

ARTICLE – The result of the United Kingdom referendum on the EU creates uncertainty

On 23 June, the British people voted to leave the European Union. The result of the referendum entails major political challenges, both for the United Kingdom and for the EU, and there have been strong reactions on the financial markets. It is difficult to assess what the consequences for future economic developments will be. The Riksbank's assessment is that the result of the referendum and the increased uncertainty primarily entail negative effects for growth in the United Kingdom and that the consequences for other countries will be limited. However, there is considerable uncertainty, and the forecasts may be adjusted further as more information becomes available.

UK referendum creates uncertainty

On 23 June, people in the United Kingdom voted to leave the European Union, EU. Prime Minister David Cameron immediately announced his resignation and at the same time left it to his successor to decide when the country should formally announce its intention to withdraw from the EU. When this happens, there will be complicated negotiations between the United Kingdom and the EU and the withdrawal shall then occur within two years, unless there is a mutual decision to extend the time limit.

The result of the referendum has created considerable uncertainty. The timetable for the withdrawal will not be clear for some time yet. In addition, the country's new government needs to deal with a number of difficult issues. A clear majority of people in Scotland voted to remain within the EU and this means that the question of independence has risen again.

The reactions on the financial markets have so far been marked by a decline in willingness to invest in high-risk assets. There have been major fluctuations on the world's stock exchanges and prices of safe assets, such as government bonds, have risen. Sterling has weakened substantially against other currencies, and the euro has weakened against the dollar and the yen. The increased risk aversion has also led to major fluctuations on the Swedish stock market and lower government bond yields in Sweden. The krona has strengthened against sterling, but weakened against the dollar and the euro, and also in competition-weighted terms. The greater unease has also created expectations of more expansionary monetary policy from central banks around the world. However, the developments have not led to any significant deterioration in the functioning of the financial markets.

How have the Riksbank's forecasts been affected?

It is difficult to assess the consequences of the results of the UK referendum. The Riksbank's assessment is that the result of the referendum and the increased uncertainty primarily entail negative effects for growth in the United Kingdom and that the consequences for other countries will be limited. But as there is so much uncertainty over the effects, the forecasts may be adjusted further as more information becomes available.

Effects on the United Kingdom and other countries

The result of the referendum and the increased unease are expected to lead to companies and households, primarily in the United Kingdom, but also in other countries, becoming more cautious and hesitant. Companies will postpone investments and become more restrictive with regard to new recruitment, while households will reduce their consumption. There will probably also be a reduction in direct and portfolio investments in the United Kingdom. In addition, more stringent financial conditions, such as higher risk premiums and thus higher interest rates and lower credit growth, may dampen demand. The fact that many European banks have low profitability and weak balance sheets to start with is likely to reinforce this effect.

If the United Kingdom leaves the EU, it will mean that the country is no longer a part of the single market. It will then need to renegotiate its trade agreements with the EU countries, and also other countries with which the EU has trade agreements. This is a complicated process, which will take a long time and, depending on how the new agreements are formulated, the effects on the United Kingdom's international trade may be more or less negative.

Prior to the referendum, a number of organisations published analyses of how the United Kingdom's and the

EU countries' economies would be affected if the United Kingdom withdraws from the EU. The effects on the United Kingdom's GDP a few years ahead are in the interval from –1 to –6 per cent and assessed to be on the whole greater than the effects on other EU countries. Table 1:3 shows the effects on GDP in the United Kingdom and the EU area according to two of these studies.²

The Riksbank has revised down its forecast for GDP growth abroad in the coming years as a result of the referendum result and the increased uncertainty. The forecast for United Kingdom GDP is revised down by 2 per cent at the end of the forecast period, while the inflation forecast has been revised upwards, as sterling is expected to weaken. The forecasts for GDP growth in the EU and the rest of the world are also revised down, but on a smaller scale. For the Euro area, the GDP-level is assessed to be 0.5 per cent lower at the end of the forecast period. The assessment also includes the assumption that monetary policy in the United Kingdom and the rest of the world will become more expansionary to counteract the negative effects on the economy.

Table 1:3. Assessed effects on the UK and EU area's GDP levels in different studies

Per cent

	Time	Scenario	United Kingdom	EU excluding United Kingdom
IMF	2019	Favourable	–1.4	–0.2
	2019	Unfavourable	–5.6	–0.5
OECD	2018		–1.3	–1.1

Note. The IMF's effects refer to the Euro area and the figure for the EU excl. United Kingdom in the favourable scenario refers to 2018. The classification of scenarios as favourable or unfavourable depends on the underlying assumptions.

Sources: IMF and OECD

Effects on Sweden

The increased uncertainty dampening growth in the United Kingdom and the rest of Europe will also have a negative effect on Swedish growth, and the GDP forecast for Sweden is revised down, roughly in line with the rest of Europe. Exports to the United Kingdom amounted to around 8 per cent of total Swedish exports last year and in 2014, the United Kingdom's direct investment in Sweden was around 7 per cent of Swedish GDP.

Following the referendum result, the Swedish krona strengthened against sterling, but weakened against the euro and the dollar. All in all, in competition-weighted terms, the krona has weakened and the Riksbank assesses that it will become weaker than was forecast in April during the second half of 2016 and the first half of 2017. This will contribute to dampening the negative effects of

the increased unease on demand and GDP. At the same time, a weaker krona means that prices of goods and services with a high import content will increase at a somewhat faster pace.

The overall effect on inflation is therefore expected to be relatively limited, given the above. However, it is difficult to assess how the uncertainty will affect households and companies and how lasting the effects will be. This is largely dependent on political developments in the wake of the referendum. It is therefore very uncertain how the real economy, inflation and thereby monetary policy in the coming period will be affected. As more information is received, the Riksbank's forecasts may be adjusted further.

² OECD (2016), "The Economic Consequences of Brexit: A Taxing Decision", OECD Policy Paper, April 2016. IMF (2016) and "United Kingdom Selected Issues", Country report no 16/169, IMF.