UK Referendum Result

Sterling Falls Sharply on Leave Vote

- **The UK voted by a narrow margin** of 52%:48% **to leave the EU in yesterday's referendum vote.** Opinion polls had pointed to a very close outcome. However, the markets had banked heavily on a Remain vote, especially after opinion polls in recent days suggested a narrow win for the Remain side. We believe that the vote to leave is likely to have profound economic and political consequences for the UK, Ireland and the EU. Already the UK Prime Minister has announced that he will resign by the autumn. The most immediate impact is being felt in financial markets. We have seen sharp falls in sterling and stock markets today.

- **For most firms though, apart from the sharp fall in sterling which will impact many of them, it will be business as usual over the next couple of years, albeit against a backdrop of heightened uncertainty and weaker economic activity.** This is because it is **likely to be at least two years before the UK actually leaves the EU.** The current free trade arrangements will stay in place until then. We don't know what the new trade arrangements will be post the UK's departure.

- **The referendum vote in itself does not trigger a UK departure from the EU. The UK government has to invoke Article 50 of the Treaty on European Union and formally notify the EU authorities that it wants to leave the EU.** It is unclear when it will actually do this. The outgoing Prime Minister has indicated that it will be a decision for his replacement to take. The new Prime Minister may well be in no rush to do so. The Treaty provides for a two year period for discussions on the arrangements for exiting the EU once Article 50 is invoked. This period can only be extended with the unanimous agreement of all other member states. Thus, the earliest the UK would leave the EU is likely to be end-2018 but it could well be end-2019 or later.

- **It is not definite that the UK will leave the EU. We would not be surprised if there is a second referendum** in the UK on either revised membership terms or on the actual exit terms themselves. A large majority of UK MPs want the UK to stay in the EU. There may be efforts by Parliament to put the issue to the electorate again, e.g. in circumstances where a very poor exit deal was on offer from the EU with no access to the Single Market, or if the UK Government managed to renegotiate its membership terms with the EU.

- **The UK currency** experienced a near 20% appreciation on a trade-weighted basis between 2013 and 2015. **Some of these gains unwound** over the past six months, largely on concerns that the UK could vote to leave the EU. **Sterling, though, recovered some ground in the past week in anticipation of a Remain vote, rising to $1.50, with the euro moving back down to 76p after polls closed last night.**

- **Sterling saw sharp loses overnight as the count began to point to a win for the Leave side, falling by over 10% to 30-year lows against the dollar, below $1.35, with the euro moving up to around the 82p level.** As expected, the euro also fell back against the dollar, declining from $1.14 to below $1.10. Sterling, though, has recovered some ground this morning and is currently at $1.37 and 81p vs the euro.

- **Sterling could lose further ground in the coming weeks as the ramifications of this vote sink in against a backdrop of heightened economic and political uncertainty. We could see the euro rise back up to its 2013 range of 84-86p, while sterling may go as low as $1.25 against the dollar.** The euro is also likely to lose further ground against the dollar, as the UK's departure will be seen as a severe blow to the EU. The EUR/USD rate could fall to its end 2015 lows of $1.07.

- **The vote to leave is also impacting the broader financial markets. Stocks are taking a major hit**, because of the risks to future earnings, especially for those companies exporting to or from the UK. Generally, stock markets are down between 5-9% this morning.

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- Meantime, **the BoE has indicated that it will inject liquidity into the markets if required**. A UK rate cut and an increase in QE could come on to the agenda in the months ahead. There is also now an increased likelihood that the ECB may cut its deposit rate again.

- **Most studies show that leaving the EU would have a negative impact on the UK economy.** It could take up to a decade for the full economic impact to be felt in terms of FDI, trade flows, migration etc. There would obviously be negative knock-on effects for Ireland given its close ties with the UK. **Uncertainty will be the main factor weighing on activity in the short-term,** especially investment. It is very difficult to quantify the full macro-economic effects on the UK and Irish economies. We don't know what the post-Brexit trade arrangements would be between the UK and EU. Note that Ireland cannot negotiate a bi-lateral trade deal with the UK. Meanwhile, the EU exit negotiations will be a prolonged and complicated process, with an uncertain outcome. FDI into the UK will be negatively impacted, especially if there is uncertainty over free trade with the EU. The EU economy itself is also likely to be negatively impacted.

- The critical question centres around what type of trade arrangements would be put in place between the UK and EU post a Brexit. **The more the UK seeks to regain control over policy and regulations, the more difficult it will be for it to negotiate a worthwhile trade deal with the EU.** In order to secure a preferential trade deal, the UK is likely to have to adhere to the rules and regulations of the Single Market.

- **We may well see the EU adopt a very hard line on trade in the exit negotiations with the UK** on the basis that if concessions are granted to Britain, other countries may also consider leaving and seek similar arrangements. Indeed, there are already calls in some countries to hold referendums on EU membership. Thus, the **most that may be offered to the UK is for it to remain in the EEA** (European Economic Area), thereby largely maintaining free trade with the EU, similar to Norway. This option might not prove attractive to the UK, though, as it is unlikely to be allowed to take control of immigration policy. The UK would also have to still abide by EU rules and regulations and make a contribution to the EU budget. However, it might prove to be the only real option available to the UK and it would validate the referendum result.

- **It would be a major drawback for the UK if it had to fall back on WTO rules**, **which is likely to involve the imposition of trade tariffs.** Some 45% of UK exports go to the EU, so it is a vital market. On the other hand, the UK takes less than 10% of EU exports. Thus, the UK is not as vital to the EU for trade as the EU is to the UK.

- **Ireland has very close trade and economic links with the UK and so would be greatly impacted by its departure from the EU.** Ireland is the UK's fifth biggest export market. Meanwhile, the UK is by far the most important market for Irish indigenous exporting firms. Those trading with the UK, at a minimum, would face non-tariff barriers including increased administrative and regulatory costs, as well as possibly tariffs. An ESRI report suggested that there could also be a significant decline in bilateral trade. Sectors such as agriculture, retailing, energy and financial services are likely to be most impacted.

- There will also be **a period of political uncertainty in the UK,** particularly within the Government. Who will be the new Prime Minister who will have a key decision to make in regard to invoking Article 50 to commence the formal withdrawal process from the EU?

- Meanwhile, the border with **Northern Ireland would become an external EU land border if the UK leaves**. This could give rise to all sorts of issues in terms of customs posts, passport controls etc, depending on the extent to which a UK exit impacted the movement of goods, services and people between the UK and EU. A UK departure from the EU could also well **trigger a second referendum vote in Scotland** on independence. If passed, it would most likely set in motion a break-up of the UK.