BREXiT UNIT | iTCU UNIT International Trade & Competition

"No Deal" Fear-checker

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"GDP already hit 2.1% - and it will only get worse"

The claims

According to a report from investment bank UBS, the UK economy is already 2.1% smaller than it would have been without Brexit. And because the UK has not even left the EU yet, the damage will only increase.

The evidence

The UBS report was only the latest of several papers using the same methodology, starting with an academic blog in November 2017. The clearest (and best) is a recent study by the Centre for Economic Reform (CER), published this June, which also put the hit to GDP at 2.1%. In short, these studies use a computer algorithm to select a weighted combination of countries whose growth best matched that of the UK economy before the EU referendum. This actual performance of the UK economy since the poll is then compared to this synthetic 'doppelganger', and the difference taken as a proxy for the impact of the Brexit vote.

Our assessment

The UK economy has probably grown more slowly due to the additional inflation prompted by sterling's fall, and the heightened uncertainty. Indeed, many Brexiteers acknowledged that the immediate impact of a vote to leave might be negative. But the figure of 2.1% for the hit to GDP looks far too high.

For a start, the 'doppelganger' methodology is unreliable, especially over relatively short periods. In this case, the US economy (weighted 24% in the CER model) has benefited from the Trump boost, which may well be temporary. Continental Europe was also due a period of catch up after several years of under-performance (flattered further by the surprisingly high weight of 23% on Hungary). What's more, sterling was already looking over-valued and UK consumer spending was unsustainably high before the referendum. In other words, the UK would have slipped down the growth league table anyway, regardless of Brexit.

Other estimates in the same ballpark are questionable too. For example, Bank of England Governor Mark Carney noted in May that the level of UK GDP was between 1.5% and 2% lower than the path implied by the Bank's pre-referendum forecasts. But to call this the Brexit impact you have to assume that those earlier forecasts would otherwise have been right, and that all the shortfall was due to the vote to leave.

For what it's worth, my own estimate is that the level of GDP is now around 1% lower than it would otherwise been (still bad, but far smaller than the hit that many, including HMT, had predicted). It is hard to argue that there has been a much larger shock than this when unemployment has continued to tumble.

The more important point, however, is that whether the initial hit has been 1%, 2%, or something else, it is wrong to assume that it can only get worse. The fact that the UK has not yet left the EU might mean that the bulk of any costs are still to come, but also the bulk of any benefits. (Look out for a forthcoming Fear-Checker on the long-run economic impacts.) Even the initial hit will be partially reversed if investment rebounds as uncertainty clears, and exporters feel more confident in taking advantage of the weaker pound.

Conclusion

The CER will be updating its estimates regularly and it will be interesting to see whether these show the 'cost' of Brexit rising, or falling. But they don't tell us much about where the economy will eventually end up.

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