

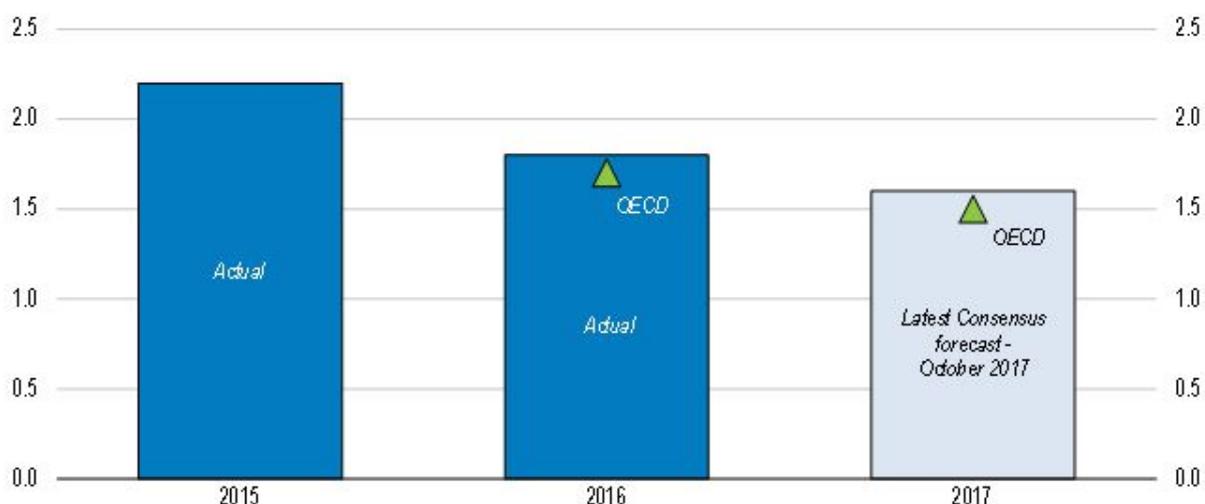
Mitigating the negative economic impact of Brexit

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Ahead of the referendum on Brexit, the OECD had been anticipating a significant decrease in economic growth if the decision to leave the EU were taken (Kierzenkowski et al., 2016). As the UK economy has started to slow down, OECD simulations remain remarkably valid so far (Figure 1).

Figure 1. OECD pre-referendum simulations for GDP growth

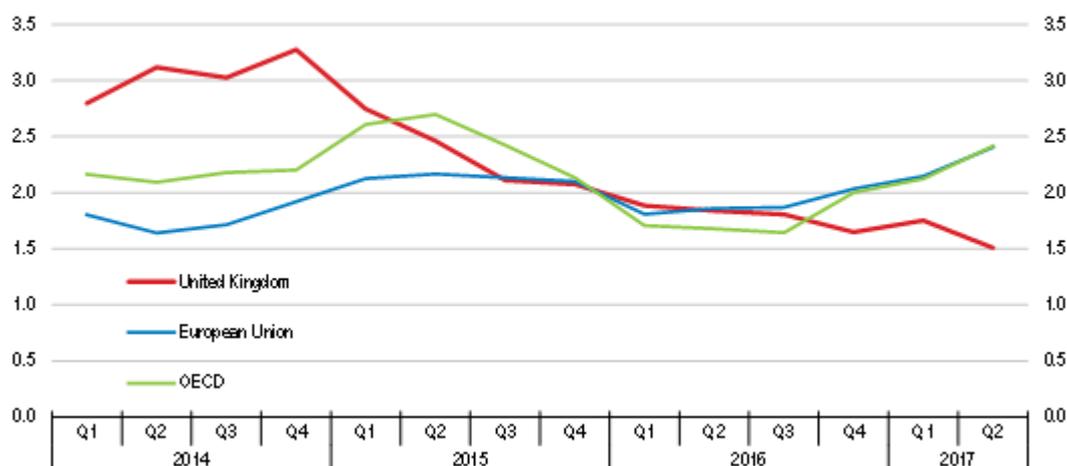
Year-on-year percentage change



Source: OECD and Consensus.

British growth was ahead of G7 economies one year ago, but has now fallen behind as other advanced economies have continued to recover (Figure 2). The recent OECD economic survey on the UK (OECD, 2017) analyses which channels Brexit prospects are currently hurting the economy and what could be done to mitigate this impact.

Figure 2. Real GDP growth
Year-on-year percentage change



Source: OECD (2017), *OECD Economic Outlook: Statistics and Projections* (database), September.

The sterling's depreciation has been a major drag on growth. It has pushed consumer prices up and hurt household consumption by reducing purchasing power. As real incomes have fallen, households have for a while supported their consumption by reducing their savings. However, the saving ratio increased in the second quarter and consumer credit growth may have peaked. Car registrations are subdued since April.

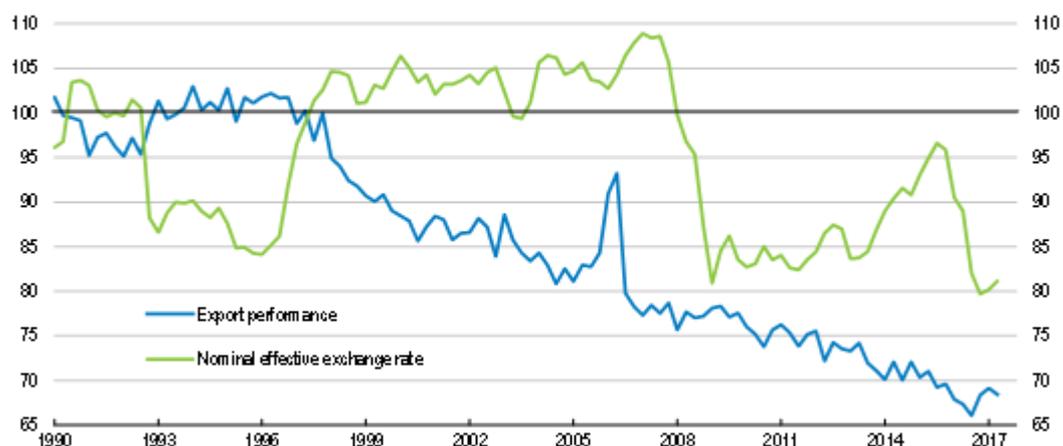
The sterling's depreciation has also cut corporate margins of domestic producers, reducing the ability of non-exporting firms to finance investment. In addition, business investment growth has weakened as economic policy uncertainty is high. Weak demand should also negatively weigh on investment of domestically-oriented firms: this is the second-highest risk cited by around half of businesses, with the effects of Brexit being the top risk for nearly 60% of them (Deloitte, 2017).

The depreciation of the pound should support export-oriented firms, but this might not be sufficient to offset the negative factors mentioned above. History indicates that British exports have had a low responsiveness to exchange rate movements and the UK's export performance has been in fact falling over the last two decades (Figure 3). This could be

due to increased participation in global value chains, implying a high import content in exports, reducing scope for exporters to win market share following currency depreciation. Moreover, exporters who rely less on imports tend to increase their margins following a depreciation, preventing them from gaining market shares.

Figure 3. Export performance and the exchange rate

Index 1990 = 100¹



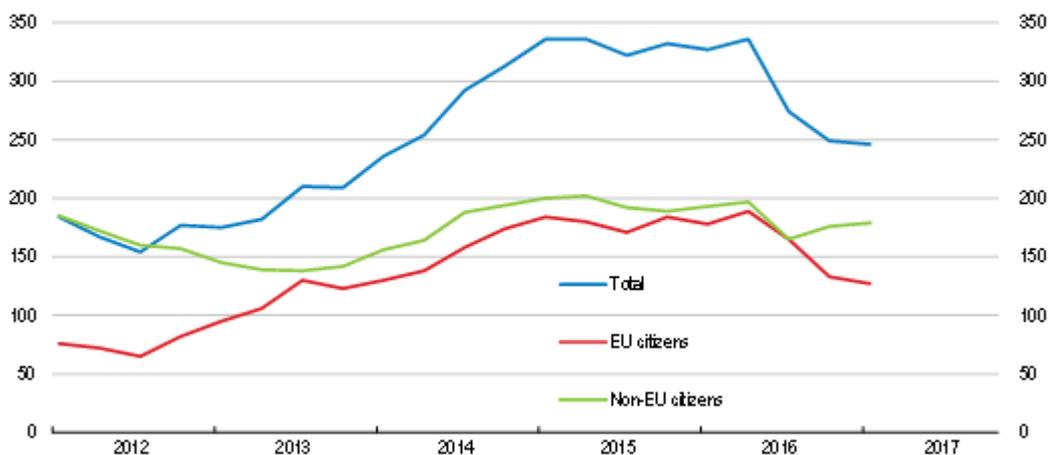
1. Export performance is the ratio of export volumes to export markets for total goods and services.

Source: OECD (2017), OECD Economic Outlook: Statistics and Projections (database), October.

Immigration has enhanced living standards by expanding the labour market and by having a positive impact on labour productivity. Following the EU membership referendum in mid-2016, there has been an important fall in net migration, mainly of EU citizens, explained by increased emigration and reduced immigration (Figure 4). Declines in net migration could tighten the labour market if labour supply falls faster than labour demand. It will significantly reduce growth eventually.

Figure 4. Net migration to the United Kingdom

Rolling annual data, in thousands¹



1. Net migration is the difference between immigration and emigration.

Source: ONS (2017), "Migration Statistics Quarterly Report: August 2017", Office for National Statistics, August.

In this context, the recent OECD economic survey recommends that the UK authorities secure the closest possible economic relationship with the European Union in its future trading arrangement. Rapidly concluding negotiations to guarantee the rights of EU citizens is a priority to sustain labour supply and ensure further progress in living standards. The United Kingdom should adopt simple criteria to deal with EU citizens living and/or working in the United Kingdom, which would minimise administrative burdens and avoid that some categories of EU citizens fall into the cracks, such as cross-border workers. The government should also identify in advance productivity-enhancing fiscal initiatives on investment that can be implemented swiftly should growth weaken significantly ahead of Brexit. A detailed evaluation of policies to offset the possible loss of European structural funds to poorer UK regions will also be necessary to avoid exacerbating existing regional economic disparities.

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