

Monday, 20 June 2016

'Brexit': More Turbulent Times Ahead?

Why Are they Doing it?

The referendum was the promise of UK prime minister David Cameron if he won the 2015 general election. Ultimately, the referendum is in response to growing resentment regarding the European Union (EU).

What Will Happen if they Choose to Leave?

In terms of the relationship between the UK and the EU, not much should change technically in the immediate aftermath. It will likely take a minimum of two years to negotiate the terms of an exit. It took Greenland three years to negotiate their withdrawal from the European Union when they voted to leave in 1982, and a British deal with the EU would be far more complex. In the meantime, there will be uncertainty regarding laws, rights of UK and EU citizens and business operations within the UK and the rest of the European Union.

What will be the Economic Impact?

Some studies have attempted to quantify the economic effects of Brexit resulting in a wide range of estimates on the impact on incomes. This uncertainty stems from the fact that no one knows what new relationship the UK will have with the European Union and the rest of the world. There are other non-EU countries such as Norway and Switzerland which have access to the single market, but they still need to accept EU rules and regulations, contribute to the EU budget and accept free movement of people. In or out, the EU is still a major trading partner of the UK. If access to the EU single market is restricted, it would more than likely result in lower trade, lower foreign investment and probably slower population growth. It is possible that the UK could establish trade deals on their own, such as with Australia, but that would likely take many years to negotiate. Nonetheless, it's important not to overstate the negative trade impacts. The UK will still trade with the rest of the world, without trade agreements, just at a relatively higher cost.

The Impact on Financial Markets?

There is no doubt that the immediate impact on confidence and financial markets would be negative which would weigh on economic activity. We would expect in the aftermath of a leave vote a drop in the pound sterling and a lift in risk aversion leading to a drop in share markets. The Australian dollar would also likely weaken. A loss in confidence and heightened uncertainty would also likely limit spending and investment across the world.

The biggest danger would be what it means for the rest of Europe and the European Union. There is a risk that other countries may follow suit and hold their own referendums on the EU, particularly in nations where eurosceptic sentiment has been on the rise. This would raise the question of the viability of the European Union and this would in turn, negatively impact the UK, Europe and the global economy.

Janu Chan, Senior Economist
Ph: 02-8253-0898

Contact Listing

Chief Economist

Hans Kunnen

kunnenh@bankofmelbourne.com.au

(02) 8254 8322

Senior Economist

Josephine Horton

hortonj@bankofmelbourne.com.au

(02) 8253 6696

Senior Economist

Janu Chan

chanj@bankofmelbourne.com.au

(02) 8253 0898

The Detail

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