
Prospects for the UK Economy: a bi-modal future

National Institute Economic Review

Issue 236, May 2016

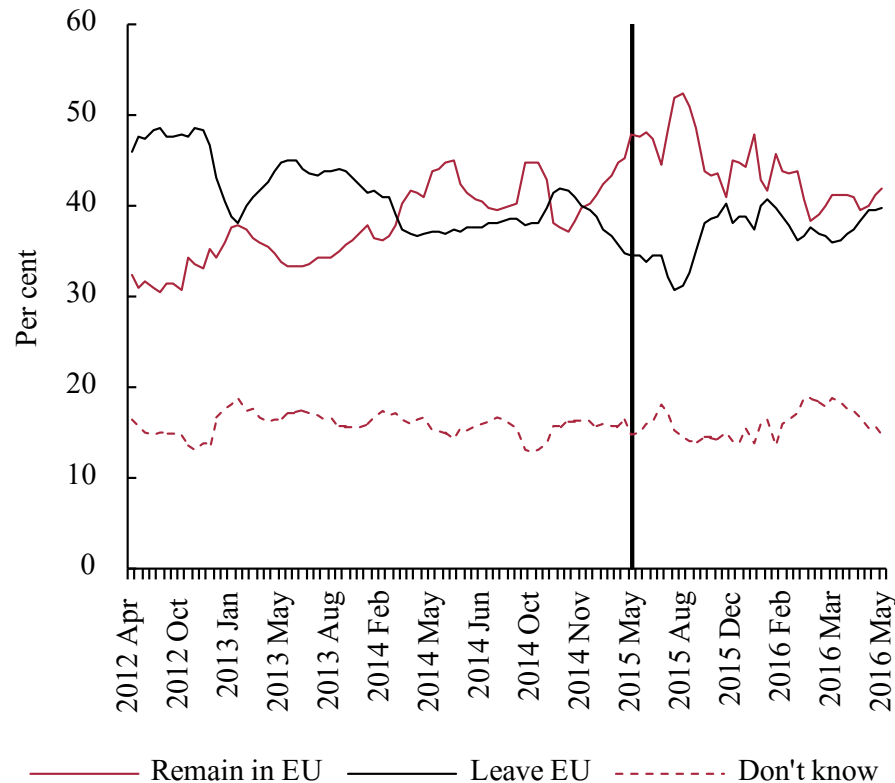
Jessica Baker, Oriol Carreras, Monique Ebell, Ian Hurst, **Simon Kirby**, Jack Meaning, Rebecca Piggott and James Warren



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A narrow spread in the polls

Polling on question of EU membership (4-poll moving average)



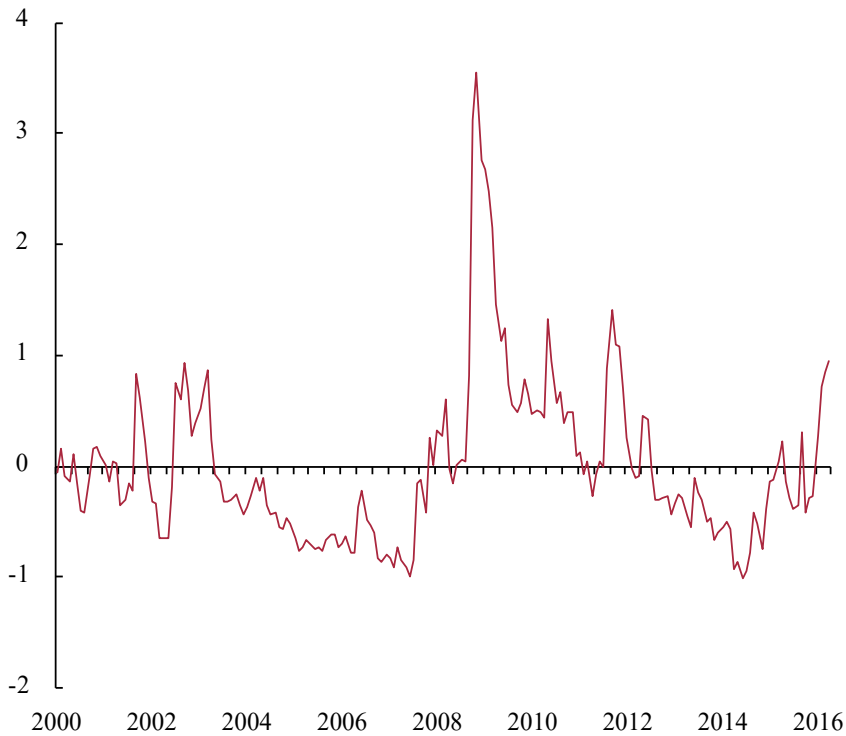
Sources: YouGov, Ipsos Mori, ICM, ComRes.

Notes: Vertical line indicates the time of the UK general election



Heightened uncertainty since the start of the year

UK uncertainty index



Option-implied 3-month sterling volatility



The Short-Term Economic Impact of Leaving the EU



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A vote to leave: uncertainty spikes and risk premia rise

Summary table of short-term shocks introduced from 2016Q3

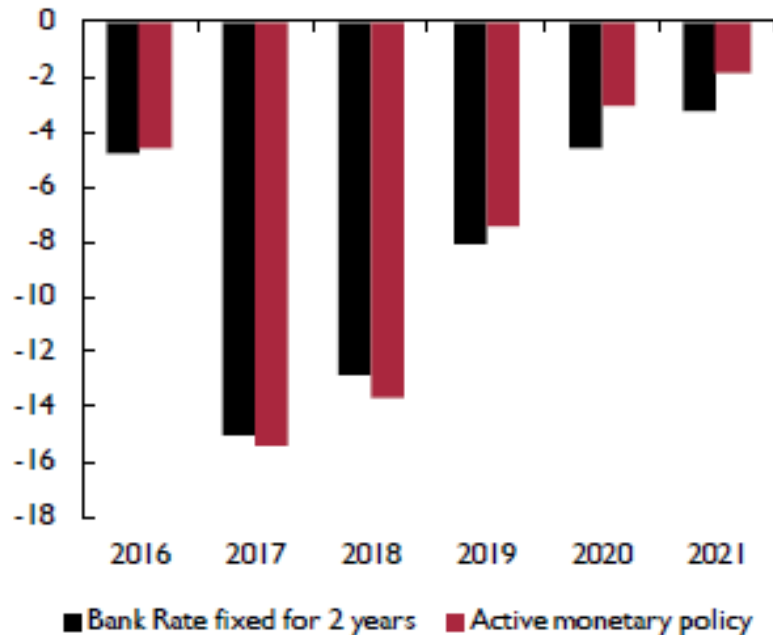
	Calibrated from	Average size of shock (over first two years unless otherwise stated)
Exchange rate premium	3-month options-implied sterling volatility	2016Q3 shock: 2/3 of the magnitude observed in 2008
Uncertainty	Betting markets and historical data	2016Q3 shock: Three times the level in 2016Q2
Term premium	Joyce et al (2011), Breedon et al (2012), Meaning and Warren (2015)	60 basis points
Household and corporate credit premium	Cantor and Packer (1996), Alfonso et al. (2012), Kiff et al. (2012), historical data and author's calculations	35 basis points
Equity premium	Historical data and author's calculations	35 basis points

Note: table in *Review* provides only initial rise in 2016Q3

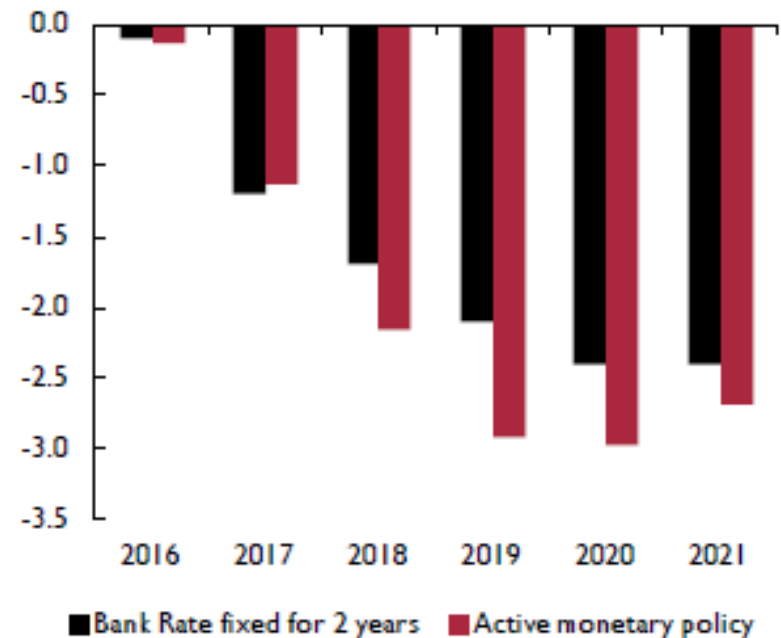


A vote to leave: private sector investment, at trough, around 15% below baseline

Private sector investment (per cent difference from baseline)



Household consumption (per cent difference from baseline)



Source: NiGEM simulations.

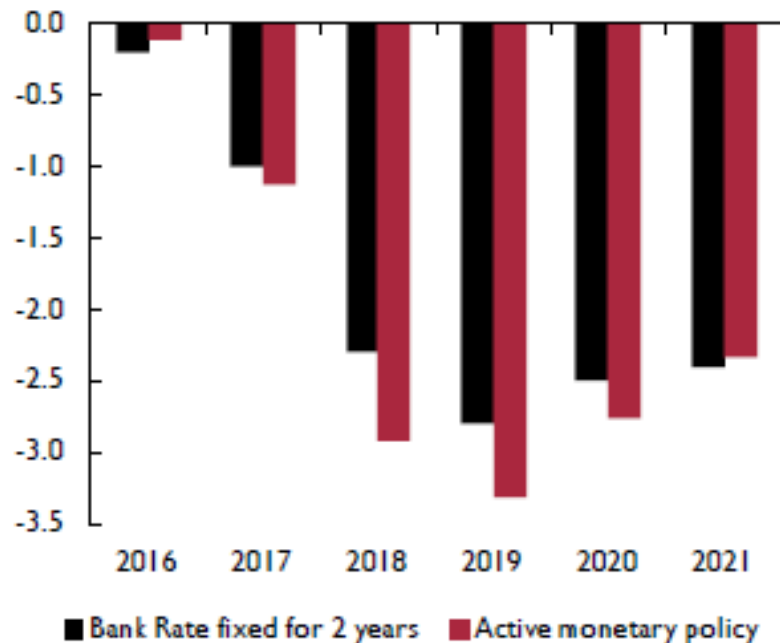
Source: NiGEM simulations.

Note: active policy suggests a tightening of interest rates from 2017. It refers to an endogenous response by the MPC, represented by a Taylor Rule (using the parameters published for the Bank's model COMPASS).



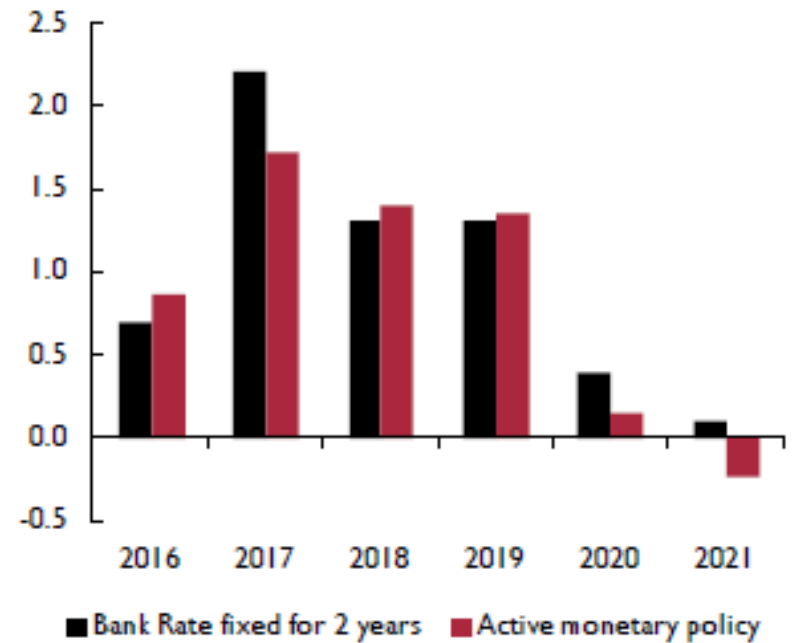
A vote to leave: GDP negatively affected by the shock of a vote to leave; inflation spikes (relative to counterfactual)

GDP level (per cent difference from baseline)



Source: NiGEM simulations.

Inflation rate (percentage points difference from baseline)



Source: NiGEM simulations.

Note: active policy suggests a tightening of interest rates from 2017. It refers to an endogenous response by the MPC, represented by a Taylor Rule (using the parameters published for the Bank's model COMPASS).



Long-term impact on the UK economy of leaving the EU

National Institute Economic Review

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Monique Ebell and James Warren



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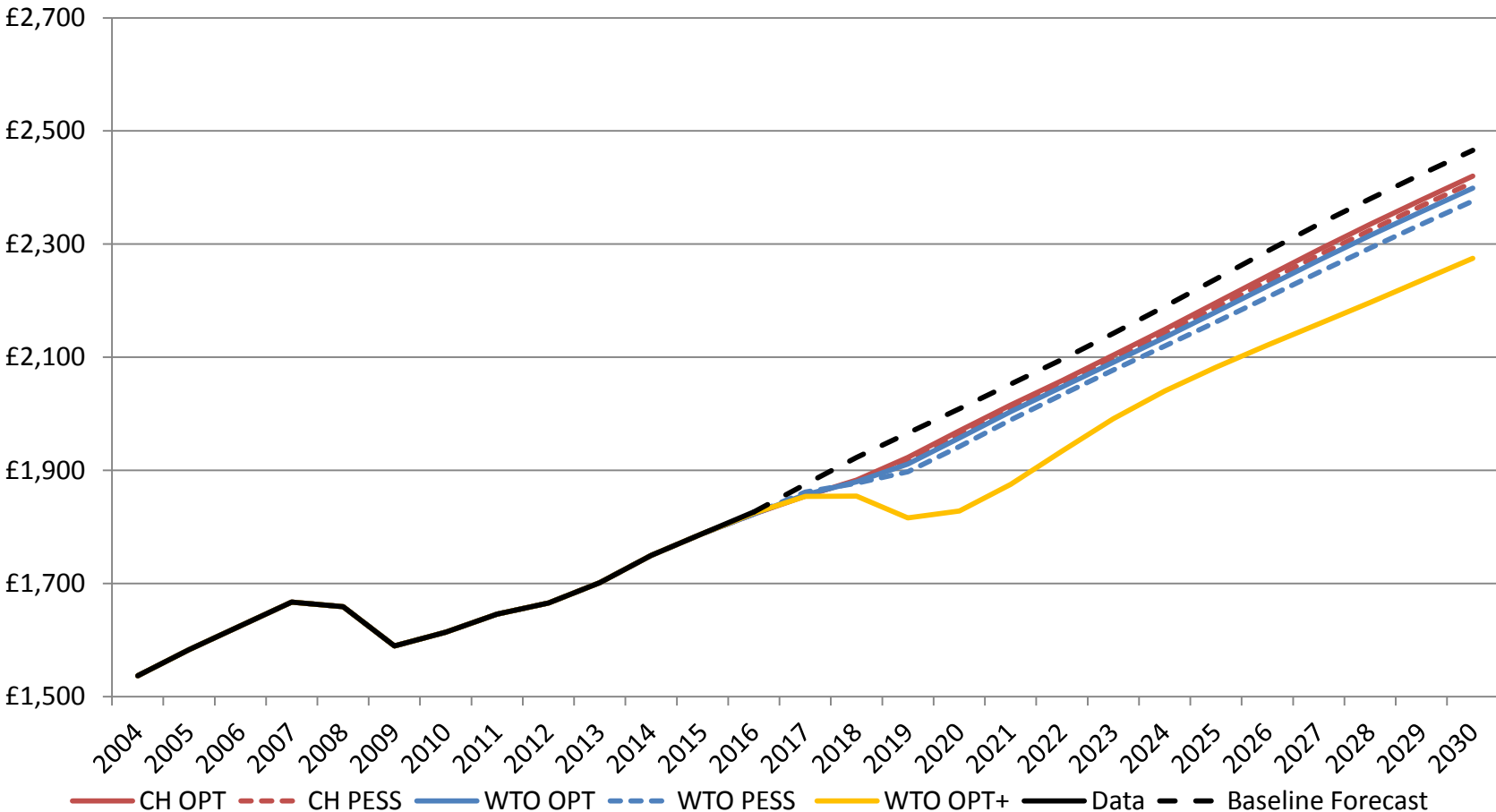
Headline Results

% decrease	Switzerland	WTO	WTO+
GDP	1.9 – 2.3%	2.7 - 3.7%	7.8%
Real wages	3.1 – 3.8%	4.6 – 6.3%	7.0%
Consumption	2.8 – 3.5%	4.0 – 5.4%	9.2%

- All results are % declines compared to the 2030 baseline of remaining in the EU
- Switzerland and WTO focus on trade and FDI effects
- WTO+ adds a 5% productivity drop to WTO-optimistic



GDP, compared to baseline forecast



Comparison of recent studies

Comparison of recent studies on the impact of Brexit on the United Kingdom

	OECD	LSE/CEP	HM Treasury			NIESR			NIESR
	WTO/FTA	EEA/FTA	EEA	FTA	WTO	EEA	FTA	WTO	WTO+
			Brexit Modelling						
Reduction in total trade (%)	-10 to -20	-12.6	-9	-14 to -19	-17 to -24	-11 to -16	-13 to -18	-21 to -29	-22
Reduction in FDI (%)	-10 to -45	none	-10	-15 to -20	-18 to -26	-10	-17	-24	-24
EU budget savings, % of GDP	0.3 to 0.4	0.0	0.4	0.4	0.4	0.0	0.3	0.3	0.3
Method	NiGEM	Estimated trade elasticities (a)	NiGEM			NiGEM			NiGEM
			Results						
GDP, % change									
Central estimate (%)	-5.1	-7.9	-3.8	-6.2	-7.5	-1.8	-2.1	-3.2	-7.8
Range (%)	-2.7 to -7.7	6.3 - 9.5	-3.4 to 4.3	-4.6 to 7.8	-5.4 to 9.5	-1.5 to -2.1	-1.9 to -2.3	-2.7 to -3.7	-7.8
Wages, % change									
Central estimate (%)	n.a.	n.a.	n.a.	n.a.	n.a.	-2.7	-3.4	-5.5	-7.0
Range (%)	n.a.	n.a.	n.a.	n.a.	n.a.	-2.2 to -3.2	-3.1 to -3.8	-4.6 to -6.3	-7.0
Ratio of GDP to trade declines	0.27 - 0.39	0.5 - 0.75	0.42	0.33 - 0.41	0.32 - 0.40	0.13	0.14	0.13	0.35
			Channels						
Reduced trade with EU	x	x	x	x	x	x	x	x	x
Productivity losses from reduced trade	x	x (a)	x	x	x				x
Reduction in FDI	x		x	x	x	x	x	x	x
Productivity losses from reduced FDI	x		x	x	x				
Change in migration	x								
Productivity gains from deregulation	x								
Lower or zero contributions to the EU budget	x		x	x	x		x	x	x

Notes: (a) The LSE/CEP analysis uses econometric estimates of the relationship between trade and GDP to estimate the impact of a given reduction in trade on GDP. These estimates would, in principle, capture any and all impact of trade on GDP, including productivity gains from increases to openness. They might also capture any increase in FDI which is associated with greater trade volumes, as well as any increases in productivity associated with this additional FDI.



Risks to the long-run after a vote to leave

- Upside Risks, might reduce losses in WTO cases
 - Deregulation, gains estimated by Open Europe at £12.8 bn annually
 - Migration, if 'optimal' migration policy were achieved
- Downside Risks, might further increase losses
 - Productivity, may be large
 - Scotland, Northern Ireland – debt?
 - Migration – skill shortages, skill mismatches
 - Tail risk - break-up of the EU?

