ECONOMIC ANALYSIS

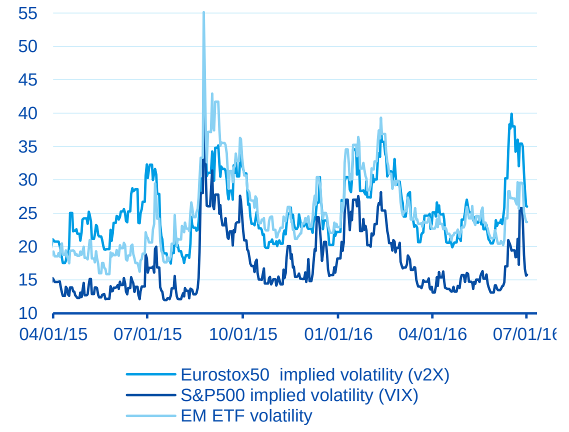
Global | “Brexit” triggers uncertainty ahead and puts a downward bias in the global growth scenario

BBVA Research

The unexpected Brexit victory triggers a period of global uncertainty that financial markets are screening. Volatility has rebounded across the board (Graph 1) and the preference of investors for safe-haven assets has driven bond yields to record low levels[1] in the days after the referendum. The sell-off of risky assets has hit especially European assets and, in particular, equity markets, peripheral debt and banks. The resilience of EM markets is in part due to the fact that Brexit is a risk event more focused on Europe and also because of the relief in EM debt and currencies provided by the expectation of a more gradual Fed tightening.

All the uncertainties about the following negotiating process between the UK and the EU do not help to anchor expectations. After his defeat, PM Cameron resigned and left the responsibility to invoke article 50 of the Lisbon Treaty to trigger the exit negotiations to the next PM, who will be chosen in September[2]. However, the possibility of early elections, the potential consequences of the vote for “remain” in Scotland and Northern Ireland and even the calls made to reverse the decision[3] do not favour clarity in the UK political scenario, needed to start to negotiate with the EU. Hence uncertainty is expected to settle in economy over the coming months.

Graph 1
Volatility in the financial markets
Equity market implied volatility (%)



Source: BBVA Research & Bloomberg

Table 1
Estimated impact of Brexit on GDP growth in 2017 (pp). Baseline scenario (transitory impact)

United Kingdom	-1,5
Eurozone	-0,3
Spain	-0,3
US	-0,2
China	-0,1
Turkey	-0,1
Mexico	-0,3
Colombia	-0,1
Chile	-0,1
Argentina	-0,1
Peru	-0,2

Source: BBVA Research

The effects of this uncertain environment on expenditure decisions explain the downside bias that affects our global growth forecasts (Table 1). Under our baseline scenario, the Brexit impact should be contained and transitory, slightly more intense in EZ countries than in the rest of the world. All in all, we think that the current level of global volatility in financial markets, well above their long term average and comparable to peaks registered in August-15 and January-16 (uncertainties linked to China), might finally

1. 36% of the total outstanding of developed sovereign bonds is at negative yield.
2. After that, a two-year period is open to negotiate with the EU the terms of separation, and especially the new agreements that will rule the relationship between the UK and the EU.
3. Signatures are being collected to repeat the referendum (here the Petition to the UK Government and Parliament: already 4.0 million).

vanish next fall. The channels of impact are mainly (lower) confidence, (heightened) uncertainty and (lower) asset prices impacting on investment and consumption. Apart from the expected activism from the BoE, a more dovish Fed (coherent with the current weakness of the domestic environment in the US) and the ECB current purchases program will contribute to soften the impacts. All in all, **the negative bias for the global GDP growth might be around -0.2pp (vs. 3.4% GDP growth in 2017 previously expected)**.

However, the impact of uncertainty could be less transitory, coherently with a worsened political scenario coming from heightened stress in the negotiating process between the UK and the EU or due to political uncertainty as regards the EU future. In that scenario, the upsurge of stress in the European banking system and a feedback loop sovereign-banking might not be discarded. In that case**, higher and less transitory negative impact on GDP will happen across the board**.

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