SYZ WEALTH MANAGEMENT

SPOTLIGHT

June 2016

WHAT TO EXPECT IF "LEAVE" VOTE ON BREXIT WINS?

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"A leave vote would potentially trigger a shock wave in the EU and the Eurozone as a Pandora's box is opened and every election becomes a potential test on EU membership, with possible referendums held in other countries. This would have a negative impact on the Euro and peripheral countries spreads, and elicits likely intervention from the ECB."

A vote to leave the EU in the 23 June referendum will herald a period of increased uncertainty and volatility, not only the UK but for the EU and its future.

Impact on economic growth

In the short term, the UK would likely experience a recession in the second half of 2016, due to heightened uncertainty dampening investment and consumption, possibly reinforced by an initial tough stance from the EU in order to make the "Exit" experience look unattractive to other countries. In the longer term, the UK would potentially experience lower growth due to the smaller weight of its financial sector, less favourable access to the EU market and reduced flows of Foreign Direct Investment.

Impact on FX and rates

We foresee a sharp decline in the value of sterling, as foreign direct investment (FDI) flows wane as a result of uncertainties surrounding the outcome of negotiations, foreign owned capital is withdrawn from the UK and British economic agents "fly to safety", probably toward the USD. The impact on long-term government rates is unclear. At present we see upward pressures from a rising risk premium, the possible loss of the UK's AAA status (rating agencies have already warned of the possibility of a downgrade), foreign selling of UK Treasury bonds and higher inflation expectations fuelled by a drop in the currency. We also see downward pressure as "safe heaven" status and GDP decline, and an easing in monetary policy.

Impact on inflation

We foresee a rise in UK inflation, with prices of imported goods rising as a result of a weaker currency.

Impact on monetary policy

A decision to leave the EU would likely lead to an easing in the Bank of England's monetary policy through rate cuts and quantitative easing. The scope and magnitude would likely depend on the balance between the negative impact on growth (pleading for easing) and a weakening in sterling (that may limit the BoE's ability to ease too much).

Impact on Rest of the World

Once the train is set in motion, it is not unreasonable to entertain a possible breakup of the United Kingdom as Scotland asks for a new referendum to leave the UK and join the EU, followed perhaps by Wales and Northern Ireland. The regional split of Brexit votes will give hints as to the likelihood of this potential development. What is clear is that a leave outcome from the referendum will send a shock wave through the EU and the Eurozone as a Pandora's box is opened. We envisage that other forthcoming European elections could become potential tests on European membership: the Spanish general elections on 26th June; the Italian referendum on Senate reform in October, which is de facto a plebiscite on the Renzi government; the French general elections in Spring 2017, German federal elections in the second half of 2017 and others. We also expect that the Netherlands and Scandinavian countries could potentially hold referendums on EU membership. A leave vote would put the risk of Eurozone breakup back in the headlines, which would be negative for the EUR and peripheral country spreads, and would likely elicit ECB intervention.

Quantified economic impact (peak over two years) of leaving the EU according to UK Treasury

Immediate impact of a vote to leave the EU on the UK (% difference from base level unless specified otherwise)

	Shock scenario[a]	Severe shock scenario[a]
GDP	-3.6%	-6.0%
CPI inflation rate (percentage points)	+2.3	+2.7
Unemployment rate (percentage points)	+1.6	+2.4
Unemployment (level)	+520,000	+820,000
Average real wages	-2.8%	-4.0%
House prices	-10%	-18%
Sterling exchange rate index	-12%	-15%
Public sector net borrowing (£ billion)[b]	+£24 billion	+£39 billion

[a] Peak impact over two years. Unemployment level rounded to the nearest 10,000. [b] Fiscal year 2017-18.

Source: HM Treasury