

US must pay greater heed of Brexit

UK shock could strike European and global economies

by Desmond Lachman in Washington

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It is tempting for Washington and for markets to dismiss the UK's exit from the European Union as a problem affecting a former imperial power with little relevance to the US and global economies. That would be a grave mistake.

Brexit is casting a dark cloud over the UK, the world's fifth largest economy, at the same time as other major European economies face meaningful difficulties. A deepening of the Brexit crisis has the potential to spill over from the UK to the rest of Europe, and even to reach the US.

The clock is ticking down to the 29 March deadline for Brexit's two-year negotiating period. Prime Minister Theresa May's Brexit deal faltered again in the House of Commons on Tuesday evening. It was rejected by a margin of 149 votes – an improvement over the 230-margin rejection in January, but still a massive defeat. Then, on Wednesday evening, parliament voted by a margin of 321 to 278 to reject a no-deal Brexit. The most probable short-term outcome now seems to be that May will request an extension to the two-year negotiating period, unless she is able somehow to convert enough opponents to her deal by the time she next brings it to the House.

The default position remains a hard Brexit on 29 March, although Wednesday's vote indicates that parliament has the numbers to step in and at least postpone that eventuality. A short extension to negotiations (perhaps until at least June, meaning the UK would participate in European Parliament elections in May), however, would do nothing to resolve Britain's underlying political divisions, and does not preclude the possibility of a still-damaging Brexit once any proposed extension expires.

According to most impartial observers, including the Bank of England, the International Monetary Fund and the Organisation for Economic Co-operation and Development, a no-deal or otherwise disruptive Brexit would deliver a crushing blow to the UK economy and more than probably tip it into recession. The UK's global supply chains would be disrupted, and both domestic and foreign investors would take flight over worries about Britain's diminished access to Europe's single market, which consumes around half of UK exports. Major companies like Honda and Dyson have indicated their intention to relocate some, if not all, of their UK activities abroad to ensure continued smooth access to the single market post-Brexit.

In the two and a half years since the June 2016 Brexit referendum, the UK has gone from being the fastest to being the slowest growing economy in the G7. British politics has fractured and there has been a marked decline in the pound.

Requesting a short extension for further negotiations will only prolong the period of investor uncertainty, to the detriment of the UK economy. It will do little to restore order to UK politics, nor will it eliminate the risk that of British crashing out of Europe at the end of the new term.

A stumbling UK is the last thing that an already challenged European economy needs. The German economy is showing clear signs of sputtering in response to a slowing of the Chinese economy and fears of US tariffs on Europe's automobile exports. Meanwhile, the rise of the 'gilets jaunes' is buffeting the French economy.

Worse yet, a highly indebted Italy has again slipped into recession for the third time in the past decade. Investor confidence is undermined by its populist government's seeming disregard of the need for disciplined budget policies. This raises the risk that a further European economic setback could trigger another and more painful round of the European sovereign debt crisis in a country around 10 times the size of Greece.

At a time of considerable global financial market fragility, it would be in the US economic interest to promote a healthy UK and European economy. Hopefully the administration in Washington will remain alert to the risks to the US and global economies associated with a hard Brexit, and do whatever it can to help prevent such an eventuality.

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