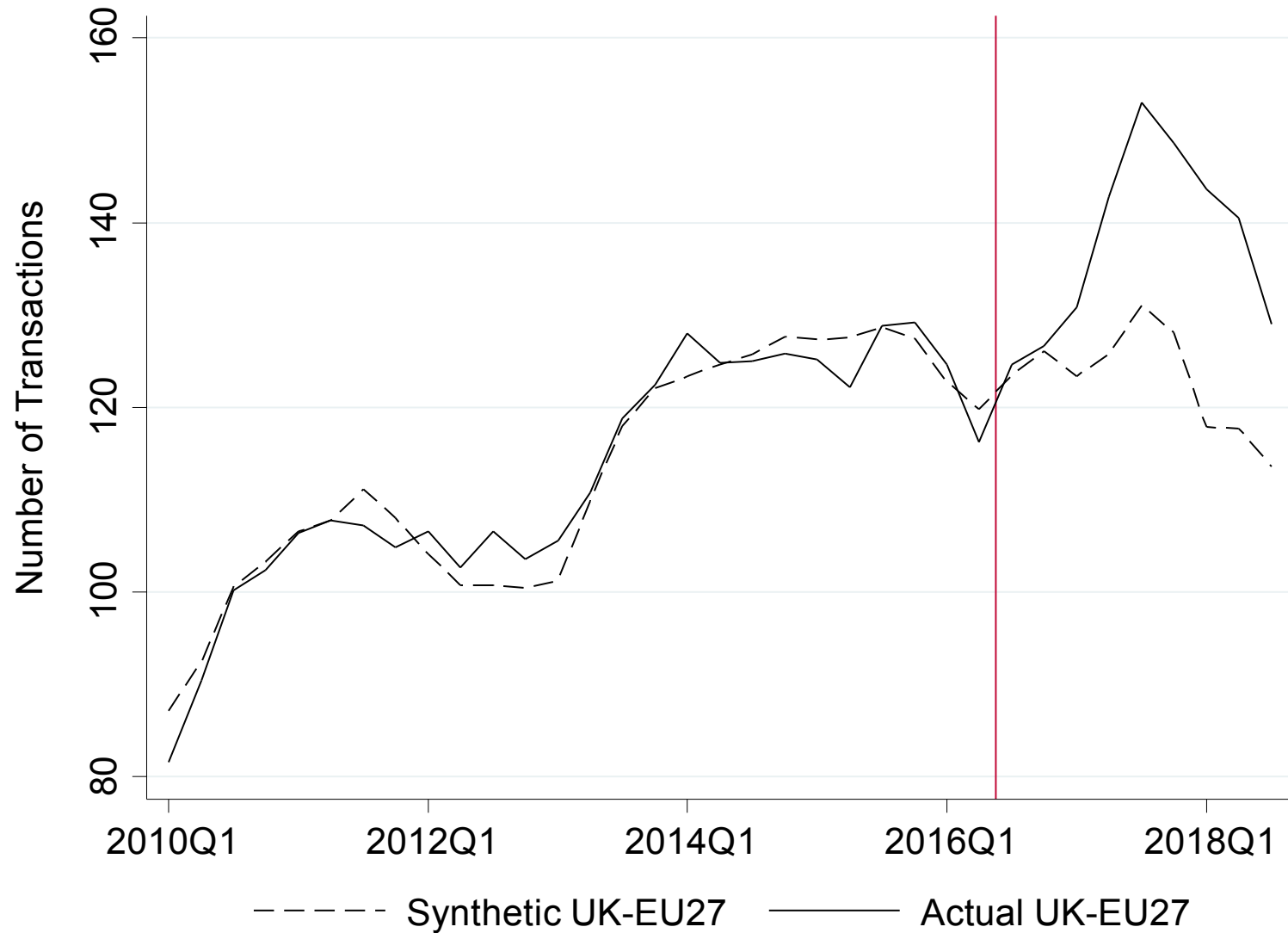
Weights: Switzerland-EU 52%, US-EU 38%

Outward investment in EU

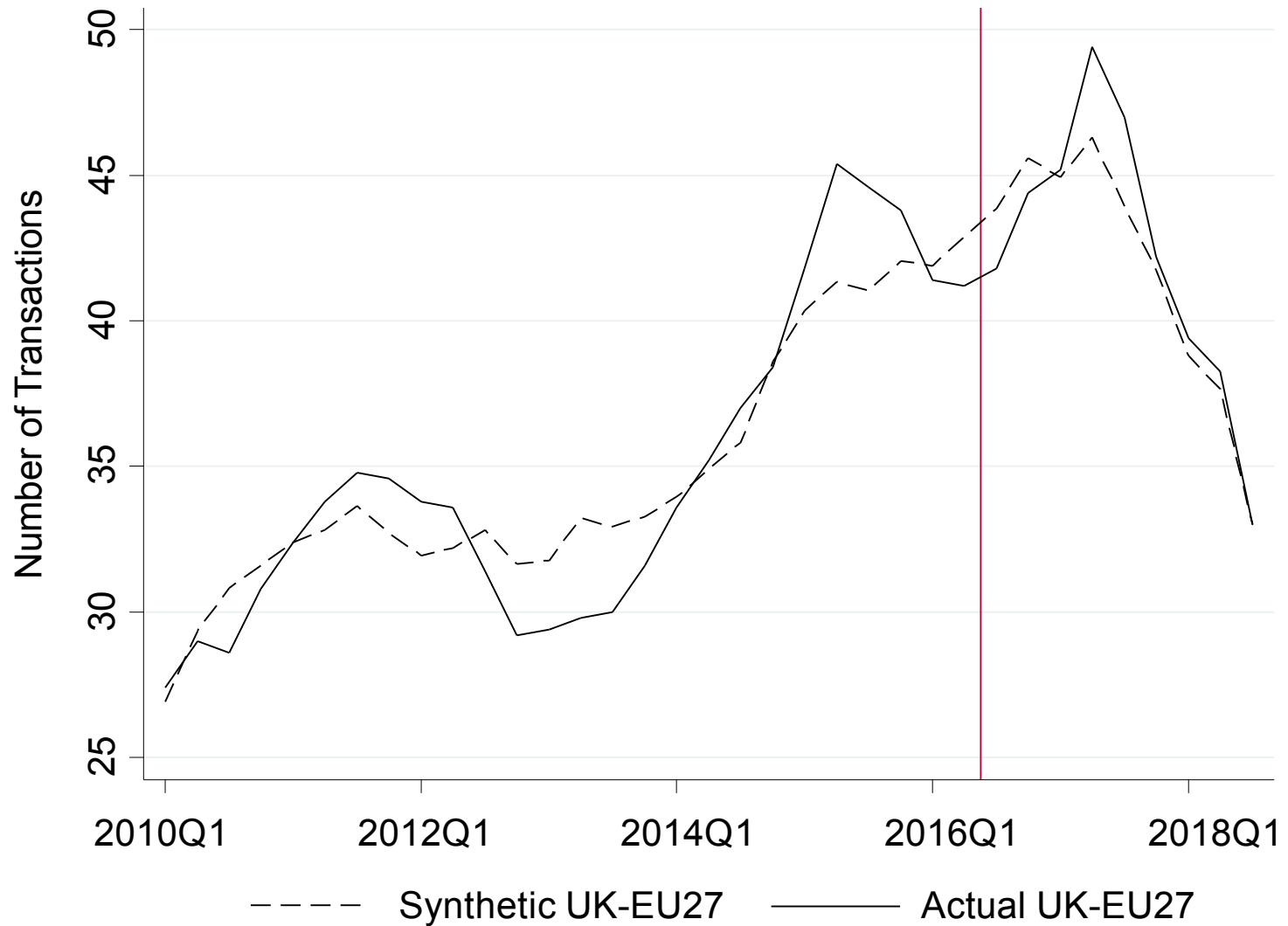


12% increase in new projects relative to synthetic control by 2018 Q3
Amounts to approximately 8.3 billion pounds of additional investment

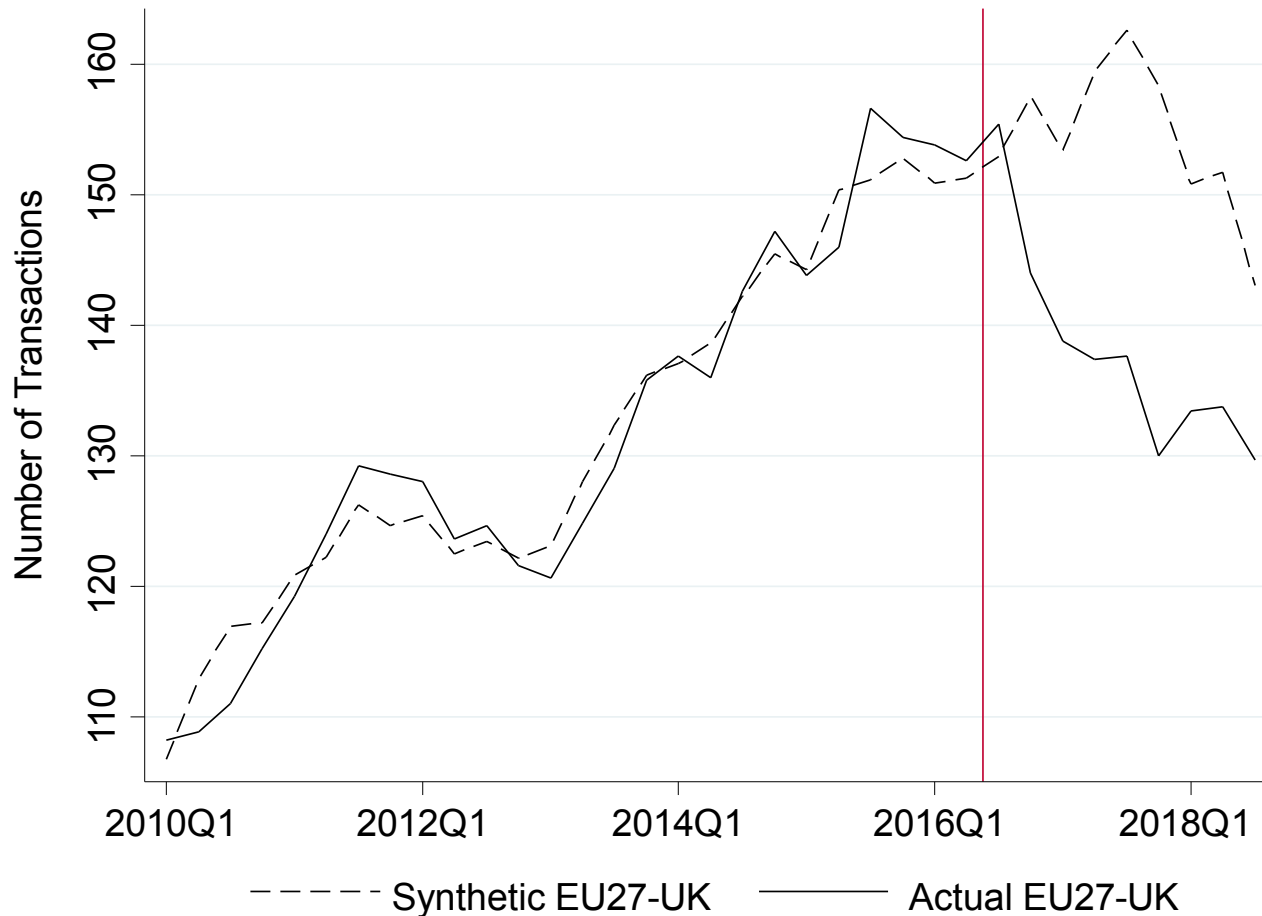
Services investment in EU



Manufacturing investment in EU



Inward investment from EU



11% decline in new projects relative to synthetic control by 2018 Q3
Amounts to approximately 3.5 billion pounds lower investment

Summary

- Brexit vote led to 12% increase in new investments by UK firms in other EU countries
- No evidence of Brexit effect on UK investment in non-EU countries
- Higher investment entirely driven by services sector (up to 2018 Q3)
- Results consistent with UK firms moving investment (and jobs?) out of UK to avoid future increases in trade and migration barriers

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