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Economic Implications of a United Kingdom Exit from the European Union

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Summary

This report provides an analysis of the possible economic implications for the United States and the global economy of an exit from the European Union (EU) by the United Kingdom (UK), commonly referred to as Brexit. It offers background information on possible implications of the vote to leave the EU, an overview of U.S.-UK trade and investment relations, and various estimates of Brexit's financial implications for the U.S. and global economies. For Members of Congress, economic fallout from Brexit could increase the risks of a slower rate of economic growth and potentially complicate economic policymaking. Brexit also could have implications for congressional oversight of U.S. trade policy, including ongoing U.S.-EU negotiations on a Transatlantic Trade and Investment Partnership (T-TIP) free trade agreement (FTA). Since the Brexit vote, resolutions have been introduced in the House and Senate supporting the negotiation of a U.S.-UK FTA. (See S. 3123 (Lee), S.Res. 520 (Rubio), H.Res. 817 (Dent), and concurrent resolutions H.Con.Res. 146 (Brady) and S.Con.Res. 47 (Hatch).)

Factors that could shape the possible impact of a UK exit from the EU include the following.

- There is no precedent for a country withdrawing from the EU, so there is a high degree of uncertainty about how a separation might work.
- The vote does not force the UK out of the EU immediately. Negotiating the UK's withdrawal and future relationship with the EU could take years to complete.
- NATO remains the preeminent transatlantic security institution, and the UK will remain a leading member of NATO, but Brexit may affect Euro-Atlantic cooperation and unity on a range of security issues.
- Various studies project that Brexit would lower UK GDP between -1.3% and -5.5% per year in the short run (2020) and between -1.2% and -7.5% per year over the long run (2030). Estimates of the yearly income loss per UK household are at between -£600 (about $900) and -£5,200 (about $7,500).
- Immediately following the Brexit vote, global financial markets reacted sharply: the pound depreciated by more than 10% at one point, reaching its lowest level in more than 30 years; the dollar appreciated against major currencies; and the yen and Swiss franc appreciated. Other currencies were mixed as some emerging market currencies depreciated; most major stock indexes and government bond yields were lower. Global financial markets recovered substantially by the end of June, although the pound and stocks of British firms remained lower.

According to some analysts, uncertainties created by Brexit may have a long-term negative impact on global markets, given the tepid pace of the current global economic recovery. A protracted political leadership struggle in the UK also could add to uncertainties over the UK's ability to implement the economic measures that may be necessary to restore stability. To date, various central banks have taken steps to calm financial markets. The depreciation in the pound and simultaneous appreciation in the value of the dollar and other currencies considered to be safe havens could add to the challenges facing some central banks in formulating monetary policy over the near term. Capital flight from emerging economies to safe-haven assets could further add to the economic challenges facing developed and emerging economies and potentially harm global growth prospects.

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Leave Campaign Wins Referendum on EU Membership

Nearly 52% of British voters in the June 23 referendum on European Union (EU) membership answered that the United Kingdom (UK) should leave the EU. Among a complex pattern of supporters and opponents of Brexit, the vote pitted Prime Minister David Cameron, who led the campaign to remain, against many members of his own Conservative Party, including in his Cabinet. Prime Minister Cameron subsequently resigned and Theresa May took over as the UK's new prime minister on July 13, 2016.[1]

The vote was the culmination of a decades-long debate in the UK about the country's EU membership. The UK joined the precursor to the modern EU in 1973, but has long been considered one of the most "euroskeptic" members, having "opted out" of several major elements of European integration, such as the euro currency and the passport-free Schengen Zone.

One of the central arguments made by the Leave campaign was that the EU had steadily eroded the UK's national sovereignty by shifting control over many areas of decisionmaking from Parliament to Brussels. Analysts also attribute the result to the prevalence of concerns about high levels of immigration to the UK, which the Leave campaign linked to the EU requirement for the "free movement of people" among member states. Leave campaigners further argued that EU bureaucracy and regulations held back the UK's economy, and that in the long-term the country would be better off economically outside the EU.

Aftermath and Uncertainty

Although technically the referendum is only advisory for Parliament, the government asserted at the start of the campaign that it "would have a democratic duty to give effect to the electorate's decision" and that it would do so quickly.[2] There is no precedent for a country withdrawing from the EU so a high degree of uncertainty exists about how the separation might work.

The vote does not force the UK out of the EU immediately. Under its treaty framework, a member country may withdraw from the EU by invoking Article 50 of the Treaty on European Union, opening a two-year period in which the two sides would attempt to negotiate a withdrawal agreement.

There is no pre-set timeframe for the notification that begins this process. While some European officials have urged moving quickly in order to limit the uncertainty surrounding Brexit, leading advocates of the Leave campaign have conveyed their view that there is no hurry to initiate the withdrawal process. The main purpose of the withdrawal agreement would be to settle transition arrangements in policy areas, such as the single market, that are covered by the EU treaties. Until the negotiation is concluded, the UK remains a member of the EU and subject to its rules. Details about the future arrangement of the relationship between the UK and the EU are likely to be negotiated as a separate agreement.

Many observers believe that the process of negotiating these agreements could take considerably longer than two years to complete. As expressed prior to the referendum by the UK government

[1] See CRS Insight IN10528, *The Brexit Vote: Political Fallout in the United Kingdom*, by Derek E. Mix.

[2] HM Government, *The Process for Withdrawing from the European Union*, February 2016, p. 7.

itself, "a vote to leave the EU would be the start, not the end, of a process. It could lead to up to a decade or more of uncertainty."[3]

In addition to uncertainties about the process and timeline for withdrawal, analysts have speculated on the possible broader consequences of Brexit. Many economists have expressed concerns that Brexit could cause an economic shock that leaves the UK facing weaker economic growth, higher inflation, job losses and depreciation of the pound (which has already happened), with potentially significant negative consequences for the U.S. and global economies. Advocates of Brexit have maintained that such economic fears are greatly exaggerated.

Meanwhile, observers have noted growing unease among some of the many multinational corporations that have chosen the UK as their EU headquarters, who now face a period of uncertainty about UK's trade and economic arrangements and the corresponding legal and regulatory frameworks.

The regional dimensions of the referendum result have also fueled questions about the future of the UK's political union. The Brexit vote has triggered a renewed push by Scottish leaders for Scotland (where 62% of voters supported remaining in the EU) to separate from the UK. It could also raise questions for Northern Ireland (where nearly 56% voted to remain) about its border arrangements with the Republic of Ireland.

Many observers have concerns that Brexit could prompt a wider unraveling of the EU. At a time of growing skepticism toward the EU in many member countries, the UK's departure could lead to more calls for special membership conditions or referendums on membership in other countries.

What Could Brexit Mean for the United States and the U.S.-UK Relationship?

Many U.S. officials and Members of Congress view the UK as one of the United States' closest and most reliable allies. In terms of broad foreign policy issues, Brexit could have a substantial impact on U.S. interests. With the UK commonly regarded as the strongest U.S. partner in Europe and a partner that usually shares U.S. views, U.S. officials have conveyed concerns that a UK break from the EU would reduce U.S. influence in Europe, weaken the EU's position on free trade (because the UK generally acted as a leading voice for economic liberalism in EU debates about trade and the single market), and make the EU a less reliable partner on security and defense issues (because British participation is widely regarded as essential for efforts to develop more robust EU foreign and defense policies).

Brexit need not cause a dramatic makeover in all aspects of the U.S.-UK relationship, however. NATO remains the preeminent transatlantic security institution, and the UK will remain a leading member of NATO. Despite recent U.S. concerns about the possible effects of cuts to UK defense spending and reductions in the size and capabilities of the British military, U.S. defense planners have long viewed the UK as one of the most capable European allies in terms of well-trained combat forces and the ability to deploy them. Observers also note that the United States and the UK have long tended to have similar outlooks on issues such as the use of force, the development of military capabilities, and the role of NATO. Close cooperation with the UK on NATO issues can be expected to continue, including with regard to the joint deployment of additional forces for the reassurance of Poland and the Baltic States (and the deterrence of Russia), and in operations to combat the Islamic State.

[3] HM Government, *The Process for Withdrawing from the European Union*, February 2016, p. 9.

A 1958 U.S.-UK Mutual Defense Agreement established unique cooperation with regard to nuclear weapons, and the United Kingdom and the United States are also key partners in terms of defense industry cooperation and defense sales. There is no obvious reason why Brexit would change these aspects of the relationship.

Most analysts and officials also agree that U.S.-UK intelligence and counterterrorism cooperation is close, well established, and mutually beneficial. UK agencies routinely cooperate with their U.S. counterparts in sharing information, and U.S. and British law enforcement and intelligence agencies regularly serve as investigative partners. The bilateral intelligence and counterterrorism relationship is likely to continue as an important pillar of the relationship.

At the same time, experts assert that Euro-Atlantic cooperation on a range of security concerns may not be immune to the effects of Brexit. Broadly speaking, some suggest that Brexit undermines the notion of "Western unity" in the face of threats such as terrorism and Russian aggression, weakening the collective ability of the United States and Europe to deal with such threats. Additionally, any wider fracturing of the EU might cause economic disruption and create upheaval in numerous other ways that could pose a serious challenge to U.S. foreign policy.

Impact of Brexit on UK and EU Economies

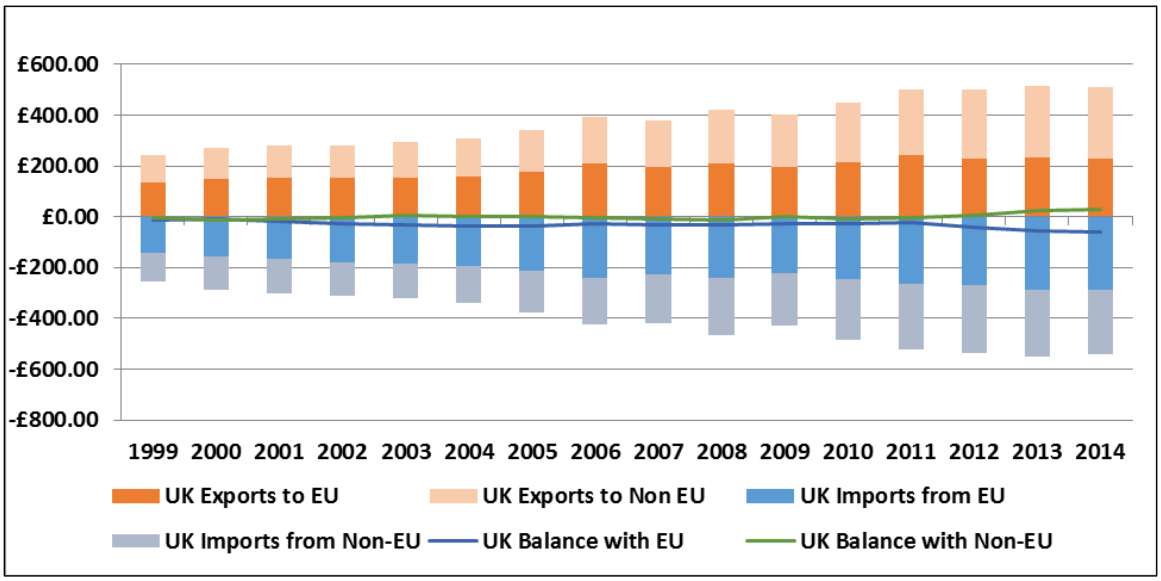
Much of the uncertainty that exists in the aftermath of a vote to leave the UK relates in some way to the UK's trade and economic arrangements and the corresponding legal and regulatory frameworks. Over the past three years, the UK economy has consistently grown in the 2% to 3% range. According to the IMF, the UK economy is slowly regaining performance levels it experienced prior to the 2008-2010 global financial and economic crises.[4] Trade is equivalent to about 60% of the UK economy, in large part due to reduced trade barriers with the EU through the EU's Single Market. The UK is also an important component of the EU economy. With the UK, the EU's GDP is greater than that of all other individual economies, including the United States and China. Without the UK, however, EU GDP would rank behind that of the United States and China. Trade with the EU accounted for 44.6% of the UK's total exports of goods and services and 53.2% of its imports of goods and services in 2014, as indicated in **Figure 1**.[5]

[4] *United Kingdom 2016 Article IV Consultation*, Country Report 16/168, International Monetary Fund, June 2016, p. 5.

[5] See http://webarchive.nationalarchives.gov.uk/20160105160709/http://www.ons.gov.uk/ons/rel/international-transactions/outward-foreign-affiliates-statistics/how-important-is-the-european-union-to-uk-trade-and-investment-/sty-eu.html.

Figure 1. UK Exports and Imports of Goods and Services to EU and non-EU Countries

(in billions of British Pounds)



Source: UK Office for National Statistics.

According to the British Treasury, the Single Market has facilitated the growth and development of a complex web of economic and financial ties between the UK and the EU. These connections have assisted in the growth of the services sector in the UK, which accounts for about 80% of UK GDP, including service industries and complex manufacturing activities that rely on cross-border supply chains, largely with EU countries.[6] In part reflecting these extensive ties, the stock market value of UK bank equities fell by more than 10% immediately following the vote; trading was briefly suspended on Monday, June 27, 2016.[7]

According to various analyses, Brexit could have an immediate and long-term effect on the UK and EU economies. In particular, financial markets reacted negatively to the referendum on the UK exit from the EU. Major stock indexes plunged in value in Asia, Europe, and on Wall Street. Within two weeks, however, most stock markets had recouped their initial losses, but uncertainty about long-term prospects for the British economy continues to feed through financial and economic linkages to developed and emerging economies.[8] In addition, central bankers in Switzerland, Japan, and Europe reportedly raised concerns over the possibilities of financial market instability associated with the vote in favor of Brexit.[9] Group of Seven finance ministers and central bankers, meeting in Switzerland for pre-scheduled sessions, issued a statement indicating, "We affirm our assessment that the U.K. economy and financial sector remain resilient

[6] *HM Treasury Analysis: The Long-Term Economic Impact of EU Membership and its Alternatives*, HM Treasury, April, 2016, p. 9.

[7] Merle, Renae, and Simon Denyer, "U.S. Stocks Down 2 Percent as Brexit Drags Through Markets," *The Washington Post*, June 27, 2016. See https://www.washingtonpost.com/world/pound-falls-but-global-stock-markets-relatively-calm-in-brexit-aftermath/2016/06/27/f5d4712a-3c2a-11e6-a66f-aa6c1883b6b1_story.html?hpid=hp_rhp-top-table-main_markets-550a-top%3Ahomepage%2Fstory.

[8] Hughes, Jennifer, Broad, Deep, and Brutal, "Asia's Brexit Reaction," *Financial Times*, June 30, 2016. https://next.ft.com/content/43080226-3cfe-11e6-8716-a4a71e8140b0.

[9] Noble, Josh and Ralph Atkins, "Brexit: Central Banks Brace for Vote," *Financial Times*, June 14, 2016.

and are confident that the U.K. authorities are well-positioned to address the consequences of the referendum outcome."[10] In addition, the Federal Reserve released a statement that read

> The Federal Reserve is carefully monitoring developments in global financial markets, in cooperation with other central banks, following the results of the U.K. referendum on membership in the European Union. The Federal Reserve is prepared to provide dollar liquidity through its existing swap lines with central banks, as necessary, to address pressures in global funding markets, which could have adverse implications for the U.S. economy.[11]

Following the announcement of the referendum, global financial markets responded in a number of ways:

- Some equity markets fell by as much as 7% in value (the Dow Jones industrial average fell by 600 points, or 3.5%), erasing nearly $3 trillion in equity value.
- The British pound depreciated to its lowest level in more than 30 years; while the dollar, the yen, and other major currencies appreciated sharply, as indicated in **Figure 2**.[12] On July 5, 2016, the pound dropped below $1.3 dollars per pound, down 13% since the Brexit vote.
- Demand for U.S. Treasury securities, which often serve as safe-haven investments during episodes of market instability, rose, pushing U.S. interest rates down.
- Some London-based American, European, and other foreign banks began reconsidering their UK presence due to concerns that Britain outside the EU will jeopardize their EU 'passport" status that allows them to operate throughout the EU.[13]
- Standard & Poor's and Fitch downgraded UK sovereign debt from AAA to AA, Fitch downgraded Bank of England debt, and Moody's Investor Services downgraded its outlook on the UK's credit status from stable to negative.[14] In its statement, Moody's indicated that "[o]ver the medium term, the UK's economic growth prospects will depend crucially on what trade agreement the UK government reaches with the EU as well as on the UK government's trade policies more generally."[15]

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[10] Mui, Ylan Q., Brian Murphy, and Emily Rauhala, "Pound Takes a Beating, Markets in Tailspin Following British Vote to Exit E.U.," *The Washington Post*, June 24, 2016.

[11] Press Release, the Board of Governors of the Federal Reserve System, June 24, 2016. http://www.federalreserve.gov/newsevents/press/monetary/20160624a.htm.

[12] Ibid.

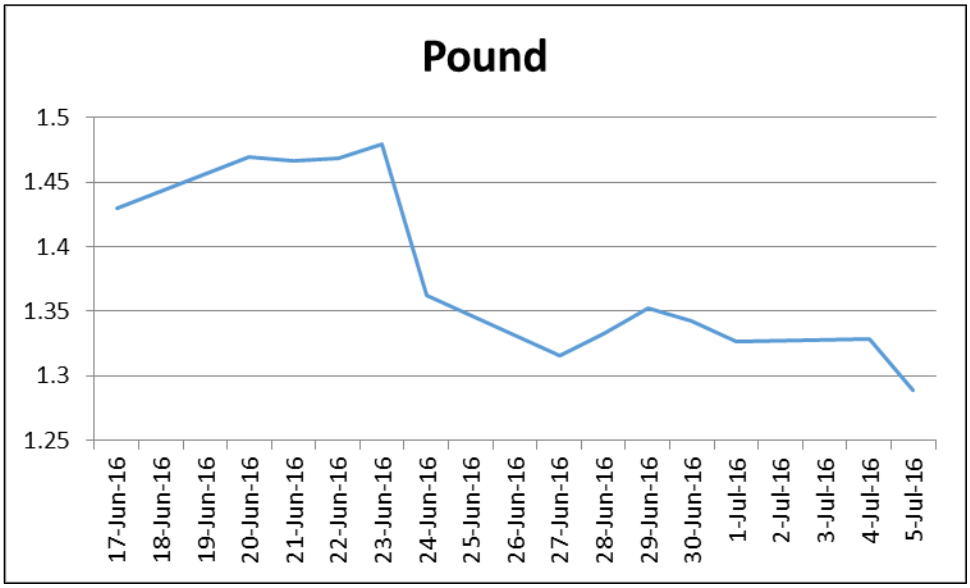
[13] Arnold, Martin, and Laura Noonan, "Banks Begin Moving Some Operations out of Briton," *Financial Times*, June 26, 2016. See https://next.ft.com/content/a3a92744-3a52-11e6-9a05-82a9b15a8ee7.

[14] Following the financial crisis of 2008-2009, national government adopted measures to provide greater oversight of credit rating agencies (CRAs) and to reduce financial market volatility by removing regulations that require certain bond holders to mechanistically alter their bond portfolios as a result of a credit rating downgrade. Through Capital Requirements Directive IV (CRD-IV), the European Union did not remove such references entirely, but opted instead to improve oversight of the credit ratings agencies and strengthen the ability of banks and other financial firms to develop their own internal risk assessment abilities comparable to that of the major credit ratings agencies.

[15] *Moody's Changes Outlook on UK Sovereign Rating to Negative From Stable, Affirms Aa1 Rating*, Moody's Global Credit Research, June 24, 2016. See https://www.moodys.com/research/Moodys-changes-outlook-on-UK-sovereign-rating-to-negative-from—PR_350566.

- Questions arose about the continued status of London as the largest global financial center and the prospects of increased risks to the global economy.[16] French President Francois Hollande told EU leaders that London should be stripped of its ability to clear derivatives and equities operations for Eurozone countries.[17]

Figure 2. British Pounds per U.S. Dollar



Source: Bank of England.

Despite the immediate reaction by financial markets, Brexit is not expected to create a financial meltdown similar to the turmoil that followed the collapse of Lehman Brothers in 2008. By early July 2016, most equity markets had recovered their losses and exchange rates had stabilized, albeit with the pound remaining below its pre-Brexit levels. The FTSE 250 (Financial Times Stock Exchange index of 250 small-to-medium-sized UK firms) remained about 9.0% below its pre-Brexit level.[18] Markets may well remain volatile over the near term, however, reflecting lingering concerns including (1) the evolving political leadership crisis; (2) uncertainties about the process for UK disengagement from the EU; and (3) the short- and long-term economic effects. These concerns are not necessarily discrete, but are potentially reinforcing. For instance, a continuing political leadership crisis can affect short-run economic conditions to the extent the markets are uncertain about the ability of the UK government to conduct economic policy. Financial markets likely will be volatile over the near term as the UK and the EU sort through these issues. Much uncertainty also looms over the UK's trade and economic arrangements and the corresponding legal and regulatory frameworks. Trade is equivalent to about 60% of the UK economy, largely due to reduced trade barriers with the EU through the EU's Single Market. The UK is the second largest EU economy after Germany.

[16] Jenkins, "What Will Brexit Mean for the City of London," *Financial Times*, June 26, 2016. See https://next.ft.com/content/23d576b0-386a-11e6-a780-b48ed7b6126f.

[17] Brunsden, Jim and Anne-Syvaine Chassany, "Francois Holande Rules Out City's Euro Clearing Role," *Financial Times*, June 29, 2016. https://next.ft.com/content/e8e0c44a-3d89-11e6-9f2c-36b487ebd80a.

[18] Binham, Caroline and Chris Giles, "Bank of England Tells Banks to Cut Buffer to Boost Lending," *Financial Times*, July 5, 2016. https://next.ft.com/content/a849fa1e-4293-11e6-b22f-79eb4891c97d.

Economic Studies

Recently, the Organization for Economic Cooperation and Development (OECD), the World Bank, and the International Monetary Fund (IMF), the Bank of England, the UK Treasury Department (HM Treasury), among others, have issued assessments of the economic impact of Brexit.

International Monetary Fund

A June 2016 IMF analysis projected that the rate of economic growth in the UK will slow to 1.6% in 2016, or about 0.5% below earlier estimates. The IMF attributes this drop in its estimates to uncertainty about the nature of the UK's long-term economic relationship with the EU and the rest of the world, which it considers to be the largest near-term risk to the UK economy.[19] Also, the IMF estimated that by 2019, Brexit could reduce UK GDP by 1.4% under the most optimistic assumptions and by 5.6% under the most pessimistic assumptions.[20] The IMF also concluded that Eurozone members that had close links with the UK in trade and finance would be the most affected by Brexit, with Ireland, Malta, Cyprus, Luxembourg, the Netherlands, and Belgium likely being the most affected.[21] According to the IMF:

> Given the range of plausible alternative arrangements with the EU, the number of channels by which countries could be affected, and the uncertainty that a vote for exit could generate, the range of possible effects on the UK and other economies is broad. Nonetheless, the balance of evidence points to notable downward economic risks to the UK economy.... The likelihood is therefore that output and employment would be lower should the UK leave the EU than should it remain. In the short run, the uncertainty generated by navigating a complicated and untested exit process could be damaging for investment, consumption, and employment; the exchange rate could act as a buffer, but not by enough to offset the negative effects on demand and output. Spillovers to other economies would likely be less severe, but still negative, with other EU economies being some of the most affected.[22]

Bank of England

In addition, the Bank of England (BOE), the UK central bank, concluded in its June 16, 2016, Monetary Policy statement that it views the most significant risks to their forecast of the UK economy related to concerns about the Brexit referendum. The BOE argued that a vote to leave the EU could

- materially alter the outlook for output and inflation, and therefore the appropriate setting of monetary policy;
- cause households to defer consumption and firms to delay investment, lowering labor demand and causing unemployment to rise;
- increase the risks for the global economy due to spillover effects through financial market and confidence channels;
- lower supply growth, reflecting slower capital accumulation and the need to reallocate resources;

[19] *UK Article IV Consultations*, p. 9.

[20] *United Kingdom: Selected Issues*, International Monetary Fund, June 2016, pp. 31-32.

[21] Cadman, Emily, "IMF Says Brexit Will Permanently Lower UK Incomes," *Financial Times*, June 16, 2016.

[22] *United Kingdom: Selected Issues*, IMF Country Report 16/169, International Monetary Fund, June 2016, p. 4.

- depreciate the international exchange rate of the British pound, perhaps sharply; and
- lead to a materially lower path for growth and a notably higher path for inflation through the combination of influences on demand, supply and the exchange rate.[23]

The BOE further concluded that this chain of events would confront the Bank with a trade-off between stabilizing inflation on the one hand and maintaining output and employment on the other. The BOE also concluded that uncertainty concerning the vote was affecting international financial markets, with investors shifting from the pound to other currencies, causing the pound to depreciate and increasing volatility in the foreign exchange value of the pound relative to other major currencies.

OECD Study

The OECD concluded in an April 2016 economic policy paper that the exit from the EU would pose a "persistent and rising cost" to the UK economy. The OECD based its estimates on a number of assumptions, including that the UK economy would experience tighter financial conditions and weaker confidence in the short run, and higher trade barriers and restrictions on labor mobility over the long run. In its April 2016 policy paper, the OECD published a comprehensive analysis of the economic consequences of Brexit and summary estimates of a number of studies.[24]

The OECD analysis incorporated a number of common assumptions that are indicative of the types of potential effects of a possible Brexit. The analysis indicated that the impact of Brexit on financial markets and capital flows would affect bank credit, foreign investment, stock market volatility, exchange rate volatility, and higher interest rates for firms and consumers, thereby reducing consumer spending and business investment in the UK, as indicated in **Table 1**. Depending on the nature of the revised relationship between the UK and the EU, Brexit potentially could reduce trade and financial activities between the UK and the EU through the loss of EU-wide passport rights, or the right of firms to operate unhindered throughout the EU. The OECD also considered three scenarios for UK trade relations that are similar to those of other assessments: the UK's trade status as a member of the World Trade Organization (WTO); a future UK free trade agreement (FTA) with the EU similar to that of the EU and Canada; and similar trade agreements the EU has signed with some 50 other countries.[25] Reduced trade and financial activities are projected to have a negative effect on the UK economy, with spillover effects on EU economies. Also, a loss of capital inflows would complicate the UK's efforts to finance its current account deficit. The OECD estimated that Brexit would limit immigration, which would lower labor force growth and long-term labor productivity.

[23] *Monetary Policy Summary and Minutes of the Monetary Policy Committee, June 15, 2016*, Bank of England, June 16, 2016, p. 3.

[24] *The Economic Consequences of Brexit: A Taxing Decision*, OECD Economic Policy Paper 16, Organization for Economic Cooperation and Development, April 2016.

[25] Ibid., p. 6.

Table 1. OECD Estimated Economic Effects of Brexit

Short run (2020)	Long run (2030)
Uncertainty would reduce confidence and hold back spending decisions and would tighten financial conditions by lifting risk premiums, thus increasing the cost of finance and reducing its availability.	Cut in FDI inflows, notably from the EU, resulting in lower UK business investment and a decline in the capital stock over time. This, in turn, would negatively weigh on trade, innovation and reduce managerial quality.
Increased prospects of large capital outflows, or a break in inflows, that could complicate financing the current account deficit.	Lower openness and innovation, weakening technical progress and productivity in the UK.
Loss of unrestricted UK access to the EU Single Market, and preferential access to 53 non-EU markets. UK trade would continue to be governed by WTO rules, leading to higher tariffs for goods and to other barriers in accessing the Single Market, notably for financial services. Bilateral UK-EU trade would be expected to contract.	Reduce long-term GDP growth through a smaller pool of skills, stemming from lower immigration and reduced FDI, reducing managerial quality.
Concluding a Free Trade Agreement with the EU would provide a partial offset for UK trade, the costs of accessing the Single Market would still be higher.	Continue to pursue additional regulatory liberalization, although gains would be modest.
The UK would face additional barriers in third-country markets to which preferential access was lost as a result of an EU exit.	Stop net transfers to the EU budget (0.3-0.4% of GDP per year); such savings would be offset by lower GDP growth.
Curbs to the free movement of labor from the EU and a potentially weaker UK economy after exit would reduce the incentives for economic migration to the UK and be a cost to the economy.	By 2030, UK GDP would be over 5% smaller than if the UK had remained a member of the EU.
Brexit would generate financial shocks beyond the UK, magnified by the appreciation of other currencies against the pound.	
By 2020, these effects are estimated to reduce UK GDP by over 3%; the GDP loss for the EU would be around 1%.	

Source: *The Economic Consequences of Brexit: A Taxing Decision*, OECD Economic Policy Paper 16, Organization for Economic Cooperation and Development, April 2016, p. 6.

In comparing various studies on the economic impact of Brexit, the OECD concluded that most studies estimated that Brexit would "harm the economy to a considerable extent."[26] As shown in **Figure 3**, a number of different studies estimated "worst case" and "best case" scenarios for the possible impact of Brexit on the UK economy. These scenarios suggest that Brexit could affect UK GDP in the range of -1.3% and -5.5% per year in the short run (2020) and between -1.2% and -7.5% per year over the long run (2030). Loss of income per UK household is estimated at between -£600 (about $900) and -£5,200 (about $7,500) per year. The studies reviewed in the OECD assessment considered different channels through which Brexit would transmit effects to the UK economy.[27] The OECD estimate, which concluded that Brexit would reduce UK GDP by 3.3% in the short run and by 5.1% in the long run, factored in all the possible implications of Brexit, or channels of transmission, for the UK economy. A study by the London School of

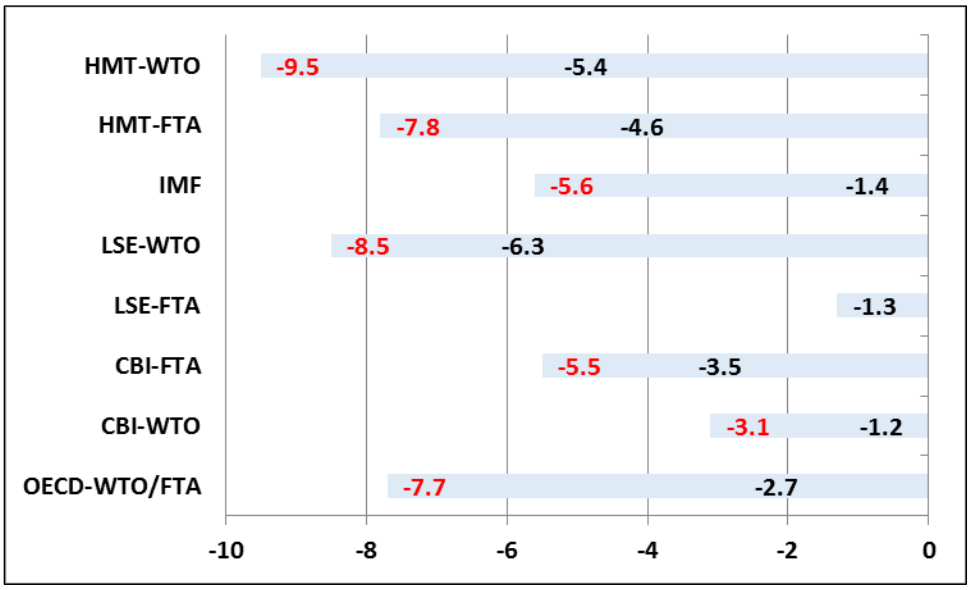
[26] Ibid., p. 36.

[27] These channels included uncertainty over the short term; tariffs on goods traded with the EU; nontariff barriers to trade with the EU; the impact of Brexit on current trade relations; a decline in migration; a decline in foreign direct investment; lower private R&D spending; lower managerial skills; deregulation; contributions to the EU budget.

Economics (LSE) and the Center for Economic Performance (CEP), which considered the fewest number of factors in their analysis, had the lowest negative assessment in the short run, ranging from -1.3% per year to -2.6% per year, and one of the most negative estimates of the impact of Brexit on the UK economy over the long run, -6.3% to -8.5%. The study by the British Treasury considered the economic impact of Brexit under three scenarios: the UK negotiates a European Economic Area (EEA) agreement similar to that of Norway, the UK attempts to replicate the FTAs negotiated by the EU, or the UK continues under the obligations of the WTO without any specific agreement with the EU.

Figure 3. Comparative Forecasts of the Impact of Brexit on UK GDP

Percentage change in GDP through 2030 (Worst case [in red] and best case [in black] scenarios)



Source: The Economic Consequences of Brexit: A Taxing Decision, Organization for Economic Cooperation and Development, OECD Economic Policy Paper No. 16, April 2016, p. 35.

Notes: FTA is Free Trade Agreement, WTO is the World Trade Organization. Economic studies include OECD calculations; *CBI/PwC study:* PwC (2016), "Leaving the EU: Implications for the UK Economy", PricewaterhouseCoopers (PwC) report commissioned by The Confederation of British Industry (CBI).; *LSE/CEP study:* Dhingra, S., G. Ottaviano, T. Sampson and J. Van Reenen (2016), "The Consequences of Brexit for UK Trade and Living Standards", Centre for Economic Performance (CEP), London School of Economics and Political Science (LSE); and *Treasury:* HM Treasury (2016), "HM Treasury Analysis: the Long-term Economic Impact of EU Membership and the Alternatives," April 2016; *United Kingdom: Selected Issues*, International Monetary Fund, June 2016, pp. 31-32.

Studies on the economic consequences of Brexit have produced a wide range of results, though most show a small negative impact, with declines in trade with the EU dwarfing the other potential effects.[28] More than 75% of the economists polled by the *Financial Times* predicted a negative outcome to the UK from Brexit, including concerns over the uncertainty such a move would generally introduce into financial and other markets.[29] Some researchers have also argued

[28] "Brexit Brief: the Economic Consequences," *The Economist*, April 9, 2016.

[29] "What are the Economic Consequences of Brexit?," *Financial Times*, February 22, 2016.

that the difficulties in modeling the numerous aspects of economic integration suggest that outcomes from a Brexit could be greater than current estimates.[30]

Impact of Brexit on UK Financial Relations

Brexit is creating uncertainty in international financial markets, which is affecting the value of the British pound and UK business investment. In response to these concerns, foreign investors reportedly have sold the pound in favor of other safe-haven currencies, such as the dollar, the yen, and the Swiss franc.[31] Concerns over Brexit also may be steering some investment funds toward the United States, which puts additional upward pressure on the value of the dollar. For the UK, a depreciated pound makes the UK's exports less expensive in relative terms, which traditionally is expected to boost exports. Similarly, an appreciation in the value of the dollar makes U.S. exports more expensive and imports cheaper. Whether the UK will experience an actual increase is questionable. Some analysts argue that the UK's exports consist of high-valued-added products and that demand for these products is not very responsive to price changes. Also, given the importance of EU trade for the UK, a slowdown in EU economic growth and continuing slow growth in emerging markets may offer little boost to UK exports.[32] Over the long term, a higher valued dollar may reduce foreign demand, which eventually would ease upward pressure on the dollar. In the interim, emerging economies and other countries are wary of a stronger dollar, because they fear it could have a negative contagion effect on their economies by drawing away much-needed capital.[33]

Uncertainties about the impact of Brexit on international capital markets apparently were among a number of factors that led the Federal Reserve on June 18, 2016, to postpone raising U.S. prime interest rates. Federal Reserve Board Chairman Janet Yellen indicated at that time that, "It [Brexit] is a decision that could have consequences for economic and financial conditions in global financial markets. If it does so, it could have consequences in turn for the U.S. economic outlook that would be a factor in deciding on the appropriate path of policy. So, it is certainly one of the uncertainties that we discussed and that factored into today's decision."[34]

Central banks have been muted in their response to Brexit. The Bank of England (BOE) followed up promises to financial markets to provide liquidity by injecting £3.1 billion (about $4.1 billion) into UK banks. Bank of England Governor Carney said a downturn for the British economy was on its way and that Britain was already suffering from "economic post-traumatic stress disorder."[35] There is speculation about whether and how quickly the BOE would consider reducing interest rates or engaging in quantitative easing should market conditions require such

[30] Berthold Busch and Jurgen Matthes, *Brexit – The Economic Impact: A Meta-Analysis*, Cologne Institute for Economic Research, IW Report 10/2016, April 8, 2016.

[31] Mui, Ylan Q., 'Brexit' Could Send Shock Waves Across U.S. and Global Economies, *The Washington Post*, June 18, 2016.

[32] Martin, Katie, Will the Drop in Sterling Boost UK Exports?, *Financial Times*, June 29, 2016. https://next.ft.com/content/18048862-6519-3cbb-8c3a-149ce6d9a982.

[33] Fleming, Sam, Post-Brexit Dollar Surge Presents Fed With New Conundrum, Financial Times, June 26, 2016. See https://next.ft.com/content/b94e60fc-3b2c-11e6-8716-a4a71e8140b0.

[34] Transcript of Chair Yellen's Press Conference, Board of Governors of the Federal Reserve System, June 15, 2016, p. 6. http://www.federalreserve.gov/mediacenter/files/FOMCpresconf20160615.pdf.

[35] Cadman, Emily, Carney prepares for 'Economic Post Traumatic Stress,' Financial Times, June 30, 2016. https://next.ft.com/content/ec42a3ba-3ed3-11e6-8716-a4a71e8140b0; Carney, Mark, *Uncertainty, the Economy and Policy*, Speech, Bank of England, June 30, 2016. http://www.bankofengland.co.uk/publications/Documents/speeches/2016/speech915.pdf.

actions.[36] On Tuesday, July 5, 2016, the BOE announced that it was suspending through at least June 2017 the countercyclical capital buffer of 0.5% on UK banks to provide them with additional resources to support loan activity for individuals and businesses.[37] The BOE also identified five areas in which Brexit would increase risks to the UK economy:

1. financing the UK's current account deficit;
2. commercial real estate, which previous to the vote had experienced large foreign capital inflows;
3. the high level of UK household indebtedness;
4. subdued growth in the global economy, including the Euro area that could be affected by a prolonged period of uncertainty; and
5. fragilities in financial markets.[38]

The Federal Reserve indicated that it was prepared to provide dollar liquidity through existing swap lines with other central banks, as necessary, to address pressures in global funding markets, which, it indicated, could have adverse implications for the U.S. economy.[39] The European Central Bank (ECB) reportedly is poised to engage in additional quantitative easing by buying sovereign and corporate bonds. It has also reduced interest rates to provide low-cost funding to banks. Capital inflows and an appreciation in the yen have worked against expansionary monetary action by the Bank of Japan, to stimulate its economy and to avoid deflation. The Bank of Mexico unexpectedly raised interest rates on June 30, 2016, to stem an appreciation in the peso. Although Mexico has only a small trade relationship with Britain and seemingly little to lose directly from Brexit, the peso is reportedly the most liquid emerging market currency.[40]

Impact of Brexit on UK Trade Relations

A Brexit vote does not immediately affect the UK's terms of trade with the EU and other countries, but could in the future. The status of UK trade relations going forward depends on the terms of the UK's negotiated withdrawal from the EU, as well as subsequent UK negotiations with the EU.[41] The process for exiting the EU will take some time to negotiate, and there is much uncertainty surrounding it. Thus, Brexit's impact on UK trade relations is unclear.

In terms of trade negotiations, Brexit likely would return authority to the UK to set its own external tariffs and its trade policy more broadly, an authority that currently resides with the EU.

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[36] Toplensky, Rochelle and Michael Hunter, Brexit – How Will Central Banks Respond?, *Financial Times*, June 29, 2016. https://next.ft.com/content/c7ce484c-3d0a-11e6-8716-a4a71e8140b0.

[37] *Financial Stability Report*, Bank of England, July 2016, p. ii. http://www.bankofengland.co.uk/publications/Documents/fsr/2016/fsrjul16.pdf.

[38] Ibid., p. i.

[39] Powell, Jerome H., Governor, *Recent Economic Developments, Monetary Policy Considerations and Longer-term Prospects*, Board of Governors of the Federal Reserve System, June 28, 2016. http://www.federalreserve.gov/newsevents/speech/powell20160628a.htm#fn4.

[40] Webber, Jude, Mexico Raises Interest Rates to Shore up Peso, *Financial Times*, June 30, 2016. https://next.ft.com/content/0f733fde-3ef7-11e6-8716-a4a71e8140b0.

[41] This process is complicated by the issue of what extent securing access to the EU Single Market for goods, services, and capital requires also accepting the free movement of people—the four collectively being known as the four "freedoms" of the internal EU market. For example, some EU and member state leaders argue that the UK should not be given access to the Single Market for goods, services, and capital unless it also agrees to abide by the free movement of people. Immigration was an issue that played prominently in the Brexit vote. See Ashley Cowburn, "Donald Tusk: Freedom of movement is non-negotiable if Britain wants access to single market," Independent, July 5, 2016.

While it is not known what course UK trade policy would take, the economic implications of this shift of trade policy back to the UK may be mixed. It could be beneficial to the extent that the UK intends to lower tariffs below current EU rates. It could, however, be detrimental if the UK loses access to the benefits of the EU Single Market and existing EU preferential trade agreements with other countries, making trade on less favorable terms for the UK. Brexit also raises issues about the status of ongoing EU trade negotiations, including current U.S.-EU negotiations to conclude a Transatlantic Trade and Investment Partnership (T-TIP) free trade agreement (FTA).

UK Relationship with the EU

Brexit presents a question as to what extent, if at all, the UK would retain access to the Single Market for goods and services and what trade-offs could this access entail. Observers have put forward a number of possible scenarios for the UK's trade relationship with the EU post-Brexit.[42] These scenarios vary in their level of access to the Single Market, obligations to implement EU rules and regulations, opportunity to participate in EU decisionmaking, and requirements to contribute to the EU's budget, not to mention their political feasibility and timeline to negotiate.

If the UK does not negotiate preferential market access with the EU, WTO rules would set parameters for the UK-EU relationship. EU tariffs on the UK would most likely be re-imposed to World Trade Organization (WTO) most-favored-nation (MFN) levels.[43] Under its WTO commitments, EU average tariff rates are low—a simple average MFN applied tariff of 5.3% (2014) and a trade-weighted average tariff of 3.6% (2013), but higher in certain sensitive sectors such as agriculture.[44] However, these rates arguably are significant compared to the zero tariffs that EU members apply to intra-EU trade. At the other end of the spectrum is the scenario of the UK negotiating a comprehensive bilateral FTA with the EU potentially to achieve access to the Single Market or more favorable terms of trade. A possible model is Canada, which concluded a Comprehensive Economic and Trade Agreement (CETA) with the EU in 2014 after several years of negotiations. Not yet in force, CETA covers tariff and nontariff barriers related to goods, services, agriculture, investment, government procurement, and regulatory cooperation. EU FTAs have varied in their scope of trade liberalization.

In between, other specialized arrangements exist for certain non-EU countries in Europe that could serve as models for the UK. For instance, the UK could attain full access to the Single Market through the "Norway model." As a member of the European Economic Area (EEA) and the European Free Trade Association (EFTA), Norway has full access to the Single Market, but in exchange, must implement EU rules to the internal market. In contrast, the "Switzerland model" would offer the UK more limited but tailored, and arguably more complicated, access to the Single Market. Switzerland has a multitude of bilateral agreements with the EU giving it partial access to the Single Market. For example, Switzerland and the EU do not have an agreement on services, including financial services. In exchange for this limited access, Switzerland is obliged to incorporate related EU regulations and directives into its legal framework. Even more limited access would occur if the UK followed the "Turkey model" and formed a customs union with the EU. Turkey's customs union with the EU gives it access to the Single Market for goods, but not

[42] See, for example, Jean-Claude Piris, *If the UK votes to leaves: The seven alternatives to EU membership*, Centre for European Reform, January 2016, http://www.cer.org.uk/publications/archive/policy-brief/2016/if-uk-votes-leave-seven-alternatives-eu-membership; BBC, "Five Models for Post-Brexit UK Trade," http://www.bbc.com/news/uk-politics-eu-referendum-36639261; and Jason French, Jovi Juan, and Jason Douglas, "Trade After 'Brexit'," June 24, 2016, http://graphics.wsj.com/trade-after-brexit/.

[43] The MFN tariff is the normal non-discriminatory tariff that a WTO member charges on imports from another WTO member, excluding preferential tariffs under free trade agreements and other schemes or tariffs charged inside quotas.

[44] WTO, Tariff Profiles.

for agriculture or services. Under these varying arrangements, the countries do not have a vote in EU decisionmaking on rules and regulations and, in the case of Norway and Switzerland, must contribute to the EU's budget.

UK Relationships with Countries Outside of the EU

Beyond the EU, a Brexit would require the UK to redefine its terms of trade with other countries. At the multilateral level, the UK presently is an individual member of the WTO.[48] However, the EU, through the European Commission, represents all EU member states, including the UK, in the WTO. Thus, the UK has terms of trade in the WTO through its commitments as an EU member (e.g., MFN tariff levels). Under Brexit, the UK would presumably remain a member of the WTO, but it would likely have to renegotiate its terms of trade within the WTO.[49] There appears to be no precedent for doing so, the process for such negotiations is unclear, and the associated time period may be lengthy.[50]

Brexit also would have implications for the UK's relations with the over 50 countries with which the EU has preferential regional or bilateral trade agreements or other agreements with a trade component in force.[51] The UK could lose access to the benefits of existing EU trade agreements with key partners such as Mexico and, more recently, South Korea, unless it negotiated otherwise with those countries. In addition, Brexit could affect the UK's potential access to EU trade agreements that have been concluded but not yet entered into force—such as with Canada—and those under negotiation—such as the plurilateral

What Could Brexit Mean for T-TIP?

Brexit's impact on the potential U.S.-EU T-TIP is an open question. Following the Brexit vote, the United States and EU expressed a commitment to continuing the T-TIP negotiations, with the goal of concluding a comprehensive and high-standard agreement by the end of 2016. U.S. Trade Representative Michael Froman stated that the "economic and strategic rationale for T-TIP remains strong."[45] According to the EU Trade Commissioner Cecilia Malmström, Brexit will not have an immediate impact on EU negotiating positions because the European Commission is continuing to negotiate on behalf of all 28 member states, including the UK.[46] In contrast, some observers argue that the vote cripples the already troubled T-TIP negotiations: the United States and EU have faced difficulties overcoming differences on key issues, and the uncertainty surrounding Brexit complicates matters. It is unknown, for example, how Brexit will affect the value of the EU market until the UK's withdrawal and relationship with the EU is negotiated.

It is possible that, at some point, the European Commission may need to "recalibrate" its T-TIP negotiating positions and proposals. Brexit may make negotiations of certain issues easier. For example, it could change the EU's demand for including financial services regulatory cooperation in T-TIP, a top UK interest that is favored by U.S. and EU financial services firms, but opposed by the United States, which prefers to negotiate such issues in other forums (e.g., G-20). Alternatively, Brexit may make the negotiations of other issues more difficult, given the UK's liberalizing role in the EU on trade issues, including in areas such as agriculture, services and investment.[47]

[45] USTR, "Statement by Ambassador Froman on the UK Referendum," press release, June 2016.

[46] "Malmström Says TTIP Negotiations Can Finish This Year Despite Brexit," Inside U.S. Trade, June 29, 2016.

[47] Victoria Guida and Adam Beshudi, "Brexit Kills Remaining Hope for TTIP Deal in 2016," POLITICO, June 26, 2016.

[48] WTO, "United Kingdom and the WTO," https://www.wto.org/english/thewto_e/countries_e/united_kingdom_e.htm.

[49] Andrew Lang, *The Consequences of Brexit: Some Complications from International Law*, LSE Law, Policy Briefing 3, 2014, http://eprints.lse.ac.uk/64046/1/Policy%20briefing%203_2014.pdf.

[50] WTO, "Azevêdo addresses World Trade Symposium in London on the state of global trade," press release, June 7, 2016, https://www.wto.org/english/news_e/spra_e/spra126_e.htm.

[51] See "Agreements in force" section of European Commission, "Agreements," http://ec.europa.eu/trade/policy/countries-and-regions/agreements/.

Trade in Services Agreement and the Transatlantic Trade and Investment Partnership (T-TIP) with the United States (**text box** above).[52]

Brexit's impact on the UK's position in renegotiating existing trade agreements or engaging in future negotiations is unclear. The UK would likely have less negotiating power without the economic heft of the full EU. On the other hand, the UK may be able to more effectively pursue its trade interests without being subject to the compromises required of the EU in negotiating on behalf of 28 member countries.

Brexit may affect UK trade relations in other ways, for instance, in terms of the unilateral favorable duty treatment (reduction, suspension, or elimination of duty) that the UK provides to beneficiary developing countries under the EU's Generalized System of Preferences.[53]

Status of U.S.-UK Trade and Economic Relations

Brexit's impact on future U.S.-UK trade and economic relations will be closely watched in light of the relationship's magnitude (**text box**). In 2015, the UK was the United States' largest services trading partner, second largest foreign direct investment (FDI) partner, and seventh largest goods trading partner. The UK accounts for roughly one-fifth of overall U.S.-EU trade and investment.

A U.S.-UK Free Trade Agreement?

In the Brexit vote's aftermath, the United States and UK may consider pursuing a bilateral FTA or bilateral investment treaty (BIT) to expand and strengthen reciprocal trade and investment ties. President Obama previously stated that the United States was focused on negotiating with a regional bloc (i.e., the EU). Since the vote, some Members of Congress, however, have voiced support for U.S.-UK FTA negotiations, given the two countries' long-standing ties, including introducing resolutions in the House and Senate. (See S. 3123 (Lee), S.Res. 520 (Rubio), H.Res. 817 (Dent), and concurrent resolutions H.Con.Res. 146 (Brady) and S.Con.Res. 47 (Hatch).)[54]

It is also possible that the UK might seek to remain in the Transatlantic Trade and Investment Partnership (T-TIP) negotiations or join a potential concluded T-TIP agreement in the future to ensure reciprocal trade treatment among the United States, EU and UK. In the meantime, in what may be a lengthy phase of negotiating with the EU its terms of withdrawal, the UK remains a part of the T-TIP negotiations as a EU member. During this transition, the EU continues to have exclusive competence over the UK's trade policy as it does for other EU member states—meaning that the EU negotiates a common trade policy with non-EU countries on behalf of all of its member states.[55] In the UK, like the United States, industry, labor, and other stakeholders differ in their support or opposition for T-TIP. The UK government has sought to dispel what it terms as "myths and misconceptions" about T-TIP; for example, that potential new investor-state dispute settlement (ISDS) provisions would threaten democracy and the UK's sovereignty, or that T-TIP would open up public services (i.e., the UK's National Health Service) to privatization.[56]

Other possible scenarios exist for U.S.-UK trade relations. For example, since the vote, U.S. Trade Representative Froman has said that it may be possible for the UK, once it exits the EU, to join the proposed Trans-Pacific Partnership (TPP), an FTA concluded among the United States and 11 countries in the Asia-Pacific region.[57]

[52] European Commission, "Overview of FTA and Other Trade Negotiations," updated May 2016, http://trade.ec.europa.eu/doclib/docs/2006/december/tradoc_118238.pdf.

[53] European Commission, "Report on the Generalised System of Preferences Covering the Period 2014-2015," January 28, 2016, http://trade.ec.europa.eu/doclib/docs/2016/january/tradoc_154180.pdf.

[54] See also, for example, Speaker of the House, "Speaker Ryan Calls for Free Trade Agreement with UK After Brexit," press release, June 27, 2016.

[55] CRS Report RS21372, *The European Union: Questions and Answers*, by Kristin Archick.

[56] Government of the United Kingdom, "TTIP: Separating Myth from Fact," April 25, 2016.

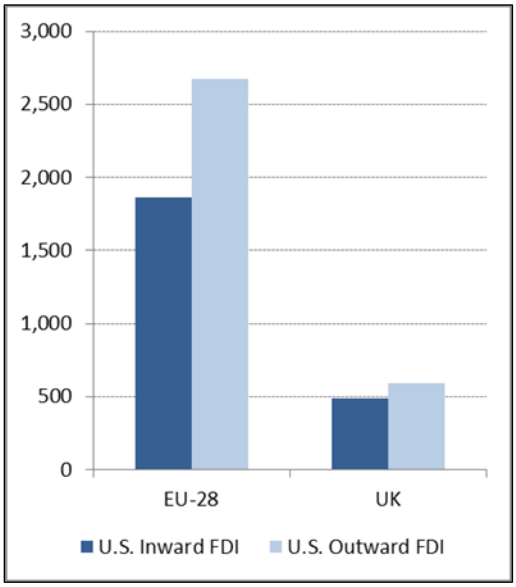
[57] "U.S. trade chief says China offer falls short, UK could join TPP," Reuters, July 6, 2016. See also CRS Report R44489, *The Trans-Pacific Partnership (TPP): Key Provisions and Issues for Congress*, coordinated by Ian F.

In 2015, U.S. FDI in the UK (outward FDI) was about $593.0 billion (**Figure 4**). Holding companies ($274.8 billion) and finance and insurance ($122.7 billion) accounted for the largest share of U.S. investment in the UK. Total U.S. corporate assets in the UK stood at around $5 trillion, representing 22% of total U.S. corporate assets abroad, and U.S. affiliates in the UK employed over 1.25 million people.[58]

The UK's access to the EU's Single Market is viewed as a significant factor for why a large number of U.S. (as well as European and other) multinational corporations have chosen London as their EU headquarters, but it is not the sole factor. Other factors include the UK's rule of law, human capital resources, and infrastructure. Nevertheless, the uncertainty and potential risks of Brexit have led many of these large companies to question whether they might need to prepare plans for moving their EU base—along with attendant jobs and capital—elsewhere.

Figure 4. U.S.-EU, -UK FDI

(2015, U.S. dollars in billions)



Source: Department of Commerce, Bureau of Economic Analysis (BEA).

Notes: Stock values based on historic cost. FDI = Foreign direct investment.

The stock value of UK FDI in the United States (inward FDI) in 2015 totaled $483.8 billion. Key sectors included chemicals ($70.2 billion) and finance and insurance ($51.4 billion).[59]

In 2015, the United States had a small goods trade deficit with the UK, importing $58.6 billion and exporting $56.5 billion (**Figure 5**). Top U.S. imports included chemicals ($13.3 billion), transportation equipment ($12.0 billion), and non-electrical machinery ($5.8 billion). Top U.S. exports were transportation equipment ($13.5 billion), chemicals ($8.0 billion), and computer and electronic products ($5.5 billion).[60]

Services trade forms a large share of the overall bilateral trade relationship (**Figure 6**). Services account for a little over half of total U.S.-UK trade, compared to nearly 40% of U.S.-EU trade and about one-quarter of U.S.-world trade. In 2015, the United States had a $14 billion services trade surplus with the UK, exporting $66.9 billion and importing $52.9 billion. Financial services represented the top U.S. services export category at $14.3 billion, accounting for about one-fifth of U.S. services exports to the UK. Travel ($12.9 billion) and charges for the use of intellectual property ($9.2 billion) were the other top export categories. U.S. services imports from the UK

Fergusson and Brock R. Williams.

[58] Daniel S. Hamilton and Joseph P. Quinlan, Center for Transatlantic Relations, Johns Hopkins University School of Advanced International Studies, *The Transatlantic Economy 2016*, p. 91.

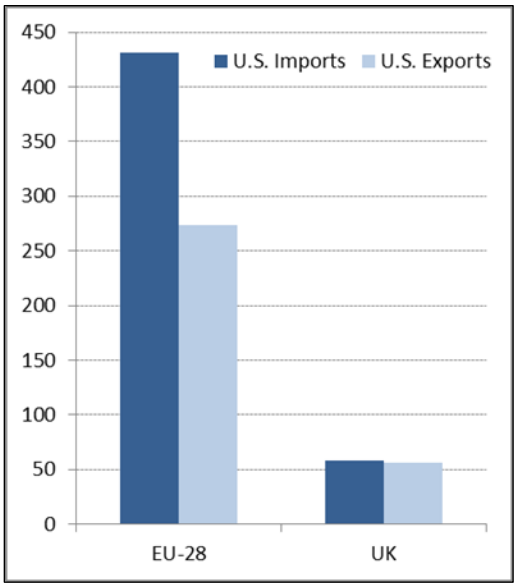
[59] In prior years, depository institutions also have been a significant destination for UK investment in the United States. For 2015, BEA suppressed this data for the UK to avoid disclosure of data of individual companies.

[60] Data from U.S. International Trade Commission, using North American Industry Classification System (NAICS) codes at the three-digit level.

were concentrated in business services ($13.8 billion), including management consulting, travel ($7.6 billion), and transport ($7.9 billion).[61]

Figure 5. U.S.-EU, -UK Goods Trade

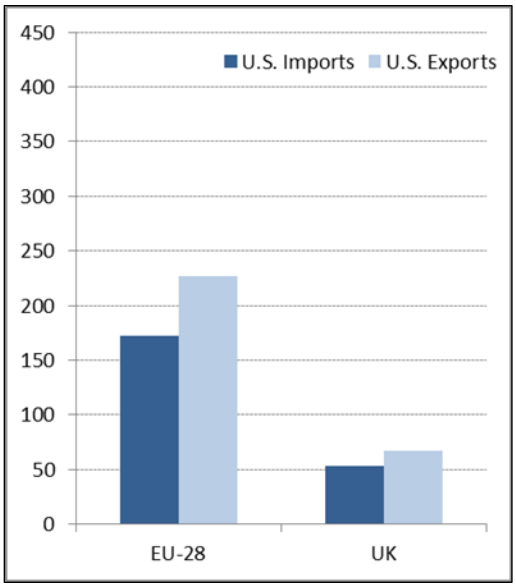
(2015, U.S. dollars in billions)



Source: U.S. Department of Commerce, BEA.

Figure 6. U.S.-EU, -UK Services Trade

(2015, U.S. dollars in billions)



Source: U.S. Department of Commerce, BEA.

Impact of Brexit on the Global Economy

According to recent analyses by the World Bank, the global economy is slowly recovering from the 2008-2010 recession. The economic performance of the United States is one of the few bright spots of the global economy; the unemployment rate fell below 5% in June 2016, and GDP growth is expected to continue in the 2% to 3% range. Uncertainties concerning the economic and financial impact of Brexit began affecting movements in exchange rates prior to the results of the referendum, which, in turn, began affecting the global economy. An appreciation in the value of safe-haven currencies, especially the dollar, can affect a broad range of economic activities. The dollar serves as the de facto global reserve currency, which facilitates many international economic and financial activities. For instance, the global banking system is based on dollars, which thus serve as an invoicing currency for many commodities, including oil and gas. (As an example of the effects of appreciation on safe-haven currencies, the recent appreciation of the Japanese yen is frustrating efforts by the Bank of Japan, which has been engaging in quantitative easing to stimulate economic growth and boost exports through a lower-valued yen.)

In its June 2016 assessment prior to the Brexit vote, the World Bank forecast global growth in 2016 at 2.4%, about equal to that experienced in 2015, but 0.5% below its January 2016 forecast. The assessment indicated that the global economy, although recovering slowly, faces a number of challenges, including uncertainty associated with Brexit:

[61] Data from U.S. Department of Commerce, Bureau of Economic Analysis.

> Weakness in the global economy has persisted and risks have become more pronounced. The divergence in economic activity between commodity exporters and importers has widened. These developments have been accompanied by heightened political uncertainties, concerns about the effectiveness of monetary policy stimulus in some advanced economies, the pace of monetary policy normalization in the United States, and policy makers' ability or willingness to use expansionary fiscal policy, if needed. In addition, for oil importers, the sizeable positive price shock represented by falling prices has not translated into the large boost to growth initially expected.[62]

Some analysts expect the uncertainties created by Brexit to have a negative impact on global markets beyond the immediate turmoil. A protracted political leadership struggle could add to uncertainties over the UK's ability to take the necessary economic and financial measures to restore stability. The simultaneous depreciation of the pound and appreciation of the dollar could add to economic pressures on both developed and emerging market economies. Various central banks, including the Swiss National Bank and the Bank of Japan, for instance, have intervened in foreign exchange markets to stall further appreciation in their respective currencies. In addition, capital flight from emerging economies to safe-haven assets could further add to the economic challenges facing developed and emerging economies and potentially add negatively to global growth prospects.

Looking Forward

For Members of Congress and other policymakers, the Brexit vote likely represents a number of potentially difficult issues. The global economic environment likely will remain somewhat more volatile as financial markets attempt to digest the impact of Brexit vote on the UK and EU economies. In addition, changes in the exchange value of various currencies, due to the Brexit vote, could affect the global economy; this could exceed the immediate effects of the pound's depreciation on the UK economy. In particular, various central banks, including the Federal Reserve, likely will continue to monitor movements in exchange rates, capital flows, and interest rates and the effects these have on the economic performance of the U.S. economy as well as the broader global economy. The Brexit vote also confronts Congress with questions about the future of U.S.-EU and U.S.-UK trade relations, including prospects for the potential T-TIP agreement and any other trade agreements the United States may pursue with the UK going forward.

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[62] *Global Economic Perspectives: Divergences and Risks*, World Bank Group, June 2016, p. 3.

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