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All about Brexit

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In the referendum on June 23, 2016, a majority of the UK electorate voted to leave the European Union (EU), laying down path to end the 46 year membership with the EU. The 'Leave' group won with majority of 51.9% to 48.1% with the turnout being about 72%. This has affected the local currency (pound), lowered business activity in the region and has raised concerns over the future of the U.K. economy and procedural uncertainties regarding Brexit.

In this Report, we look at the major factors that laid ground for Brexit, the major details of the withdrawal bill and the reasons behind the rejection of the Brexit deal by Members of the UK Parliament. In addition, we have also examined the impact of Brexit on pound along with its implications on the Indian economy.

What is the EU?

The European Union is an economic and political partnership created post World War II involving 28 European countries formulated with the idea that countries which trade together are unlikely to go to war with each other. It has since evolved to become a single market where goods and people move around freely as if the member states were one country. The Union has its own currency, the euro, used by 19 member countries, its own Parliament and sets rules areas such as environment, transport, consumer rights and even things such as mobile phone charges. UK is to leave this Union on 29th March 2019.

Why Brexit?

Some of the main factors that laid ground for Brexit include:

Immigration – Unrestricted migration rules by EU led to higher number of migrants in UK, pressurizing job markets over the years which resulted in depressed wages in the region.

Cost of EU Membership Fee – Britain's contribution to the EU budget is much higher than the benefits they receive in the form of rebates or direct expenditure. Leaving the EU will result in cost saving, as the country will no longer have to contribute to the EU budget.

Sovereignty – People in support of Brexit view that the move will allow the country to establish itself as an independent nation, and enable them to establish their own tax laws and trade agreements with rest of the world.

Timelines of Key Events leading up to Brexit Vote

June 23, 2016	• Britain votes to leave the European Union
June 24, 2016	• David Cameron's resignation
July 13, 2016	• Theresa May becomes the new Prime Minister
Mar 29, 2017	• The British Govt. triggers Article 50, setting in motion a plan to leave EU on March 29, 2019
July 7, 2018	• Resignation of David Davis (Brexit Secretary) , Boris Johnson(Foregn Secretary)
Nov 25, 2018	• EU leaders approve a withdrawal deal reached with Britiain.
Dec 10, 2018	• Theresa May delays the planned Brexit vote in UK Parliament
Jan 15, 2019	• Theresa May's deal gets rejected and no-confidence vote gets scheduled on May's government
Jan 16, 2019	• Theresa May survives no-confidence vote.
Jan 21, 2019	• Theresa May to return to the Commons with a Plan 'B'.
Mar 29, 2019	• The UK is expected to leave EU.
Dec 31, 2020	• The transition period ends (unless somehow extended past 2020.)

What does Withdrawal Bill include?

The draft agreement on the withdrawal of the United Kingdom from the EU was published on 14th November 2018 which provides the details on how the UK will exit the EU.

The agreement encompasses some of the below stated key points:

1. **Transition period** – The agreement sets out a transition period which is to last until 31 December 2020 and can be extended on mutual consent between EU and UK. This transition period will enable the affected industries and government agencies to get accustomed to the changes for a smooth transition. During the transition period, UK will still continue to be a part of EU, bound by the obligations of the EU law as a result of which free flow of goods, capital, services and people will continue.
2. **Citizens' rights –** With free movement of citizens allowed during the transition period, EU citizens can reside in Britain and vice-versa. However, citizens taking up residence before the end of the transition period will be allowed to remain beyond transition and a stay for 5 years will ensure permanent residence.
3. **Contribution to EU budget**: The UK will continue contributing to EU budget uptil the transition period. The agreement has not specified any estimate of the total amount to be paid by the EU.
4. **Trade deal –** During the transition period, UK will be able to negotiate its own trade deals while still being a part of the existing EU trade deals with other countries.
5. **Situation of Northern Ireland –** A backstop plan has been proposed that will ensure free movement of goods from Northern Ireland to UK and EU, implying that Northern Ireland will be tied to EU customs rules as long as any solution is devised. However, in absence of any solution during the transition period, the Northern Ireland will be bound to EU rules and regulations in future.

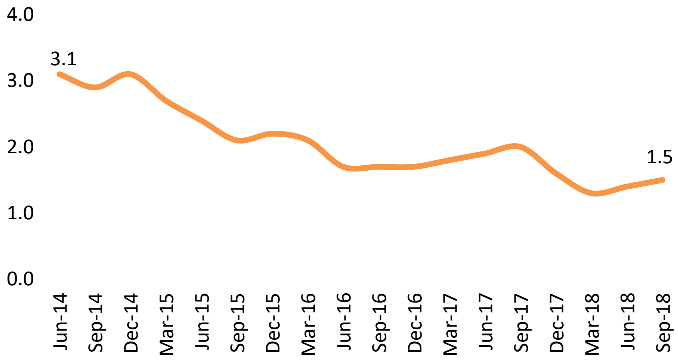
Why Theresa May's Brexit deal got rejected by Members of the UK parliament?

British Prime Minister Theresa May's Brexit deal was rejected by the UK Parliament that has triggered political upheaval in the country and increased chances for a disorderly exit from the EU or even to a reversal of the Britishers' decision to leave EU. After the rejection of the deal, Theresa May had to face a vote of no confidence which she won. Winning this no confidence vote has provided her with the required time to formulate another plan which will be discussed on 29th January 2019 in the UK parliament.

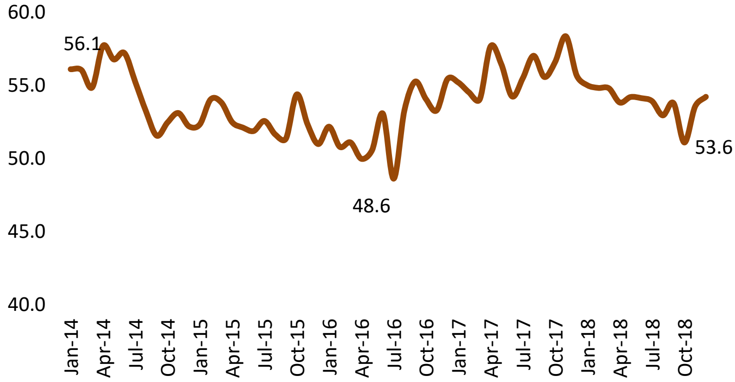
The main issue of contention in the deal was the discussion surrounding Northern Ireland. Both the countries wish to maintain free movement of goods and services through Northern Ireland and have proposed a backstop – a kind of safety measure (which will be effective post the transition period) to ensure free movement of goods and services irrespective of the outcome regarding the future trade talks between both the countries. This backstop would mean keeping the Northern Ireland in the EU customs union which will retain EU's authority over the province. This has been seen as UK compromising its independence and having no authority in establishing their own rules and regulations by most of the Britishers. In addition, UK is supposed to contribute to EU's budget until the transition period ends. As there is no clarity over the duration of the transition period, Britishers might have to extend their contribution which was opposed by the Parliament as this will lead to loss of funds.

Has concerns over Brexit affected the Britain's macroeconomic situation?

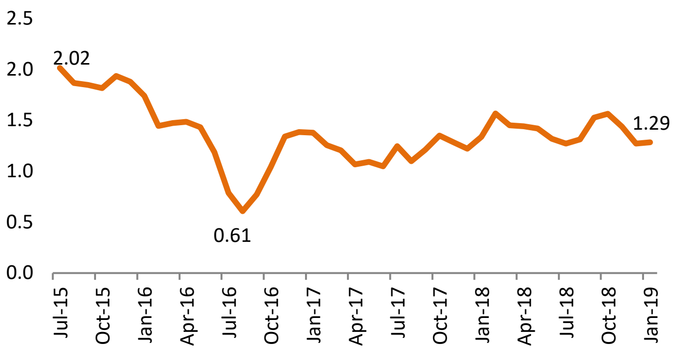
Decline in quarterly GDP growth on y-o-y basis



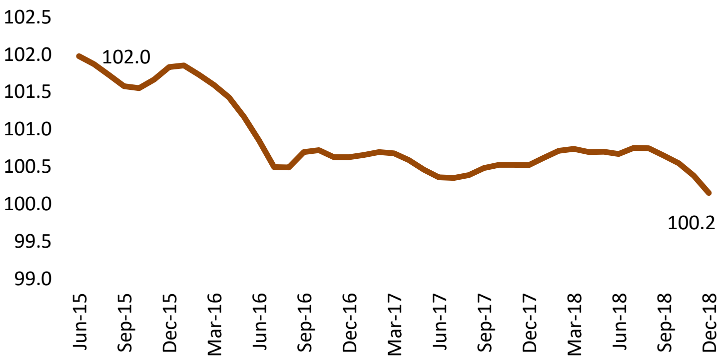
Decline in manufacturing activity as per PMI data (fell to 48.6 in July'16 (a month after referendum)



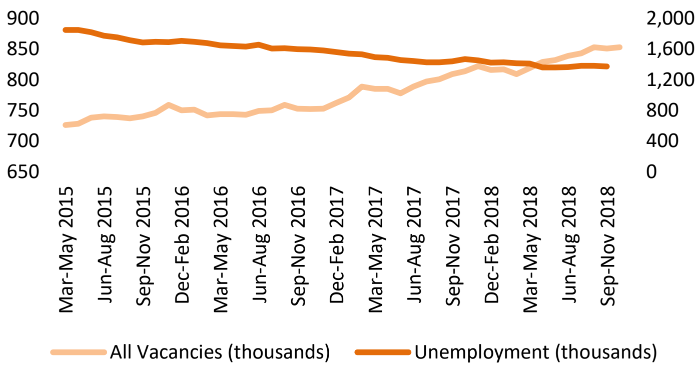
Decline in 10 year UK government bond yields (%) on increased demand for safe haven amid Brexit uncertainties)



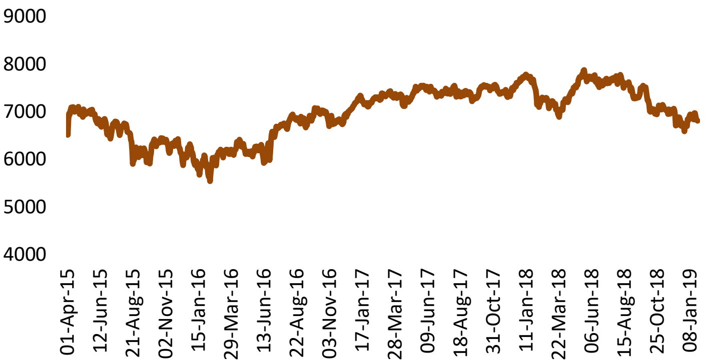
Fall in Consumer confidence Index



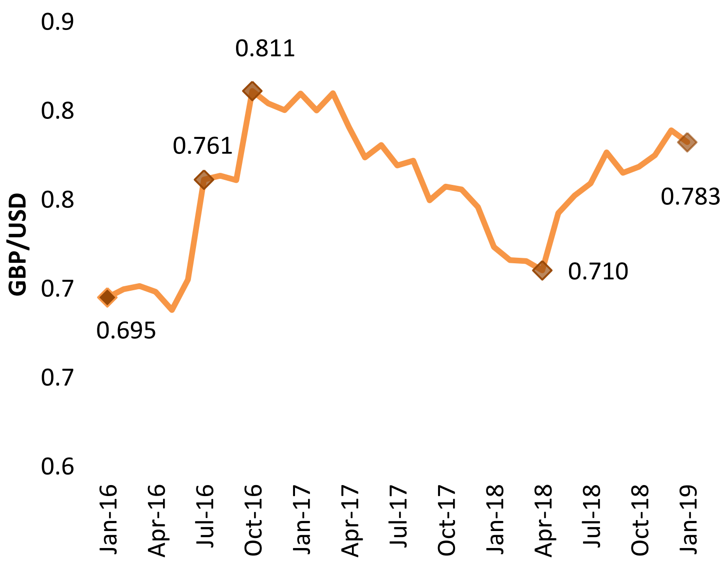
Mixed picture for employment scenario : Decline in unemployment rate while increase in Job vacancies



Movement in FTSE



Impact of Brexit on Pound:



Although the movement in pound has been volatile post the referendum results, it has largely weakened against dollar, depreciating by nearly 14% during 22[n] June 2016 to 18[th] Jan 2019. It fell sharply by 8.5% against dollar during 23rd June'16 – 24th June'16 post the referendum results which was its biggest one-day loss in the history. Since then from the enactment of the Article 50 to deciding whether article 50 can be triggered without the Act of Parliament has weighed on pound. In addition, doubts over the stability of UK leadership following resignations of Mr Dominic Raab (Brexit Secretary) and Ms Esther McVey (work and pensions secretary) further exerted downward pressure on the currency. There have been several times when the pound surged back, however, it still has not reached anywhere near to pre-Brexit value.

Concerns over the future of the U.K. economy and procedural uncertainties regarding Brexit have weighed on currency.

Summary of Brexit Scenarios on Britain's asset classes:

1. **Exit with an agreement:** This will provide temporary relief to the markets/stocks and will mark a beginning of further long term trade negotiations between EU and Britain.
2. **Parliament rejects the agreement and UK Exit with no deal:** It could result in end of Theresa May's leadership and may result in turmoil in stock markets amid increased concerns over UK economic prospects. There will be an increased demand for safe haven assets that will increase the demand for UK bonds.
3. **Extend Article 50:** A second referendum might result in either extending Article 50 (current deadline is 29[th] March) or remain in the EU. Both the scenarios will result in increased demand for safe haven and increased chances of general elections.
4. **Remain in the EU:** This could lead to increased positive sentiments and gains in the UK equity markets.

Implications on Indian economy

There could be a series of positive and negative impacts of Brexit on Indian Economy.

Positive impact

1. Restricted migration from Europe to Britain could result in probable increase in demand for skilled labor from India.
2. Britain is one of the preferred destinations for Indian students. After Brexit, British universities will no longer be obliged to offer subsidized education to the students of EU, resulting in freeing up of funds available for other countries, including India.
3. Britain's share in Indian exports is relatively lower (nearly 3%) compared with EU and other countries. A possibility of free trade agreement between the two countries could enhance their trade relations and improve UK's share in India's total exports.
4. UK is likely to become a less attractive destination for FDI flows amid uncertainties surrounding Brexit. Therefore, India being its prominent source of FDI could receive bigger incentives in terms of tax breaks and easier regulations.
5. Central banks would defer interest rate hikes in Europe as well as USA given the uncertainty which will again be useful for emerging markets including India in terms of FPI flows.

Negative impact:

1. India being one of the largest emerging economies could witness possible FPI outflows mainly due to uncertainties in the global markets regarding Brexit, exerting downward pressure on Indian currency.
2. Indian companies based in UK could witness a rise in input cost and lower margins with depreciation in pound and restriction of free flow of goods and services to EU. They would have to look for other markets.
3. Depreciation in pound does not bode well for the Indian IT sector and can negatively impact the growth in the sector as Britain accounts for nearly 17% of India's export of IT related services.

The impact on India will get clear once the outcome of Brexit negotiations unveil. In absence of finalization of Brexit negotiations, any likely impact be either positive or negative will be difficult to gauge at this point in time. However, Indian markets tend to be vulnerable to developments in the global markets. Therefore, any uncertainties arising in the global space are likely to be percolated in the Indian markets in terms of volatility in the equity markets and currency.

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