

# Boxes

## 1 Economic developments in the aftermath of the UK referendum on EU membership

**This box analyses recent developments and the outlook for the UK economy and the euro area following the outcome of the referendum on EU membership held on 23 June 2016.**<sup>2</sup> A majority of around 52% voted in favour of the United Kingdom leaving the EU. The Prime Minister recently indicated that, by March 2017, the country will formally notify the European Council of its intention to withdraw from the EU. According to Article 50 of the Treaty on European Union, this would start a process culminating in a withdrawal agreement between the EU and the United Kingdom. Failing that, the EU Treaties would cease to apply to the United Kingdom two years after the notification triggering Article 50, unless the European Council, in agreement with the United Kingdom, unanimously decided to extend this period. At present, high uncertainty surrounds the United Kingdom's future economic relationship with the EU, in particular its future access to the Single Market.

**Despite heightened uncertainty in the immediate aftermath of the referendum, economic activity in the United Kingdom has so far been resilient.** Private consumption appears to have been particularly robust. In fact, the GfK consumer confidence indicators rebounded in August and September, following strong declines immediately after the referendum (see Chart A). Retail sales have also held up relatively well. However, uncertainty appears to have weighed on investment, as shown by the drop in investment sentiment indicators (see Chart B).

**Looking at the foreign exchange markets, the outcome of the referendum took many market participants by surprise.** The pound sterling depreciated sharply in the days following the referendum before stabilising somewhat during the summer (see Chart C). In September and, in particular, early October, the pound sterling weakened further, as political announcements in the United Kingdom were widely interpreted as decreasing the likelihood of the country retaining Single Market access in the future. Overall, the pound sterling has depreciated by around 14% in nominal effective terms since the referendum.

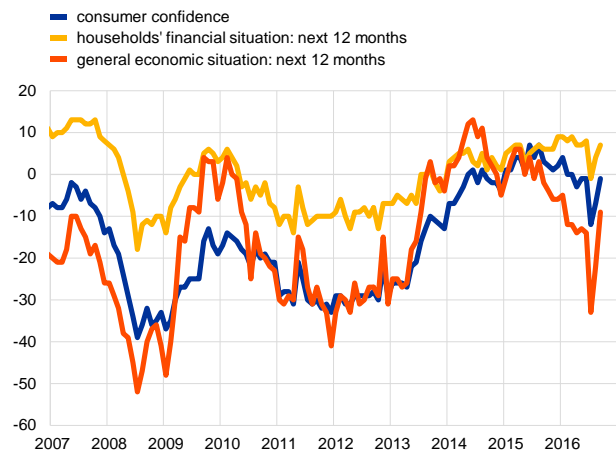
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<sup>2</sup> See also the box entitled "Impact on the euro area economic outlook of the outcome of the UK referendum on EU membership" in the September 2016 ECB staff macroeconomic projections for the euro area.

## Chart A

### GfK consumer confidence indicators

(balance of opinions as a percentage)

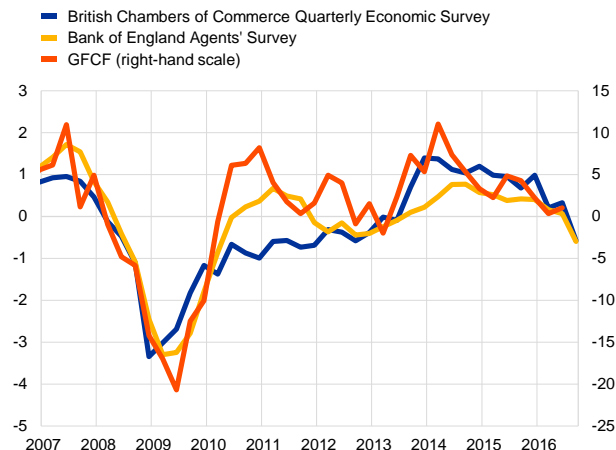


Source: Consumer Confidence Barometer.  
Note: GfK stands for Gesellschaft für Konsumforschung.

## Chart B

### Investment sentiment indicators

(left-hand scale: standardised series; right-hand scale: annual percentage changes)

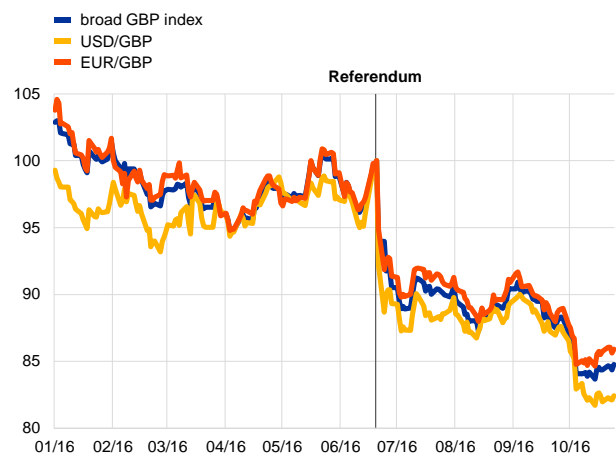


Sources: Bank of England (Agents' Survey), British Chambers of Commerce and Office for National Statistics.  
Notes: GFCF stands for gross fixed capital formation. The survey indicators were constructed by aggregating the indices for services and manufacturing, using value added weights. The Agents' Survey is based on monthly data up to August 2016.

## Chart C

### Exchange rates

(23 June 2016=100, decrease=depreciation of GBP)



Source: ECB.

### Other financial markets have weathered the rise in uncertainty relatively well.

Stock markets have recovered from their abrupt decline in the days following the referendum. Yields on gilts and private bonds stand below their pre-referendum levels, although they increased somewhat on the back of the above-mentioned political announcements in early October. In August the Bank of England cut Bank Rate by 25 basis points to 0.25%, expanded its asset purchase programme and launched a Term Funding Scheme to support the interest rate pass-through to the economy. Furthermore, the new Chancellor of the Exchequer has abandoned the objective of achieving a fiscal surplus by 2019-20 and stated the government's readiness to reset fiscal policy if needed.

### Looking ahead, economic activity is generally expected to slow down.

Recent forecasts for real GDP growth have been revised down significantly since the referendum (see Table A). These projections entail a marked economic downturn, with real GDP growth in 2017 falling to levels ranging from 0.8% to 1.1%. Indeed, heightened uncertainty is likely to continue to weigh on investment in the future. Moreover, the recent sharp depreciation of the pound sterling (see Chart C) will gradually erode real incomes, dragging down private consumption while supporting net exports. Over the longer run, output growth is generally expected to remain below the path projected before the referendum. This partly reflects the transition to a less open economy (in terms of trade, migration and foreign direct investment), which adversely affects innovation,

competition, specialisation and allocative efficiency, and hence productivity and potential output.

### Table

Forecasts for real GDP growth in the United Kingdom

(annual percentage change; percentage point change from pre-referendum forecasts in brackets)

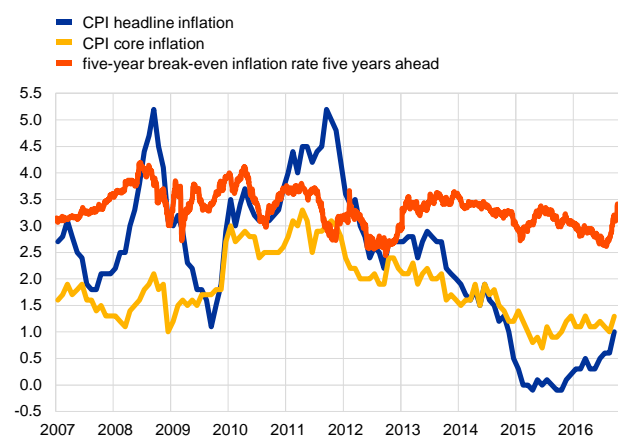
	2016	2017	2018	Latest	Pre-referendum
<b>Bank of England</b>	2.0 (=)	0.8 (-1.5)	1.8 (-0.5)	August 2016	June 2016
<b>International Monetary Fund</b>	1.8 (-0.1)	1.1 (-1.2)	1.7 (-0.6)	October 2016	April 2016
<b>European Commission</b>	1.6 (-0.2)	1.1 (-0.8)	n.a.	July 2016	May 2016

Sources: Bank of England, International Monetary Fund and European Commission.

### Chart D

Inflation developments

(year-on-year percentage changes)



Sources: ECB and Office for National Statistics.

### While inflation currently stands at low levels, it is expected to rise in the near term.

In September annual consumer price inflation increased to 1%, still below the Bank of England's target of 2% (see Chart D). However, indicators of pipeline price pressures, such as the PMI indicator for input prices, have increased over recent months, along with import prices. The pipeline price pressures mainly reflect the sharp depreciation of the pound sterling over recent months. Market-based inflation expectations have also edged up.

### Turning to the euro area economy, recent data releases have overall shown resilience and a limited impact of the UK referendum so far.

Measures of policy uncertainty in the euro area have declined in recent months and the euro area Economic Sentiment Indicator and the PMI, which declined in August, recovered in September and October.

### Looking ahead, adverse medium-term spillover effects to the euro area cannot be excluded.

The aggregate impact will critically depend on future euro area trade developments with the United Kingdom and third country spillovers.<sup>3</sup> The impact could vary across euro area countries, for example as a result of differences with regard to the importance of the pound sterling in the economies' effective exchange rates and related to their trade linkages with the United Kingdom. At the same time, activity in the euro area could possibly be stimulated, for instance by the potential relocation of financial services or increased foreign direct investment flows in the euro area redirected from the United Kingdom.

<sup>3</sup> See also the box entitled "Impact on the euro area economic outlook of the outcome of the UK referendum on EU membership" in the September 2016 ECB staff macroeconomic projections for the euro area.