UK households are already suffering the consequences of the vote. The worst may be yet to come

UK households are already suffering the consequences of the vote (close to one week’s wages), and macroeconomic indicators are not looking good. It has become harder to look on the bright side of Brexit, writes Elsa Leromain (LSE). To minimise the economic costs of Brexit the UK should remain in the Single Market and the Customs Union, she argues.

An informal but important meeting was held on 21 September in Salzburg between the EU leaders and the British Prime Minister, Theresa May. Time is running out and it seems that the UK is still far from agreeing a deal. The Chequers proposal was clearly rejected by EU leaders. Donald Tusk, the President of the European Council, gave the UK four weeks to revise its position to reach an agreement. These are decisive weeks for Brexit negotiations and the future of the United Kingdom.

While the UK government presents the choice as a binary one – Chequers or no deal – heads of leading economic institutions have already expressed their concerns regarding the no-deal exit. Mark Carney, the Bank of England governor, has warned May’s cabinet that a no-deal Brexit could lead to economic chaos, including a drop in housing prices, a rise in inflation and unemployment. On September 17 Christine Lagarde, director of the IMF, warned that the UK economy would start to contract rapidly in the event of a disruptive exit from the EU.

The referendum vote per se was an important shock to the UK economy. It did lead to an immediate change in expectations about the future of the UK’s economic relationships with other countries. And since economic behaviour depends on both the current state of the world and expectations about the future, the referendum had immediate consequences for the UK economy. Most obviously, between 23 and 27 June 2016, sterling depreciated by 11% against the US dollar and 8% against the euro, and in August 2016, the Bank of England loosened monetary policy through a 25 basis point interest rate cut and renewed quantitative easing. The depreciation of sterling has increased the cost of imports into the UK and made UK exports to other countries cheaper.

A conference was held at the CEP on 19 September, gathering economists who have been analysing the impact of the vote on the UK economy along various dimensions: GDP, trade, bond premium, inflation, and workers training, among others. All of the studies presented seem to point out that the vote is already having significant consequences on these important economic outcomes.

LSE Brexit: UK households are already suffering the consequences of the vote. The worst may be yet to come

Date originally posted: 2018-09-24
Blog homepage: http://blogs.lse.ac.uk/brexit/
Macroeconomic indicators are not looking good. Forward-looking households and businesses have lowered spending in response to the Brexit vote, causing a loss in UK GDP close to 2 per cent. Roughly speaking this equals to a £36 billion loss in output. Gernot Mueller emphasized that this loss was almost entirely explained by economic policy uncertainty and agents’ expectations.

While one could have expected exporters to benefit from the depreciation of the pound, they seem to have been negatively affected by the vote. Meredith Crowley established strong evidence that 5200 firms did not enter into exporting new products to the EU, whilst almost 4000 firms exited from exporting products to the EU in the year following the referendum. Entry in 2016 would have been 5.1 per cent higher and exit 4.3 per cent lower if firms exporting from the UK to the EU had not faced an increase in trade policy uncertainty.

UK households are already suffering the consequences of the vote. In our recent paper, we find robust evidence that the Brexit vote has reduced household living standards by increasing the cost of living. The vote led to a 1.7 percentage point increase in inflation in the year following the referendum. This means that by June 2017, the Brexit vote was costing the average household £7.74 per week, or £404 per year, through higher prices. We find no evidence that the vote has affected nominal wage growth, hence inflation has also led to lower real wage growth. Our estimates imply that higher inflation due to the referendum has cost the average worker close to one week’s wages.

Our colleagues at the CEP, Rui Costa, Swati Dhingra and Stephen Machin, are focusing on the impact of Brexit on workers. Workers in the UK have experienced a reduction in training opportunities as a result of the referendum and increasing input costs. While workers are already bearing the costs of the vote, they are likely to suffer going forward, especially when it comes to employment protection. Outside the jurisdiction of the European Court of Justice EU laws are no longer binding, hence the UK will not be limited by EU rules and regulations.

Two years after the referendum, the UK economy is already bearing the cost of the vote, and this is unlikely to get better whatever the outcome of the current negotiations. Nonetheless, pre-referendum analysis showed that the costs would depend on the path chosen. To minimise economic costs the UK should remain in the Single Market and the Customs Union. Theresa May made it pretty clear that this is not what she wants for the future of her country. Determinant pending issues remain unanswered, namely the Northern-Irish border, migration policy towards EU migrants, and services deal. It has become harder to “look on the bright side of life”.

This post represents the views of the author and not those of the LSE Brexit blog nor of the LSE.

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