

BRIEFING: INDUSTRY AND REGIONAL EFFECTS OF A NO-DEAL BREXIT

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OVERVIEW

Ever since EU exit has started featuring in the public debate, NIESR has contributed analyses of the long-run economic impact of different types of Brexit, including the deal proposed by the government in November 2018, a customs union deal and no deal. Since the EU referendum, NIESR has monitored the effects of uncertainty about the kind of exit on economic performance and highlighted policy trade-offs for various Brexit scenarios, including a no-deal exit. The production of this briefing was supported by the ESRC through its Impact Acceleration Award and it focuses on:

- The impact of Brexit so far on the UK economy as a whole
- New NIESR estimates (based like all our estimates on our economic model NiGEM) of the long-run economic impact of a no-deal Brexit on UK regions
- Possible policy responses to a no-deal Brexit

KEY TAKEAWAYS

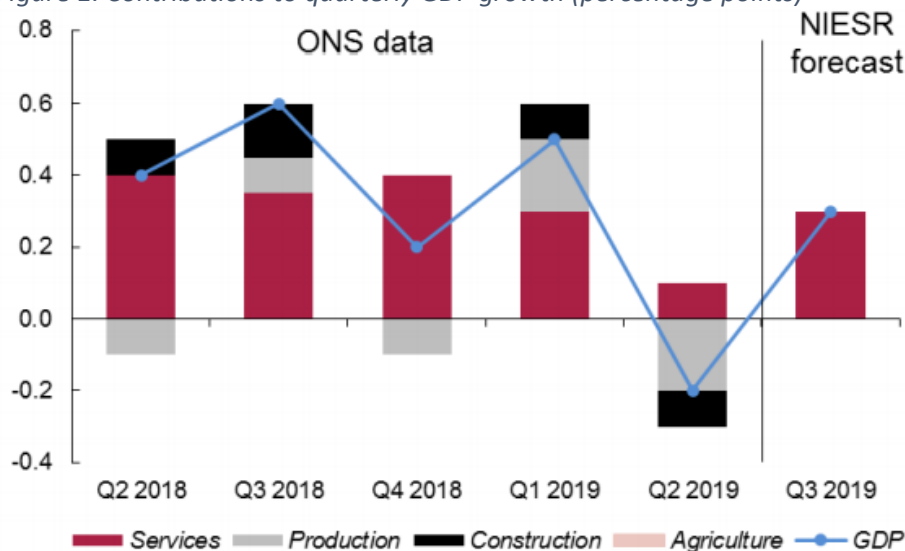
- **Brexit uncertainty** explains a large part of the current lack of momentum in the UK economy through its impact on investment, alongside global economic weaknesses.
- NIESR estimates the UK economy will eventually be around 5 per cent smaller than it would otherwise have been if there is a **no-deal Brexit**.
- **All parts of the UK are set to be poorer with a no-deal Brexit** than they would have been if we had stayed in the EU. The worst affected parts of the country include North Eastern Scotland, Kent, Surrey, East and West Sussex and East Anglia.
- In the short run, the response of the economy to no deal depends on the **level of preparedness** of businesses and **mitigating policy measures** adopted by the government and Bank of England.

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The impact of Brexit so far on UK industries

- Brexit uncertainty alongside global weaknesses explains the **slowdown in UK economic activity**. GDP fell by 0.2 per cent in the second quarter of 2019 and recent indicators, like the PMIs, suggest there has been little growth in the third quarter (Figure 1). Uncertainty around the two Brexit deadlines in March and April instilled **volatility** into the economy.
- **Production sector output** was supported by **stockpiling activity** in the first quarter of 2019. Planned factory shutdowns in the automobile industry in April and a halt to stockbuilding contributed to lower production sector output in the second quarter. Survey information discussed at NIESR's [Business Conditions Forum](#) in August showed no sign of renewed stockbuilding yet. We forecast production sector output to be **flat in the third quarter**.
- The **service sector** accounts for 80 per cent of economic output. **Lack of momentum** in this sector contributes to an underlying weakness in the UK economy. Recent PMIs suggest that the service sector has **grown slightly** in the third quarter.

Figure 1. Contributions to quarterly GDP growth (percentage points)



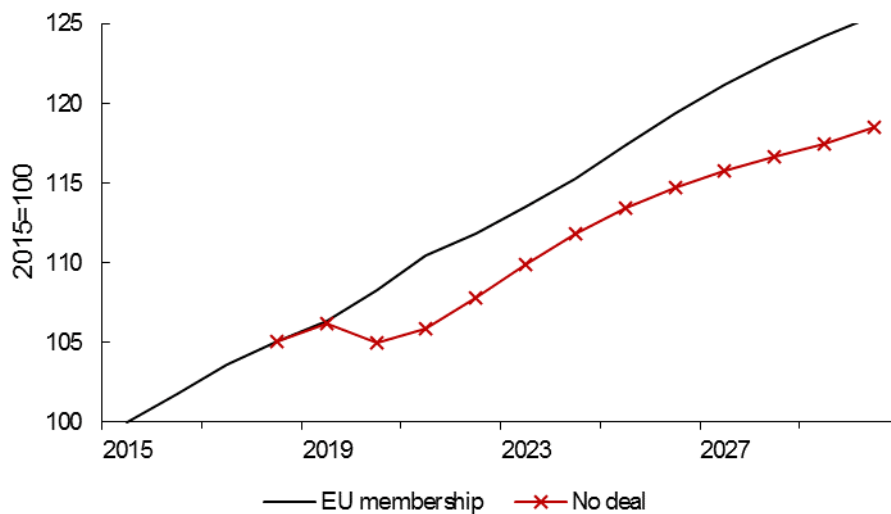
Sources: ONS, NIESR GDP Tracker

- NIESR's [GDP Tracker](#) from August indicates that whole-economy output will expand by **0.3 per cent in the third quarter**, only just offsetting the contraction in the second quarter. But with little hard data published yet, there is a significant risk that the economy is **already in a recession** that began in April, and the clear **possibility of a more material downturn** should there be a no-deal Brexit.

The long-run economic impact of no deal on UK regions

- **All parts of the UK are set to be poorer** with a no-deal Brexit than they would have been if we had stayed in the EU. The **worst affected parts of the country** include North Eastern Scotland, Kent, Surrey, East and West Sussex and East Anglia.
- For the UK as a whole, we estimate that in the event of a no-deal Brexit **UK GDP would be 5-6 per cent smaller** in the long run than if the UK stayed a member of the EU. This would be the result of reduced trade, less net migration and less productivity growth ([Hantzsche, Kara and Young, 2018](#)).

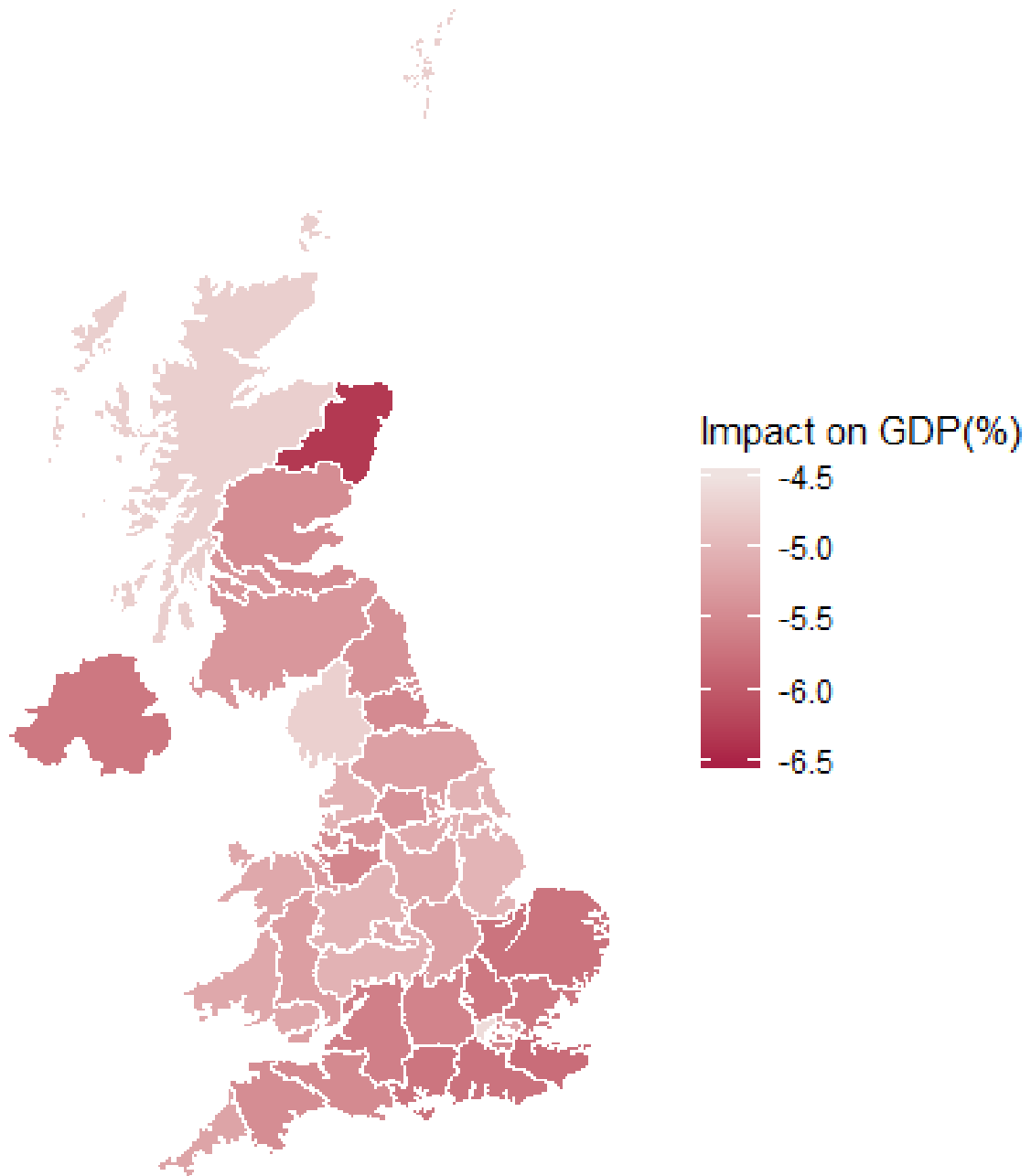
Figure 2. The impact of different Brexit scenarios on UK GDP



Sources: NIESR, NiGEM simulation

- The **production sector** would be directly affected by **new tariffs** charged on EU trade as the UK exits the European customs union to trade on the basis of WTO terms. It would also face barriers in the form of **health and safety** checks once the UK leaves the European single market. We estimate that **UK-EU goods trade would be 50-65 per cent lower** in a no-deal scenario.
- **Trade in services**, which account for around 40 per cent of all exports to the EU, is estimated to be **40-65 per cent lower** if the UK were to leave the regulatory framework of the single market. What is often neglected is that the service sector would also be **severely affected even with a deal**, for instance if the UK were to strike a free trade agreement in goods trade with the EU or negotiate a UK-EU customs union ([Hantzsche and Young, 2019](#)).
- **Linkages between sectors and global value chains** mean that contraction in sectors with a high exposure to trade will be propagated to all domestic sectors and regions to some extent.
- Updated NIESR estimates show that 10 years after exiting on WTO terms, **real personal disposable incomes are estimated to be lower by 7½ per cent** compared to continued EU membership. Reduced spending power will be dispersed across the country, for instance by commuting workers in the London and the South East.

Figure 3. The impact of a no-deal Brexit on regional GDP (% relative to EU membership)



Sources: NIESR, NiGEM simulation

- Reduced incomes would lead to a reduction in tax receipts and thus a **revenue shortfall for HM Treasury**, which according to updated NIESR estimates would reach around **£40 billion per year** in the long term. This would only partly be offset by reallocating **net EU budget contributions of £14 billion per year** to domestic government spending. A significant share of the shortfall would have to be met by **spending reductions** which would likely affect regions heavily reliant on public sector output, like South Yorkshire, and West Wales and the Valleys.

Table 1. The impact of a no-deal Brexit on regional GDP

Region	GDP, % difference relative to continued EU membership
North Eastern Scotland	-6.3
Kent	-5.8
Surrey, East and West Sussex	-5.7
East Anglia	-5.7
Hampshire and Isle of Wight	-5.7
Bedfordshire and Hertfordshire	-5.7
Northern Ireland	-5.7
Essex	-5.6
Gloucestershire, Wiltshire and Bath/Bristol area	-5.6
Berkshire, Buckinghamshire and Oxfordshire	-5.5
Inner London - East	-5.5
Cheshire	-5.5
Outer London - South	-5.5
Dorset and Somerset	-5.5
Tees Valley and Durham	-5.5
Devon	-5.4
Eastern Scotland	-5.4
Merseyside	-5.4
Northumberland and Tyne and Wear	-5.4
West Yorkshire	-5.4
Greater Manchester	-5.3
South Western Scotland	-5.3
Inner London - West	-5.3
East Wales	-5.2
North Yorkshire	-5.2
Leicestershire, Rutland and Northamptonshire	-5.2
Outer London - East and North East	-5.2
Cornwall and Isles of Scilly	-5.2
Derbyshire and Nottinghamshire	-5.2
West Wales and The Valleys	-5.1
South Yorkshire	-5.1
West Midlands	-5.1
Lancashire	-5.0
Herefordshire, Worcestershire and Warwickshire	-5.0
Shropshire and Staffordshire	-5.0
East Yorkshire and Northern Lincolnshire	-5.0
Lincolnshire	-5.0
Highlands and Islands	-4.7
Cumbria	-4.7
Outer London - West and North West	-4.6

Sources: NIESR, NiGEM simulation

- Areas with a large share of high-skilled workers employed in services sectors, like London, will find it easier to **adjust and switch** from producing financial services to other high value added services while other regions will face a slower adjustment process that requires **retraining and reskilling of workers and changes to economic structures**. If **labour mobility** is high, workers will move to sectors and regions with higher pay and more jobs, further propagating the economic impact of no deal.
- We draw on **multisector trade analyses** ([Dhingra, Machin and Overman, 2017](#); [Mion and Ponattu, 2019](#)) to provide **new estimates of the regional impact of a no-deal Brexit**, taking account of some of the aforementioned propagation mechanisms (Figure 3).
- The region facing the **largest output loss** of 6.3 per cent, relative to continued EU membership, is **North Eastern Scotland**, likely a result of the local oil industry and its reliance on EU trade (Table 1). This is followed by **Kent** (-5.8 per cent), **Surrey, East and West Sussex**, and **East Anglia** (-5.7 per cent), mainly due to their geographical proximity to continental Europe and the location of exporting firms and importers.
- While least affected, the estimated economic impact on Highlands and Islands, Cumbria and Outer London West and North West is still greater than 4½ per cent.

Possible policy responses to a no-deal Brexit

- The impact of no deal on the UK economy in the short run will depend on the **level of preparedness** among firms, households and the government. It will crucially also depend on the **response of monetary and fiscal policy** ([Chadha, 2019](#)).
- With a no-deal Brexit affecting both the demand side of the economy by reducing investor and consumer confidence as well as the supply side by making trade more costly, monetary policy faces a **trade-off between stabilising output and inflation** (see also Box B, [NIER February 2019](#)).
- In the event of no deal, we **recommend a temporary reduction in Bank Rate to 0.25 basis points** in November, possibly accompanied by quantitative easing, as long as inflation expectations remain stable. Provided that contingency measures are also scaled up significantly, this could help **avoid a severe recession in 2020** and keep GDP flat that year.
- **Fiscal policy** should focus on the provision of contingency measures and support to industries directly affected by no deal or currently reliant on EU funding.
- In the long run, Brexit should be thought of as a **structural shock** bound to affect the output capacity and to **transform the current set-up of the economy**. This leaves little room for standard demand-side policies but requires **structural policies** to support the adjustment of the economy to the new trading relationship, e.g. through training and active labour market programmes, funds for education and research and development and regional development grants.