



Brexit and After

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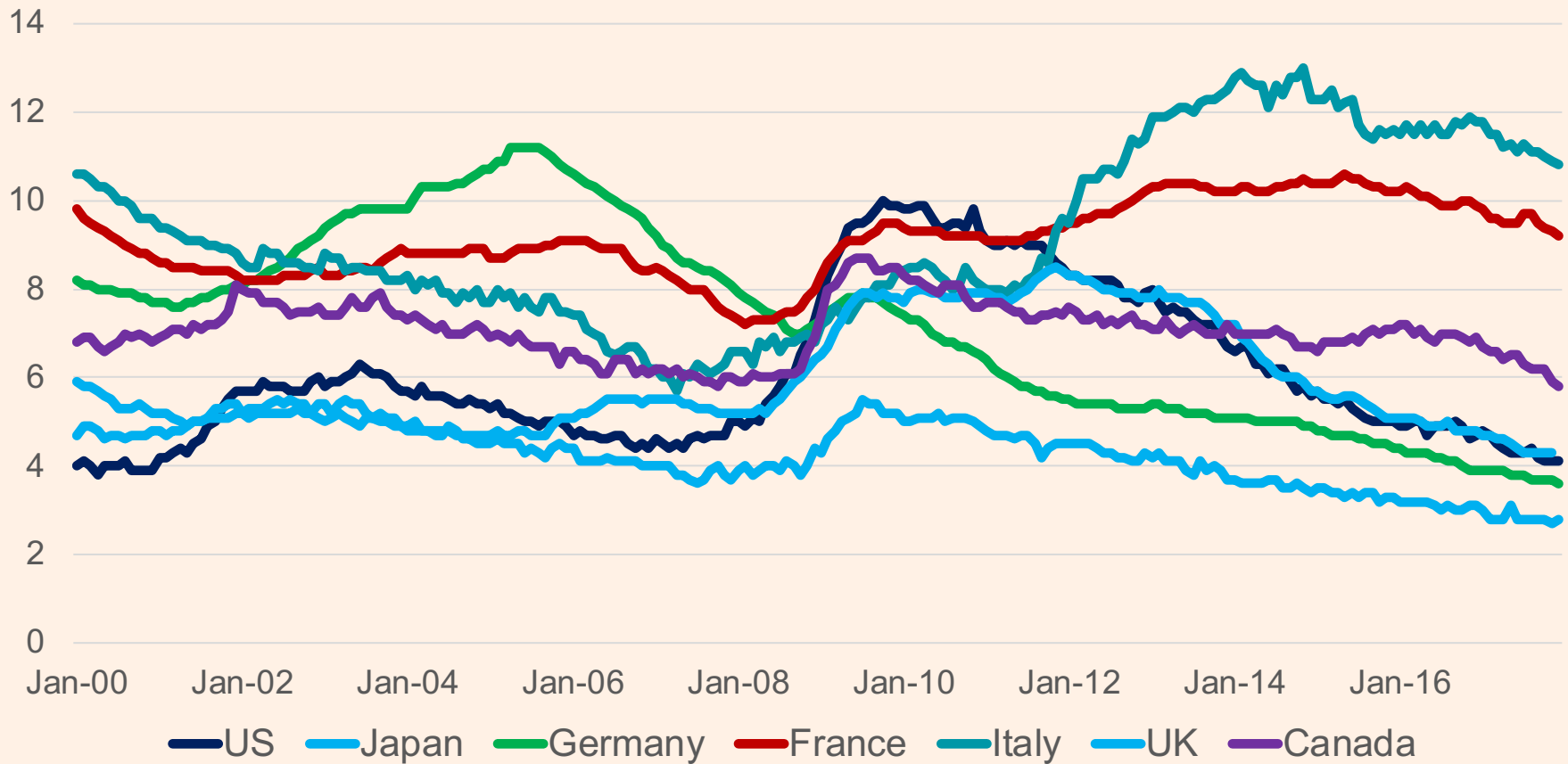
Brexit and after

- The economy
- UK economic relations
- State of the negotiations
- Economic outcomes
- Political outcomes
- Conclusions

1. The economy

BUT SUCCESSFUL ON JOBS

UNEMPLOYMENT RATES



1. The economy

AND DREADFUL ON PRODUCTIVITY

UK WHOLE ECONOMY OUTPUT PER WORKER



1. The economy

STERLING FELL AGAIN

TRADE-WEIGHTED REAL EXCHANGE RATE

(JPM UK REER CPI (2010=100))



1. The economy

THIS RAISED INFLATION AND LOWERED REAL INCOME

HEADLINE AND CORE UK CPI INFLATION
(year-on-year, per cent)



1. The economy

REAL DISPOSABLE INCOMES STAGNATE AGAIN

REAL AGGREGATE HOUSEHOLDS DISPOSABLE INCOME (£bn)

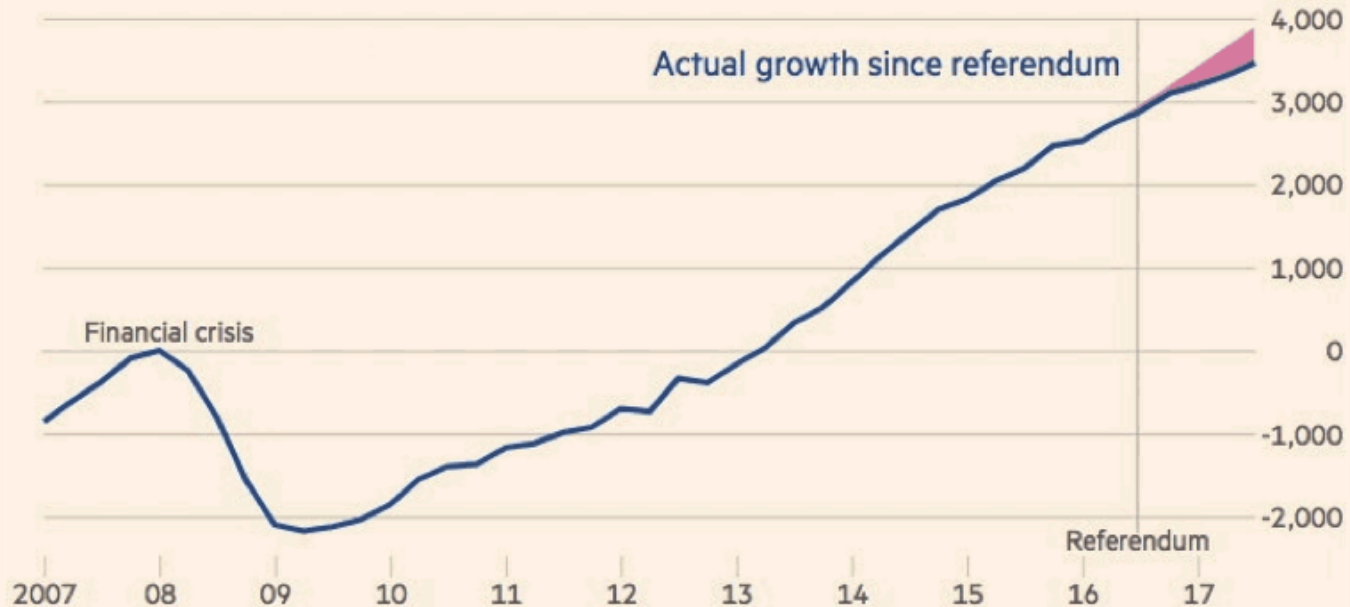


1. The economy

LOST OUTPUT IS ALREADY VISIBLE

Based on historical growth patterns, the EU referendum has already cost the UK billions

Weekly gross domestic product (2016-17 prices, £m, difference from Q1 2008)



Graphic Alan Smith, Keith Fray, Chris Giles

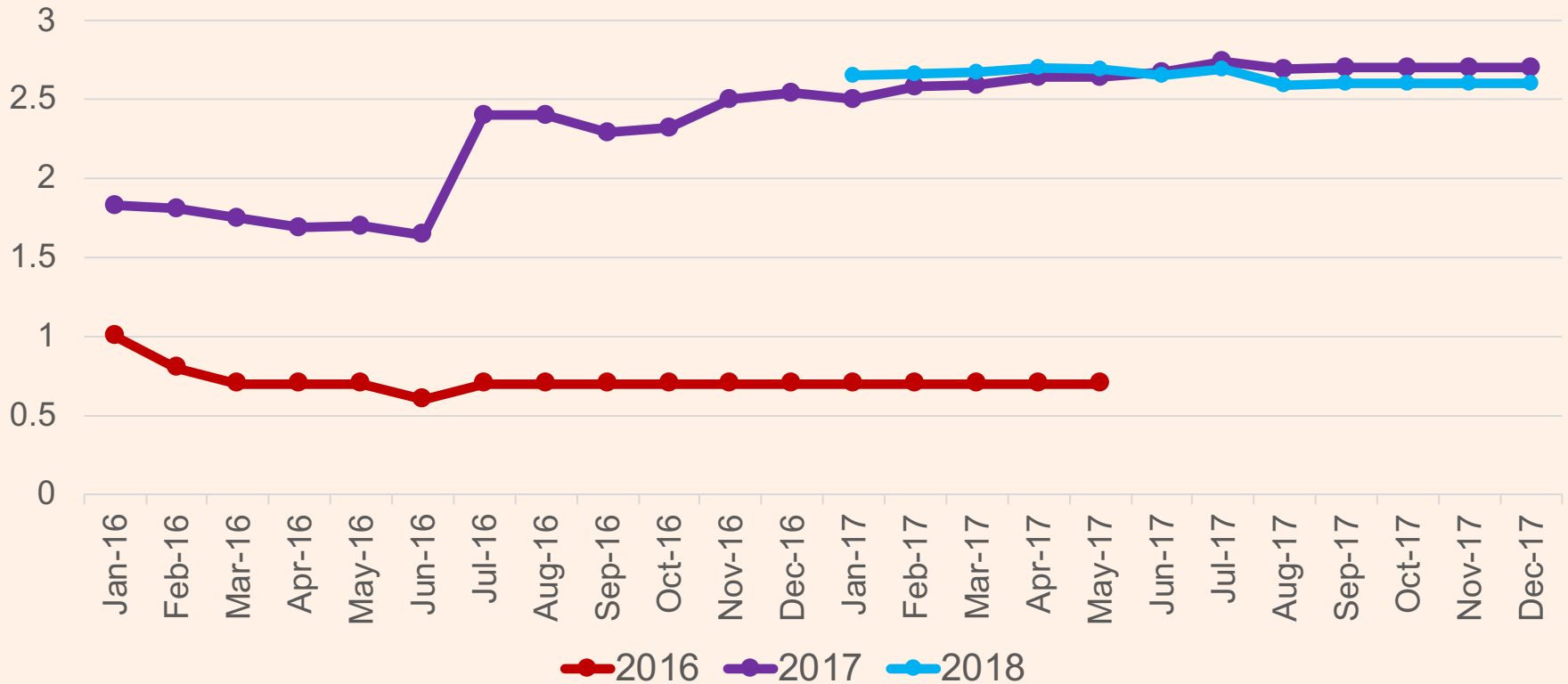
Sources: ONS; FT research

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1. The economy

FORECAST OF HIGHER INFLATION TURNED OUT TO BE REAL

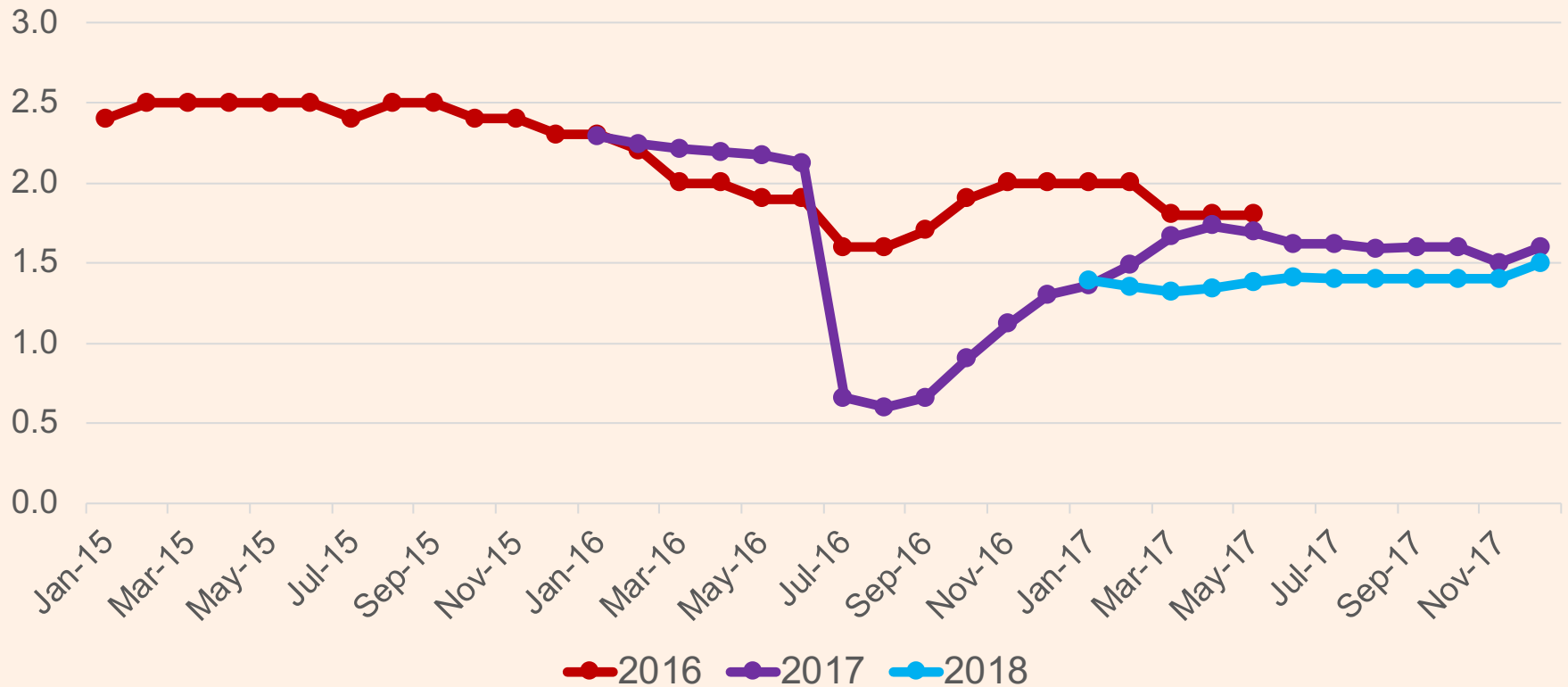
SUCCESSIVE CONSENSUS FORECASTS FOR UK CPI INFLATION



1. The economy

PESSIMISM EXAGGERATED, BUT NOT MISTAKEN

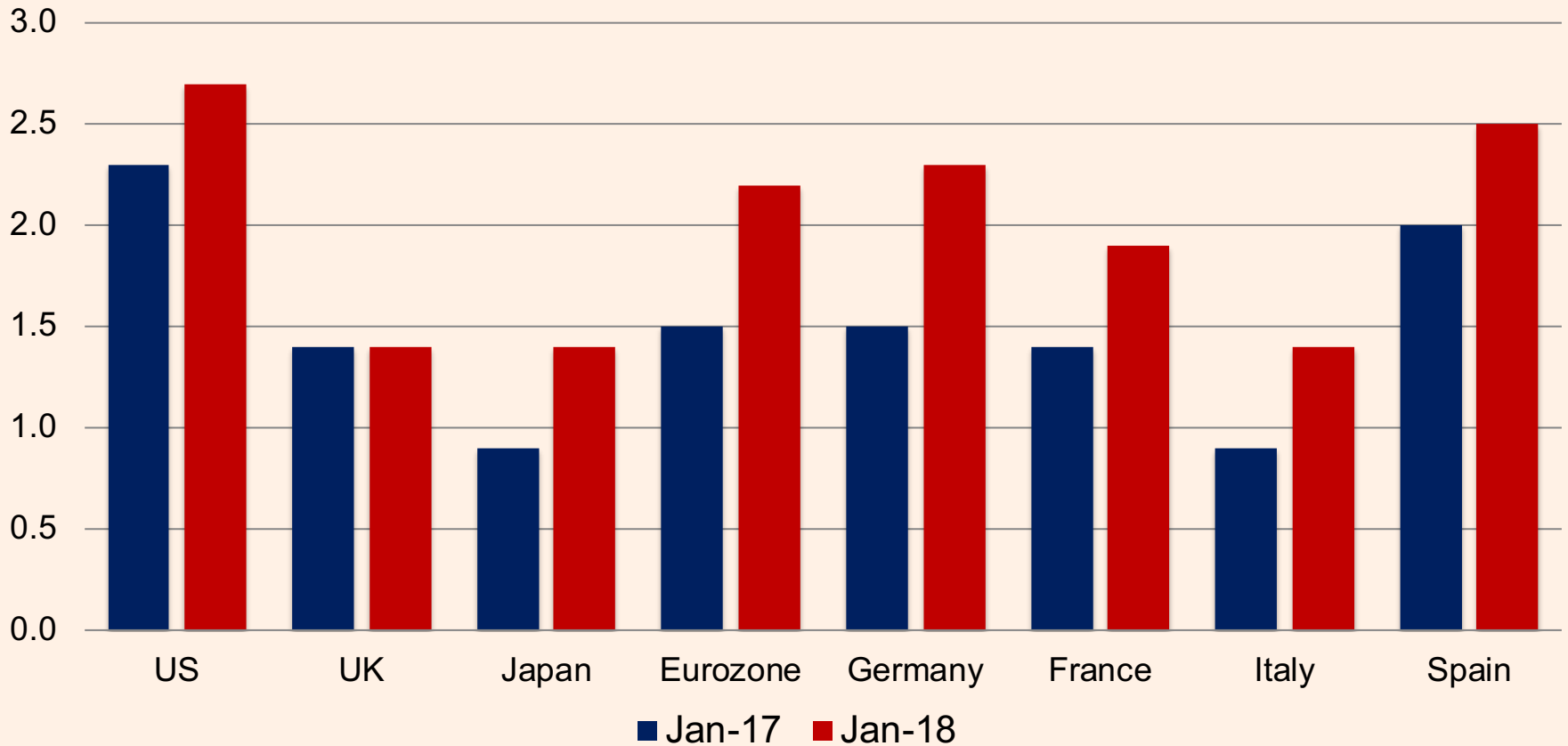
SUCCESSIVE CONSENSUS FORECASTS FOR UK GDP GROWTH IN 2016, 2017 AND 2018



1. The economy

A BRITISH EXCEPTION TO THE EUROPEAN RECOVERY

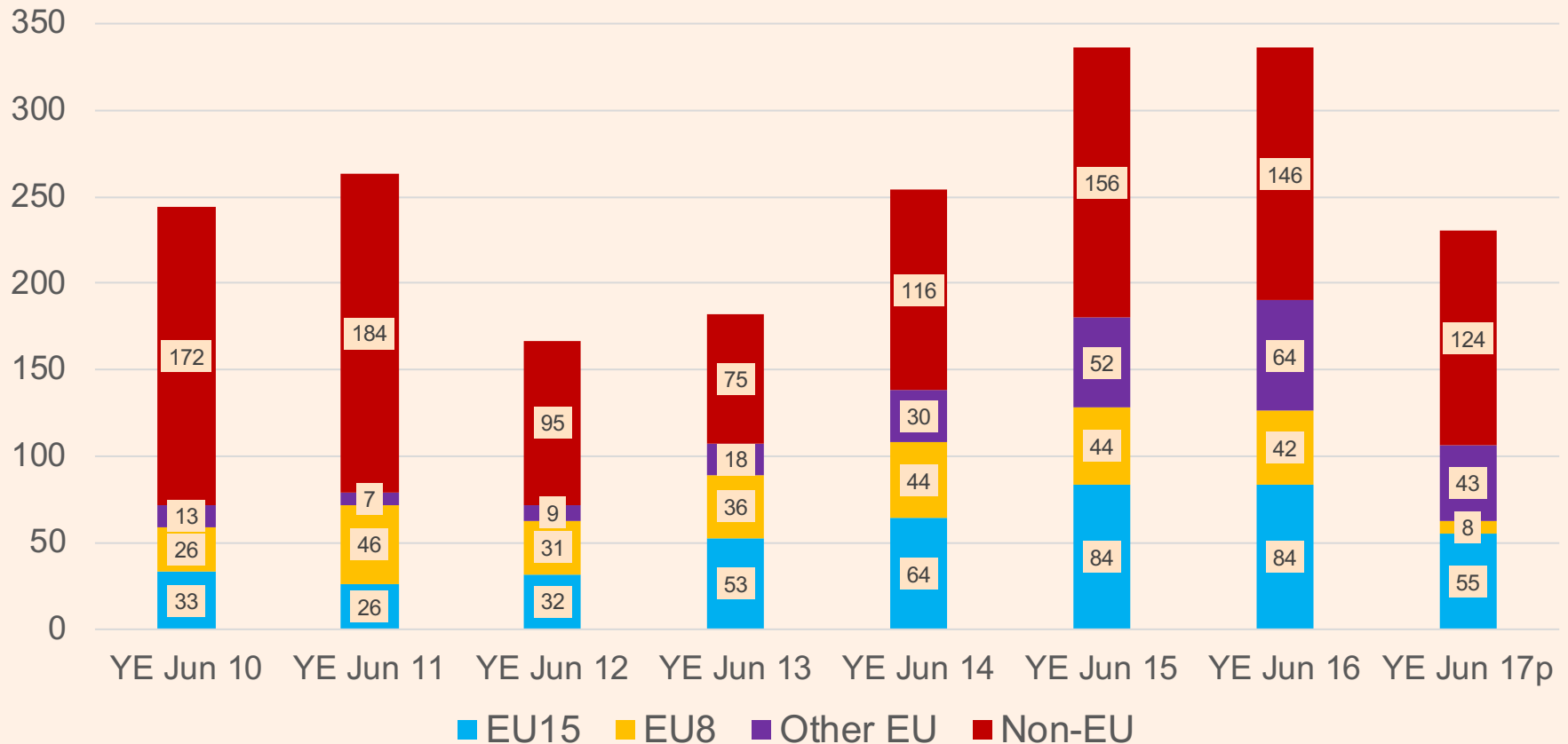
CONSENSUS FORECASTS FOR GROWTH IN 2018



1. The economy

IMMIGRATION HAS ALREADY SLOWED SHARPLY

NET IMMIGRATION INTO THE UK (hundred thousands)



1. The economy

- The UK's productivity performance is poor, but its employment performance is excellent
- Net immigration surged temporarily at the time of the referendum. It has fallen sharply since then
- The referendum caused a fall in sterling, higher inflation and falling real disposable incomes
- The slowdown in growth post-referendum was real and costly, though not as bad as forecast
- It is likely however that the economy will indeed be about 3 per cent smaller in 2010 than would otherwise have been the case

2. Economic relations

THE EU MADE THE UK FAR MORE OPEN

Benefits of membership

Trade openness (real exports and imports as a % of real GDP)



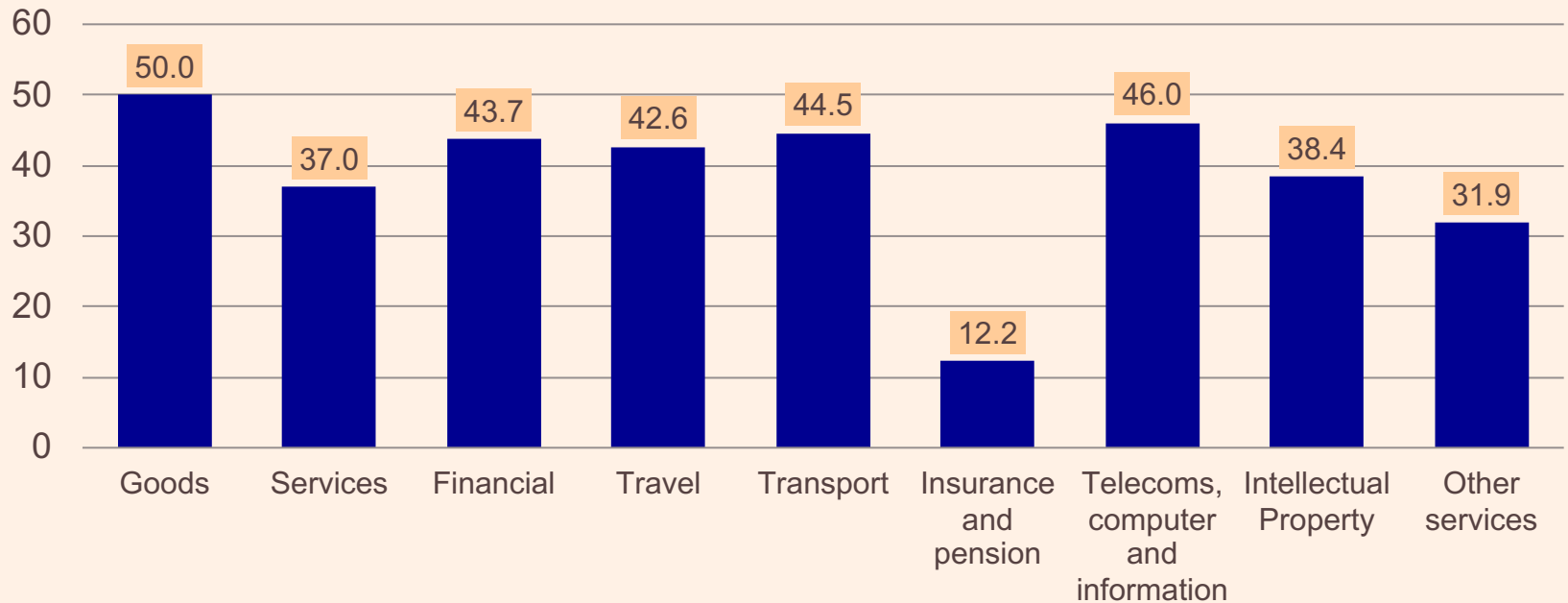
Source: Bank of England

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2. Economic Relations

SCALE AND DIRECTION OF UK EXPORTS

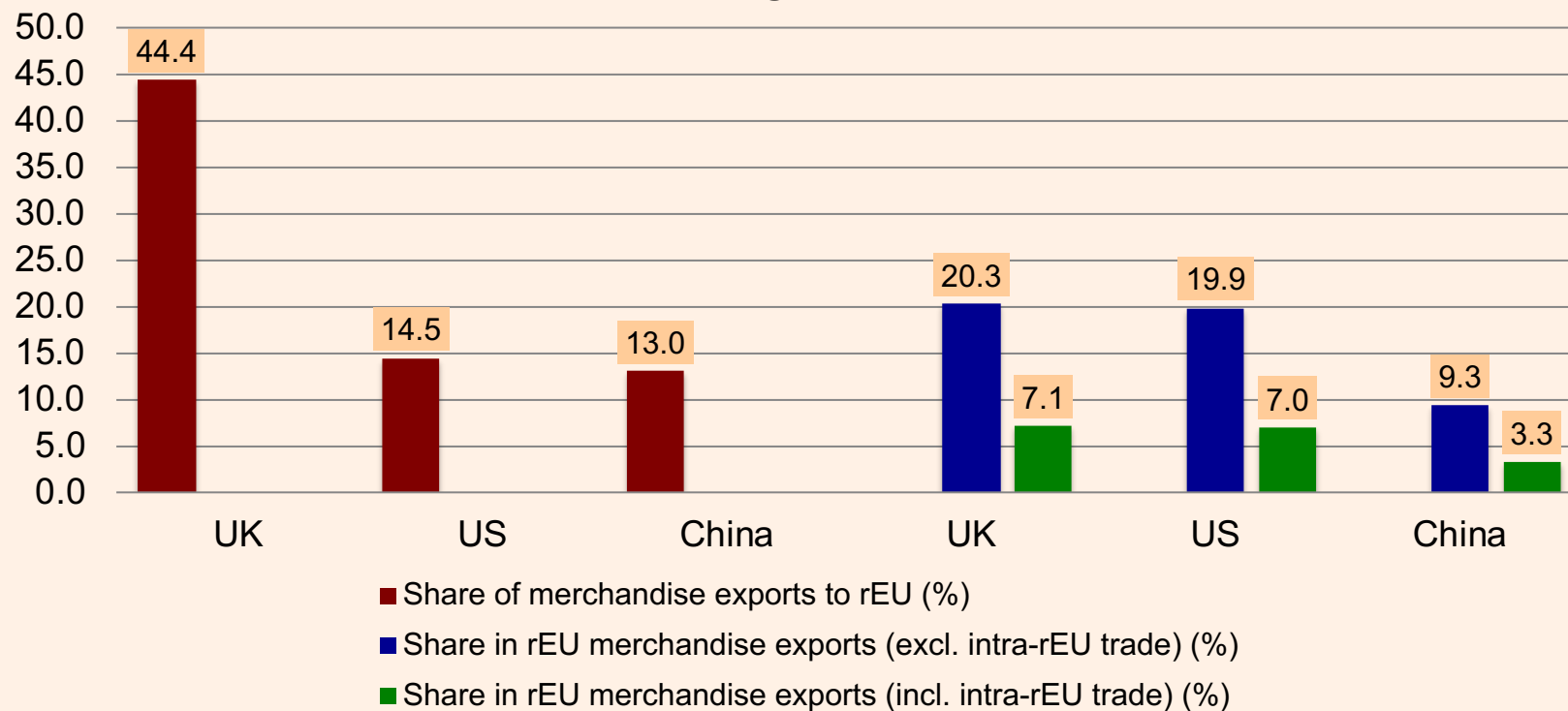
PER CENT OF CATEGORY'S EXPORTS TO EU, 2014
(Source: UK Trade Policy Observatory)



2. Economic relations

IMPORTANT TO BOTH SIDES, BUT UNBALANCED

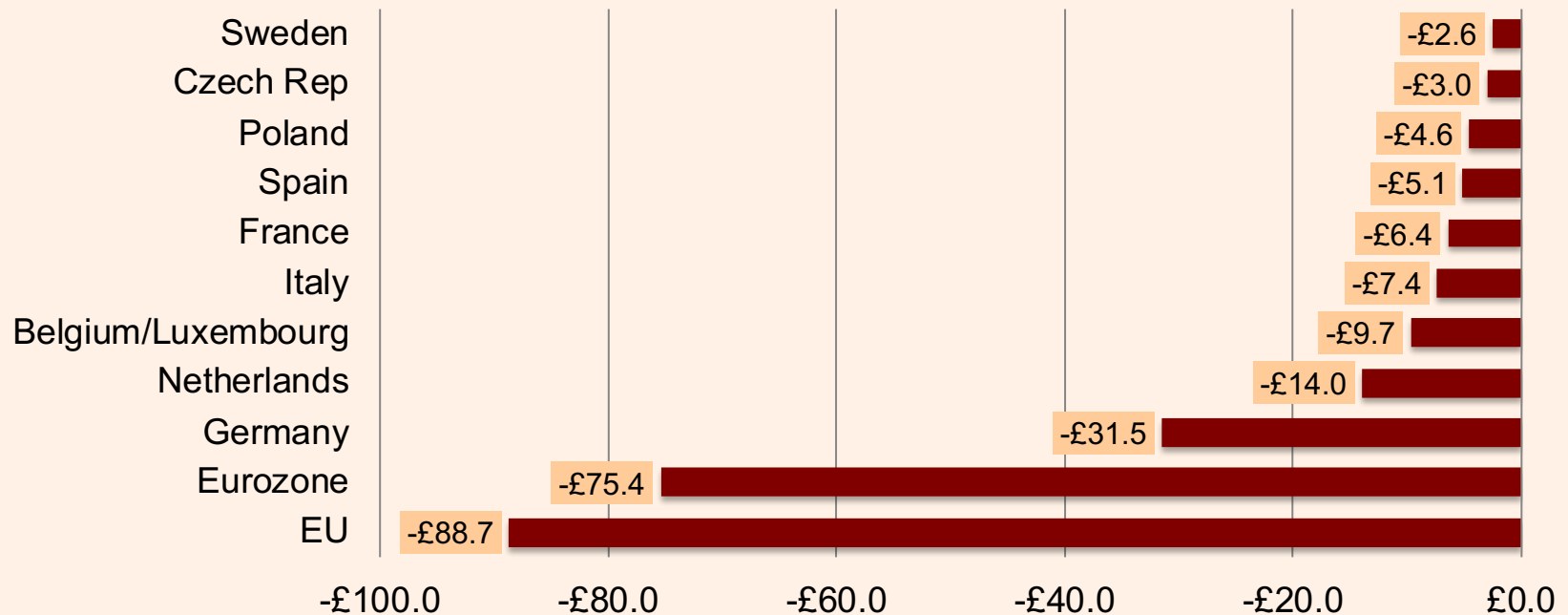
IMPORTANCE OF THE UK AND REST OF EU TO ONE ANOTHER



2. Economic relations

A FEW EU MEMBERS HAVE A LOT TO LOSE

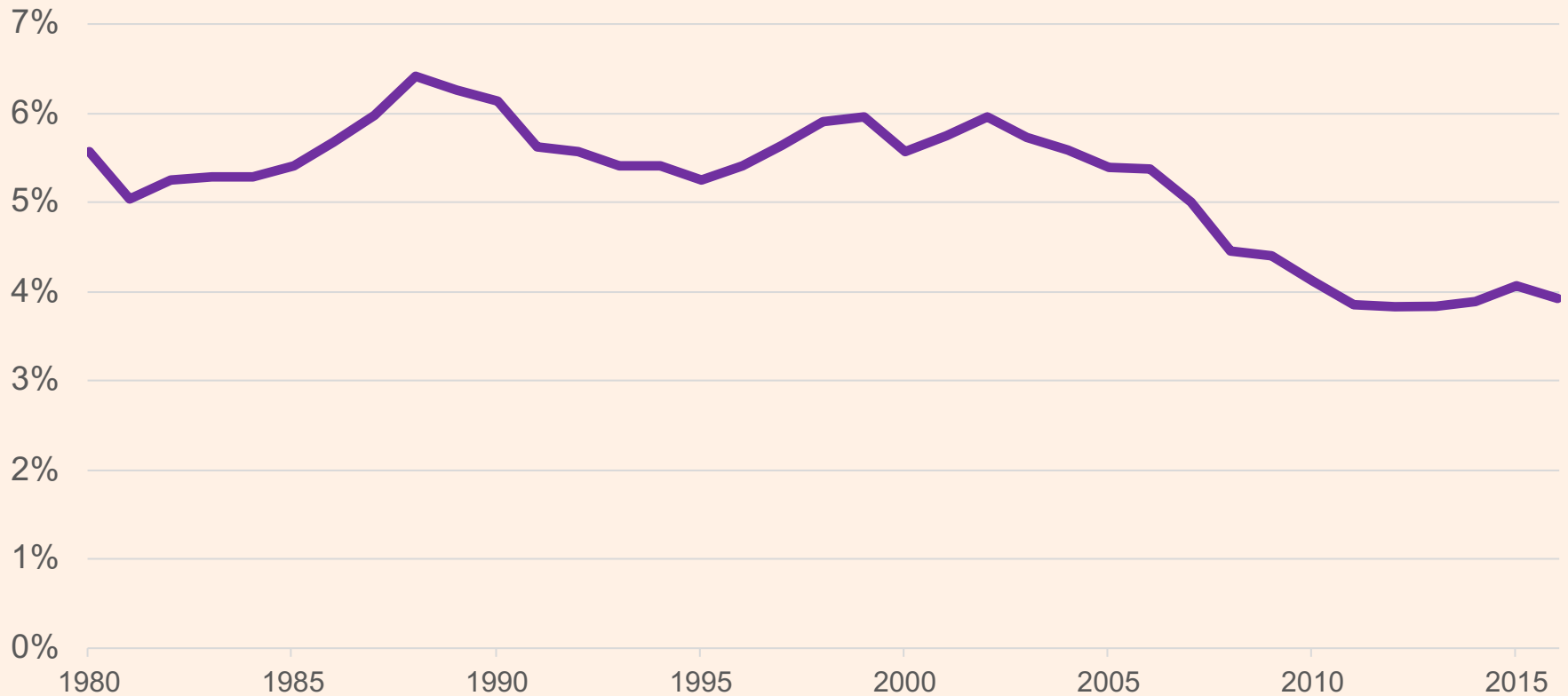
UK DEFICITS WITH THE EU IN GOODS (£bn, 2015)



2. Economic relations

UK'S DECLINING IMPORTANCE IN WORLD TRADE

UK SHARE IN WORLD IMPORTS OF GOODS AND SERVICES



2. Economic relations

- The UK is far more dependent on the EU than the other way around, even though the UK is a very important trading partner for the EU. This is true in both goods and services.
- Distance matters in modern trade: trade between two countries approximately halves as the distance between them doubles.
- This is the main reason why the UK is as important a trading partner to the rest of the EU as the US and more important than China.
- The UK is a declining power and cannot hope to drive multilateral trade negotiations.
- No other trade deals could replace trade with the EU, especially as it has proved so hard to liberalise trade in services in other negotiations.

3. State of negotiations

- The negotiations have had three main components:

- The divorce: money; people; and Ireland

- Post-March 2019 transition: customs union; single market; and movement of people

- Post-Brexit long-term arrangement

- Obstacles to reaching a deal:

- The EU is a ponderous negotiator, with many other priorities.

- The prime minister triggered Article 50 before any agreement had been reached in the government on what it actually wanted. This was foolish.

- The UK government is considering the end state only now - 11 months after the exit process was triggered.

3. State of negotiations

- The UK has spent most of this time negotiating with itself:
 - This is because there was and is no agreement on what the vote for “Leave” means. This issue divides the Tory party (and the Labour party).
 - The UK’s Brexiters regard compromises as treason and want to blame failure on the EU’s unreasonable approach.
- The EU, however, knows what it wants and is going to get it: so there will be no having and eating of cake. (Thank you, Boris!)
- The divorce was (provisionally) agreed in December 2017, because the UK government recognised reality after months of delay.
- Very complex negotiations lie ahead, with little time left.

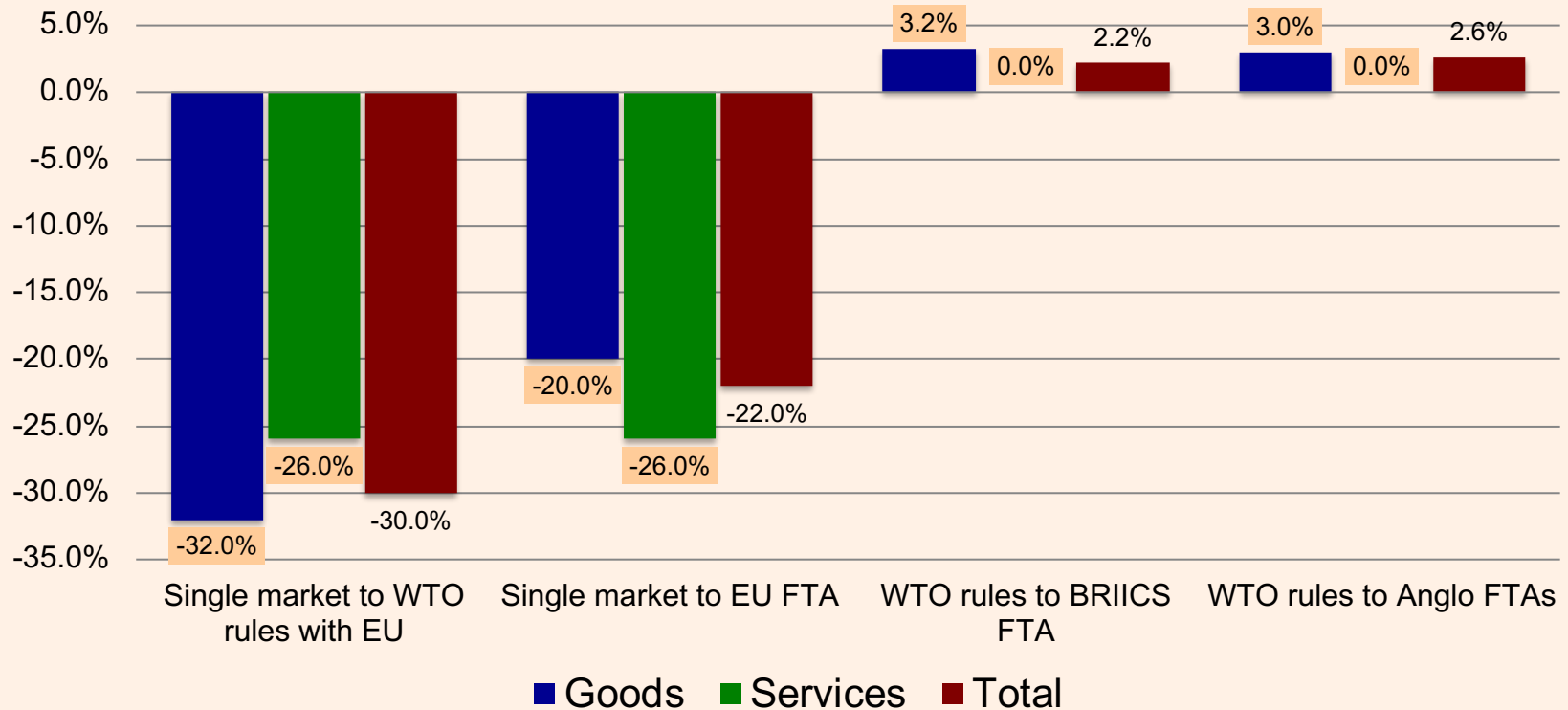
3. State of negotiations

- Here are some possible outcomes (with probabilities):
 - A transition that includes membership of the customs union and single market: 70 per cent likely.
 - Followed by a Canadian FTA, plus something more: 35 per cent likely. BUT this wouldn't solve Ireland.
 - Followed by a Canadian FTA for Great Britain, plus customs union in Ireland (Irish sea customs border): 10 per cent likely.
 - Followed by a customs union agreement, but not the single market. 10 per cent likely.
 - Followed by Norway (including free movement), plus a customs union agreement, 10 per cent.
 - Followed by a "permanent transition" – customs union and single market forever. 5 per cent.
 - No transition and no post-exit agreement. 20 per cent.
 - Reversal of Brexit: 10 per cent. Not clear EU would allow this.
 - In all, the UK either has a painful Brexit or a meaningless Brexit.

4. Economic outcomes

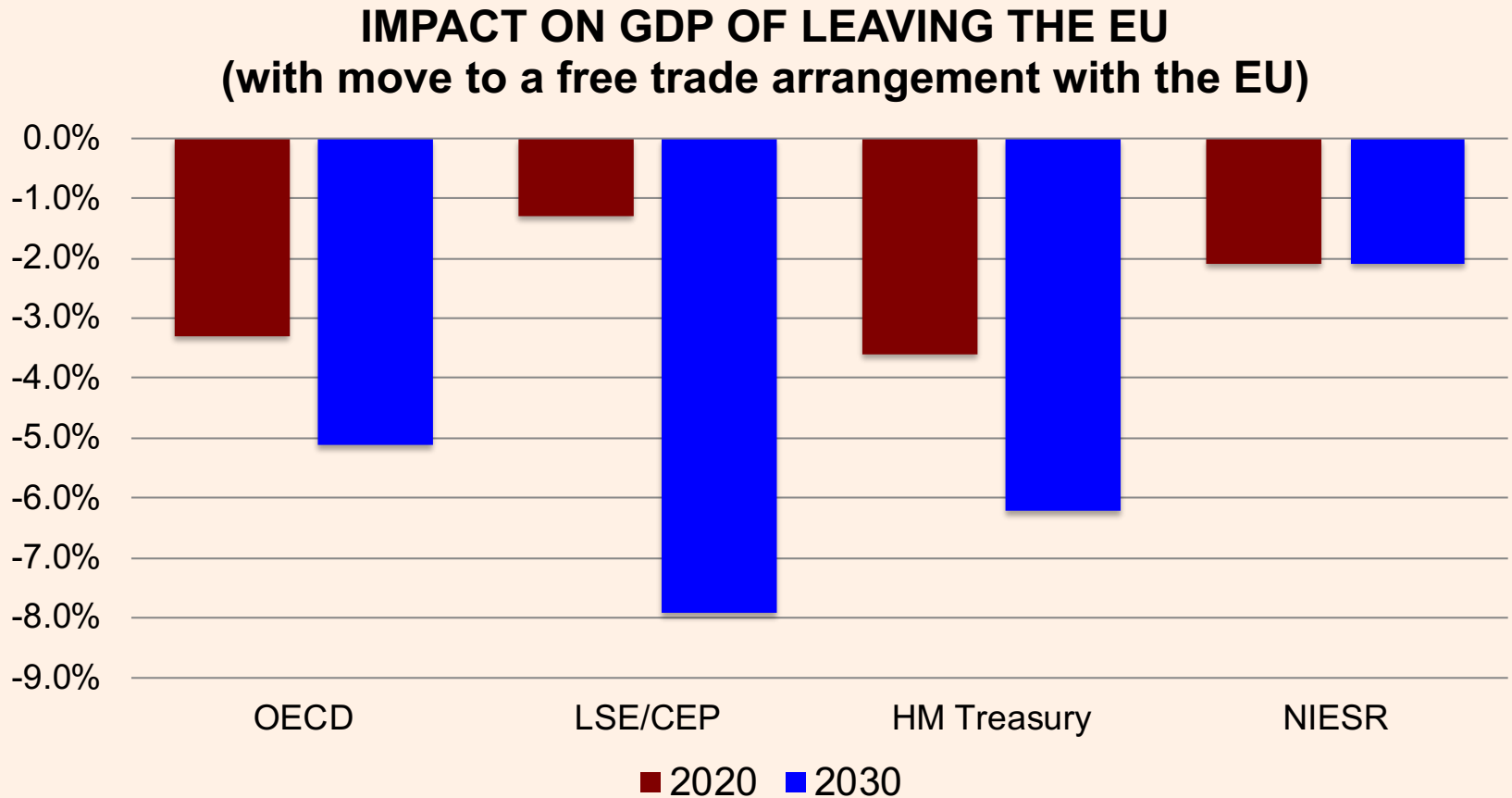
IMPACT ON TRADE OF LEAVING THE EU

CHANGE IN TOTAL UK TRADE AFTER LEAVING EU
(Source: Ebell, NIESR)



4. Economic outcomes

POSSIBLE ECONOMIC COSTS TO THE UK



4. Economic outcomes

- Meanwhile a partially-leaked government report argues that:
 - A no-deal scenario, which would see the UK revert to World Trade Organization rules, would reduce output by 8 per cent over the next 15 years, other things equal.
 - Under a comprehensive free trade agreement with the EU, UK output would be 5 per cent lower over the same period, other things equal.
 - Continued Norway-style single market access through membership of the European Economic Area (ruled out by Prime Minister Theresa May), would in the longer term lower output by 2 per cent.

5. Political outcomes

- Brexit has inevitably destabilised UK politics:
 - It has caused deep divisions inside both main parties.
 - It has undermined the credibility and authority of the Conservatives.
 - It has, almost by default, increased the electability of Jeremy Corbyn.
 - It has destabilised the Good Friday Agreement framework for peace in Ireland.
 - It has altered the dynamics of Scottish independence, by increasing both the likely costs of independence and the potential benefits. This makes any referendum more fraught.
- This is a civil war – a peaceful one, but still a civil war.
- Polls suggest that the country is still very evenly divided. The war rages on. It may take decades to burn out.

6. Conclusion

- It seems almost certain that the UK will leave the EU. It is not impossible to imagine a reversal, but this seems unlikely, particularly given the political salience of the immigration issue
- Given agreement on the "divorce" issues, the most likely outcome will be a standstill transition, plus a free trade agreement on much the same lines as Canada's.
- This would be bad for UK trade and the economy. But a closer relationship, especially on services, would be difficult for both sides: for the EU, because it would probably mean accepting immigration controls; for the UK because it would mean immigration controls and ECJ supervision.
- A Canada deal would not solve the Irish problem. This looks hard to fix now.

6. Conclusion

- The UK economy is doing well on employment and extremely badly on productivity
- Brexit will make the UK poorer.
- Trade deals with the rest of the world not offset a loss of market access to the EU
- Plausible assumptions for future economic growth (on trend) are somewhere between 1 and 2 per cent a year. This depends mainly on productivity trends
- The UK's political future has become quite uncertain