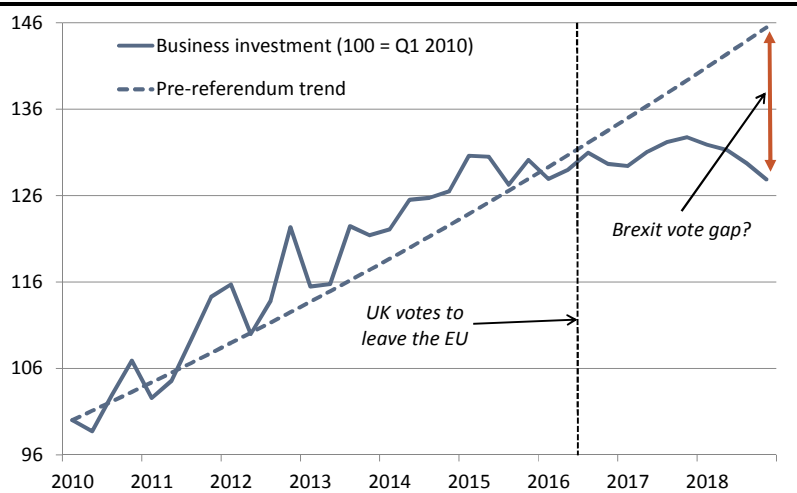


14 February 2019

Brexit impact on investment – what is at stake?

Business investment has stalled since the June 2016 vote to leave the EU



Quarterly data. Source: ONS, Berenberg

- Brexit already hurts:** The UK economy has lost significant momentum since the June 2016 Brexit vote. Compared to the three years before the referendum, annual average real GDP growth has slowed from 2.4% to 1.6%. With dampened private sector risk appetites, productivity-enhancing business investment has fared badly. After rising a bit in 2017, business investment declined in each quarter of 2018. By Q4 2018, it was c14% lower than it would have been had the pre-referendum trend (from 2010 onwards) continued – see chart.
- Other factors matter too:** As a medium-sized open economy, the UK is partly at the mercy of the global business cycle. In 2017, the synchronised global upswing partly helped buffer domestic demand weakness caused by Brexit-related worries. In 2018, rising global uncertainties linked to the slowdown in China, the US-China trade skirmish, stalling Eurozone economies (especially Germany and Italy), and fears late in the year that the US could be heading for a sharp slowdown in 2019 exacerbated the negative Brexit effect on UK business investment.
- A glimpse of the future:** As a major hub for global savings and the location of choice for companies wanting to serve the entire EU market, the UK consistently enjoys a higher rate of investment than its rate of domestic savings would otherwise allow. The c17% drop in trade-weighted sterling since the Brexit vote shows that global markets have marked down the UK’s long-run prospects. Future growth of inward foreign investment will likely be lower than before. Unless domestic savings rise, which seems unlikely as Brexit will also lower future income growth, trend aggregate investment is probably now on a permanently shallower growth path.
- Watch the hard Brexit risk:** After some two weeks of fresh talks, the UK and the EU do not look likely to strike a sufficient compromise on the contentious “Irish backstop” that would enable a majority in the UK parliament eventually back Prime Minister Theresa May’s Brexit deal. Although neither the UK nor the EU wants a hard Brexit, we still see [a 30% risk of one by accident on March 2019](#). A hard Brexit would deliver a large negative supply-side jolt to the UK that would likely depress short-run business investment even further.
- Brexit outlook:** PM May has promised that parliament will be given the opportunity on 27 February to have a say on what should happen next if she has not secured new terms on her deal by then. At that point, we expect the cross-party majority in parliament that wants to retain close ties with the EU to step up and see off a no deal by mandating the government to seek a delay to Brexit while seriously exploring the alternative options for the future UK-EU partnership. This would be a major boon for business confidence.
- Investment rebound on a Brexit deal:** Labour markets are tight: unemployment is at a 40-year low; vacancies are at a record high; and wage growth is accelerating. Companies report that capacity constraints are at a post-Lehman high and the real costs of capital are low. This is an ideal environment for a modest investment rebound once the risks fade. As long as the hard Brexit risk does not materialise, [and global risks do not go badly wrong](#), UK companies will likely feel more confident to step up investment over the medium term. Along with stronger real consumption growth, this will help to lift UK real GDP growth from 1.4% in 2018 to 1.7% in 2019 and 1.8% in 2020.

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