SCB Economic Intelligence Center

Flash by EIC

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Impact of Brexit on the world economy

Event

- British Prime Minister David Cameron set the date of June 23 this year for a referendum to decide whether the United Kingdom (UK) will stay with the European Union (EU), setting stage for a potential Brexit (British Exit). The announcement came after Cameron completed a negotiation with other EU leaders on the EU membership of the UK on February, 19. The deal secures the UK special status in the EU that includes the continued use of pound sterling and the right to deny further integration such as political integration. It also unlocks the condition regarding benefits for migrant workers, easing the UK's burden from the influx of refugees. This issue is considered one of the factors pressuring the UK to leave the EU.

Analysis

- **The risk of the UK leaving the EU increases financial market volatility in the short term, but remains much less severe than the case of Greece.** After the announcement of the referendum date, the British pound weakened 2.3% against the US dollar, lowest in 7 years. The UK government bond yields however did not change. EIC views these movements as short-term volatility with a predetermined timeline. If the UK chooses to stay with the EU in June, the outcome will reaffirm its status as an EU member. However, in the case of an exit outcome, the Lisbon Treaty (2009) specifies that once the member state notifies the European Council of its intention to exit, it will take at least 2 years before the membership ends. This time lag allows for both sides to formulate a transition plan as well as negotiate for new deals. Note that the case of Brexit differs greatly from the Grexit risk in 2015. In the case of Greece, the main cause was the possibility of Greece defaulting on its debt, while Brexit is not related to financial problems.

- **EIC maintains that the possibility of Brexit is low due to large potential negative consequences.** At present, opinion polls suggest that "in" votes are leading "out" votes at 43% to 40% (17% are undecided). The votes to exit have been gathering momentum since mid-2015 partly due to the migration problem in Europe and the pressure on EU members to share refugee burden. Other factors that support the UK to leave the EU include the fiscal burden to prop up weaker economies within the EU and restrictions on some political issues. However, EIC views that the outcome of the referendum is likely for the UK to stay. The newly negotiated deal helps ease concerns over burden from migrant workers and reduce also pressure for further integration. Although an influential politician like Boris Johnson, Mayor of London, has joined the Brexit campaign, the exit could prompt another referendum in Scotland whether to split from the UK as most Scots prefer to stay with the EU. Past episodes show that most English do not want Scotland to depart from the UK. Moreover, recent volatility in the economy in response to the possibility of Brexit could sway the undecided group towards staying votes more.

- **The case of Brexit will hurt both the UK and the Eurozone economies especially through the uncertainty over trade and labor movement agreements.** The UK exit from the EU could hurt trade between the two sides, as their trade flow accounts for a third of all international trade from the UK. This is because the uncertainty on whether they will be able to renegotiate to maintain the "single market" condition. For the UK, trade agreements with other counties that it has signed as a member of the EU could be in jeopardize; this includes free-trade agreements with Switzerland, South Korea, and some Scandinavian countries. Furthermore, the end of free labor movement may prompt multinational corporations to relocate their headquarters away from London, the current financial hub of Europe. HSBC, a large international bank, has recently threatened to move its investment banking office to Paris in the case of Brexit. Additionally, Fitch Ratings and Moody's, international credit rating agencies, have warned of lowering the UK's rating, which would affect its financial market significantly. These aforementioned factors could put both the UK and the EU economies into recession.

Implication

- **The UK referendum adds uncertainty to the global economy on top of existing fragility.** The weakening of the euro and pound from the increasing Brexit possibility reveals market concerns over negative consequences on both economies. EIC assesses that recent developments reflect short-term market panic rather than fundamental changes. A correction should occur as the panic subsides. Despite being short-term, the increase in market volatility could hurt business sentiment in terms of economic prospect and investment, adding pressure to the recovery of the overall European economies. Therefore, the likelihood of the ECB expanding its QE program in March has increased.

- **Impact on the Thai baht and export remains limited.** Thai exports to the UK are about 2% of total Thai exports. Therefore, the short-term direct effect on trade is limited. Also, the effect of the Brexit risk on THB/USD is small. Nonetheless, the referendum remains on a list to be closely monitored. The unlikely event of Brexit could put the EU and UK economies in recession. This could have a strong consequence on Thailand's export sector because combined exports from Thailand to the EU and the UK account for 12% of total exports. Additionally, the ongoing free trade negotiation between Thailand and the EU (currently suspended since mid-2014) will not cover the UK and will require a separate talk.

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