Economic Alert iQ

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United Kingdom
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Bank of England's Report on Brexit

In June 2018, the House of Commons Treasury Committee requested the Bank of England (BoE) to publish an analysis of how Brexit will impact its ability to fulfil its objectives for monetary and financial stability. In conducting the analysis, several assumptions had to be made as persisting uncertainties made it difficult to derive the economic impact of two main Brexit scenarios (scenario 1. "Economic Partnership under the Withdrawal Agreement and Political Declaration," scenario 2. "No deal no transition").

Findings

- The pound's value fell sharply after the 2016 referendum and depreciated by 18% prior to the referendum. Inflation increased consequently and household income declined as a result. GDP in Q3 2018 was 1% lower than the Monetary Policy Committee (MPC) projected in May 2016.
- The UK economy will continue to be influenced by growth in the world economy and in particular, conditions in global financial markets will influence the local markets.
- The BoE will increase the Bank Rate by 1.5% in the disruptive scenario and 4% in the disorderly scenario, on average during the next 1-3 years to stabilise inflation and the value of the pound.

Table 1. Summary of overall results (2023)

Economic Indicator	Economic Partnership		No Deal No Transition	
	Close	**Less Close**	**Disruptive**	**Disorderly**
Real GDP Growth (%)	1.75%	-0.75%	-3%	-8%
Unemployment	3.75%	4.25%	5.75%	7.5%
Inflation	2.1%	2.3%	4.25%	6.5%
House Prices			-14%	-30%
Commercial Property Price			-27%	-48%

Source: Bank of England, First Citizens Research and Analytics

Key Assumptions

- The United Kingdom's (UK) access to European Union (EU) markets will decline as trade barriers will be established upon withdrawal from the customs union. Tariffs will be implemented if no Withdrawal Agreement is signed but can remain unchanged provided it is signed. Non-tariff barriers will be introduced including customs checks and regulatory barriers and product standards that will involve checks reducing transportation times.
- New trade deals, which usually take years to be negotiated between countries, will have to be implemented if the EU denies the UK access to export goods and services to third countries under the EU's negotiated trade deals.
- The UK's preparedness for withdrawal can have an effect on economic activity as resources may need to be shifted away from areas that export to the EU to those that import goods from the EU. The shift of resources and jobs may take a considerable amount of time to complete and will impede the country's ability to respond quickly to the withdrawal.

- Automatic fiscal stabilisers will continue to be effective during the withdrawal and changes in spending and tax policies will not change. Monetary policy will continue to balance variations in inflation from the target and output relative to potential.
- Net migration is assumed to decline in 2021 to around 100,000 annually keeping in line with the upper bound of the Government's migration policy.

Economic Partnership

- Two scenarios have been put forward by the BoE which are 'Close Economic Partnership' and 'Less Close Economic Partnership.'
- Assumptions include:
    - Trade barriers will be minimised for goods but increased for services; trade agreements for free trade in goods will be retained; non-financial services regulatory trade barriers with the EU will increase; equivalence will be implemented in the financial services sector; trade barriers will be applied symmetrically in both cases; new independent deals with other countries will not be implemented.
    - Uncertainty will decline as an agreement is forged.
    - Net migration will decline to 100,000 annually over the course of 2021 keeping in line with the Government's current policy.
    - The transition period until the end of 2020 is assumed to be sufficient for all sectors to prepare for new trading arrangements and the period will not be extended.
    - Fiscal stabilisers will operate and no changes in spending or tax policies will be introduced. Monetary policy will be accommodative for deviations in inflation but interest rates will rise in both scenarios.

No Deal, No Transition

- There are two scenarios under this situation labelled 'Disruptive' and 'Disorderly' under which the overall impacts on economic activity are assessed.

- Assumptions include:
    - Tariffs and other barriers to trade will be introduced abruptly from Q2 2019 and onward. The UK will apply duty rates to imports from the EU, customs checks will be implemented that can raise the cost of trade and trade in services will be based on World Trade Organisation (WTO) terms.
    - The EU will not accept the product standards set forth by the UK but the UK will accept those of the EU.
    - No new trade deals will be implemented within a five year period.
    - There will be expectations of lower future incomes and job losses which will lower consumer spending and business investment.
    - Financial conditions will tighten due to expected economic downturns making credit conditions worsen and government bond yields are expected to rise due to lower output and higher economic uncertainty.

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