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Brexit and the Pandemic: The Economic Impact on Wales and the Borders

for Schrodgers Investment Webinar

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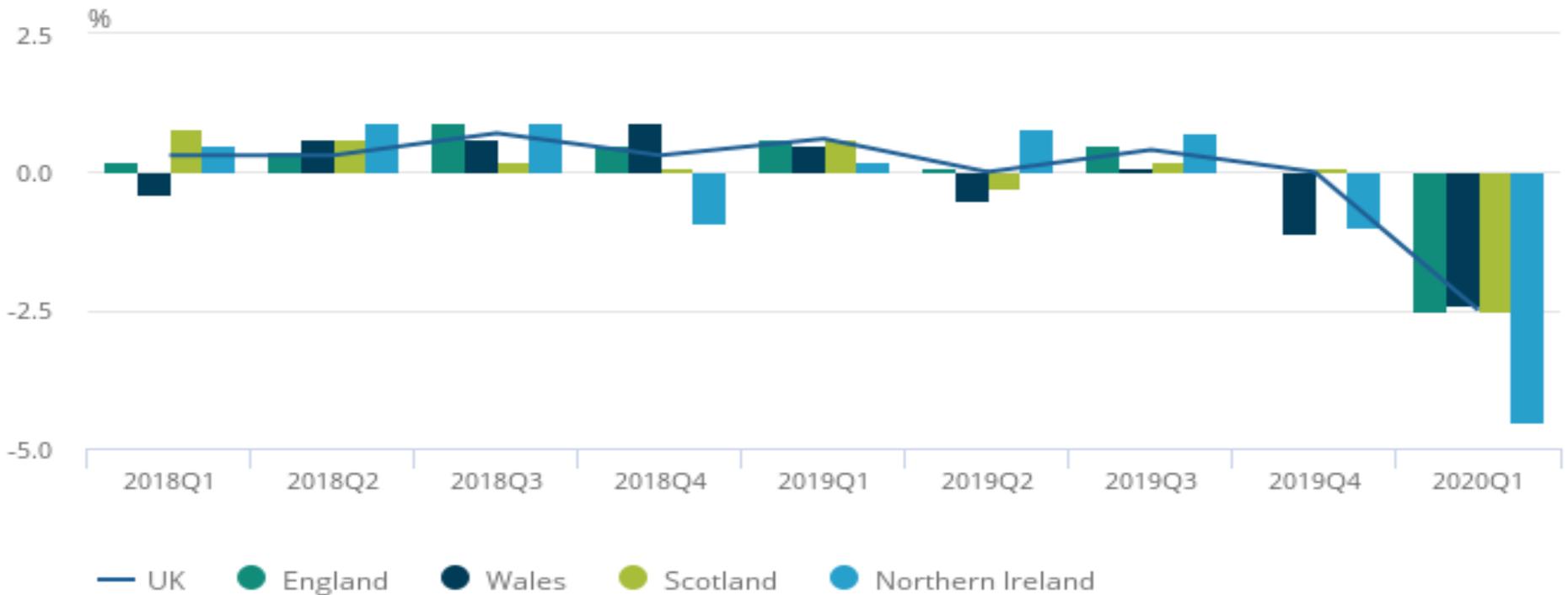
18 November 2020

Recent changes in UK GDP

- For the last couple of years, the rate of economic growth across UK has not been great
(Summarised in Fig 1)
- In the final quarter of 2019, UK growth fell to **zero**.
- Then as the pandemic began to impact the economy, growth turned sharply **negative** in Q1 2020.

Figure 1: All four countries in the UK had negative growth for Quarter 1 (Jan to Mar) 2020

Quarter on quarter gross domestic product (GDP) growth for the UK and its countries, seasonally adjusted, Quarter 1 (Jan to Mar) 2018 to Quarter 1 (Jan to Mar) 2020



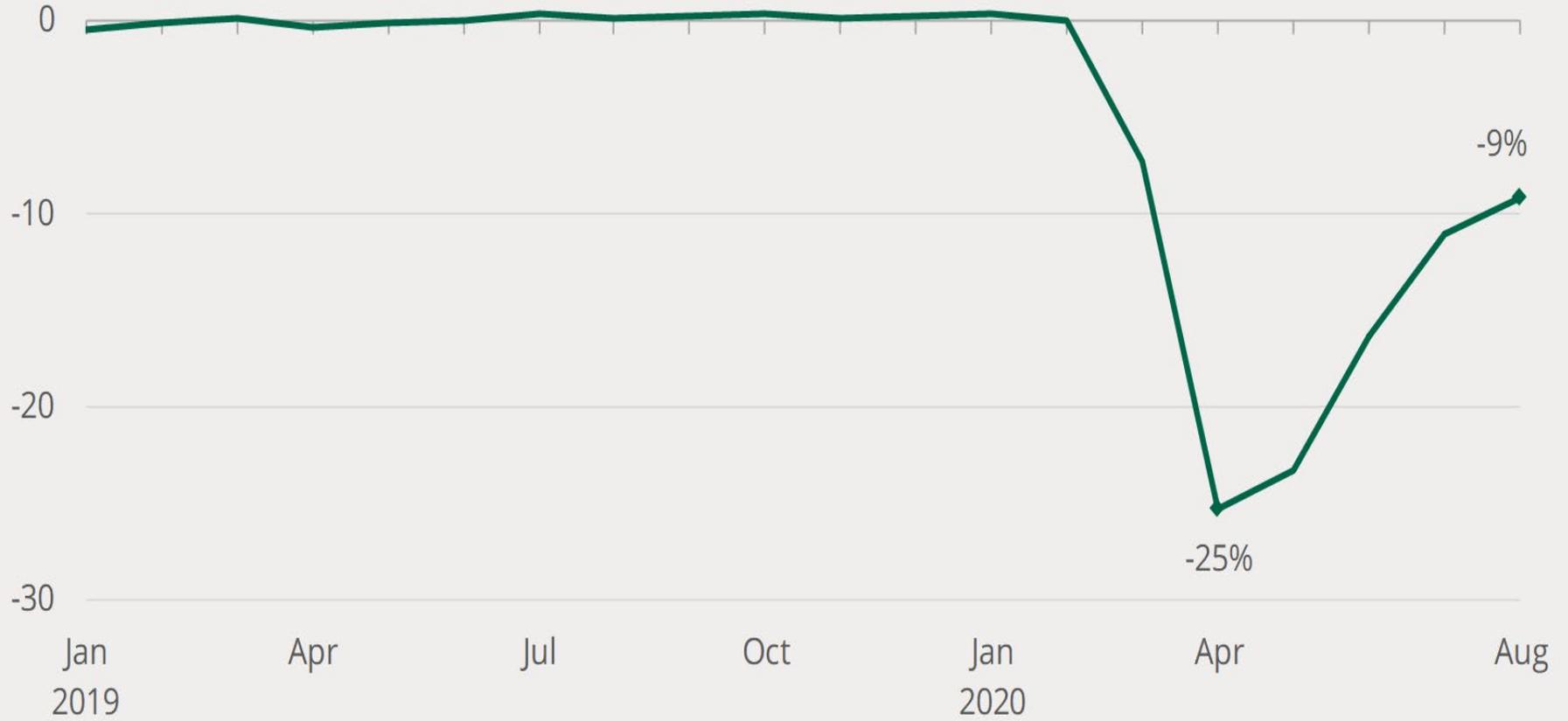
Source: ONS

Into and Out of Lockdown

- As the lockdown continued during second quarter, the UK saw the biggest ever quarterly fall in GDP. (20% in Q2)
- But in the third quarter there was a strong bounce back – GDP rose by 15%
- But, going back into lockdown in November has postponed the rebound
- Q4 2020 will probably see another (smaller) decline of around 2.5% in UK GDP.
- Overall, 2020 will likely see a decline of around 11% in UK GDP

GDP has recovered more than half of lost output

Real GDP level, % change compared to February 2020



ONS

The Budget

- The Autumn budget was cancelled
- But the Chancellor has managed give away more money in terms of handouts, tax breaks etc. than any budget in history
- £250 bn so far and still rising.
- This will produce the biggest budget deficit ever and will lead to the national debt rising to over 100% of UK GDP = about £2 trillion
- Strange times

Regional Growth

- During the 2020 recession, the English regions outside London have borne the brunt of this decline in GDP,
- In particular East and West Midlands have not performed well
- Two charts

Figure 2: The largest negative growth in Quarter 1 (Jan to Mar) 2020 was in the East Midlands with negative 4.1%

Quarter on quarter gross domestic product (GDP) growth for the regions of England and countries of the UK, seasonally adjusted, Quarter 4 (Oct to Dec) 2019 and Quarter 1 (Jan to Mar) 2020

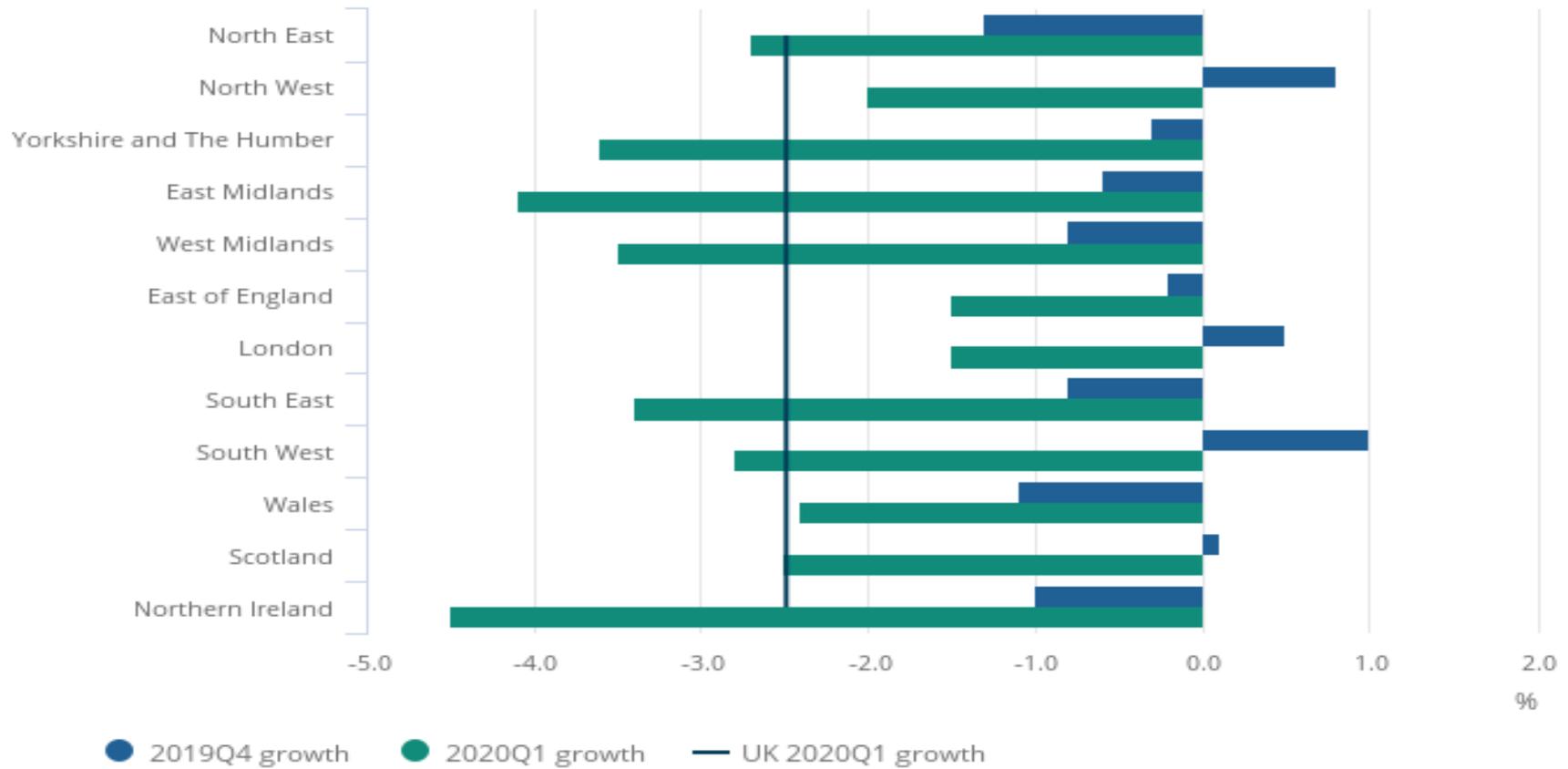


Figure 3: London was the only region to show positive growth in GDP in Quarter 1 (Jan to Mar) 2020 when compared with the same quarter a year earlier, at 1.5%

Quarter on quarter a year earlier gross domestic product (GDP) growth in the regions of England and Wales, seasonally adjusted, Quarter 1 (Jan to Mar) 2020

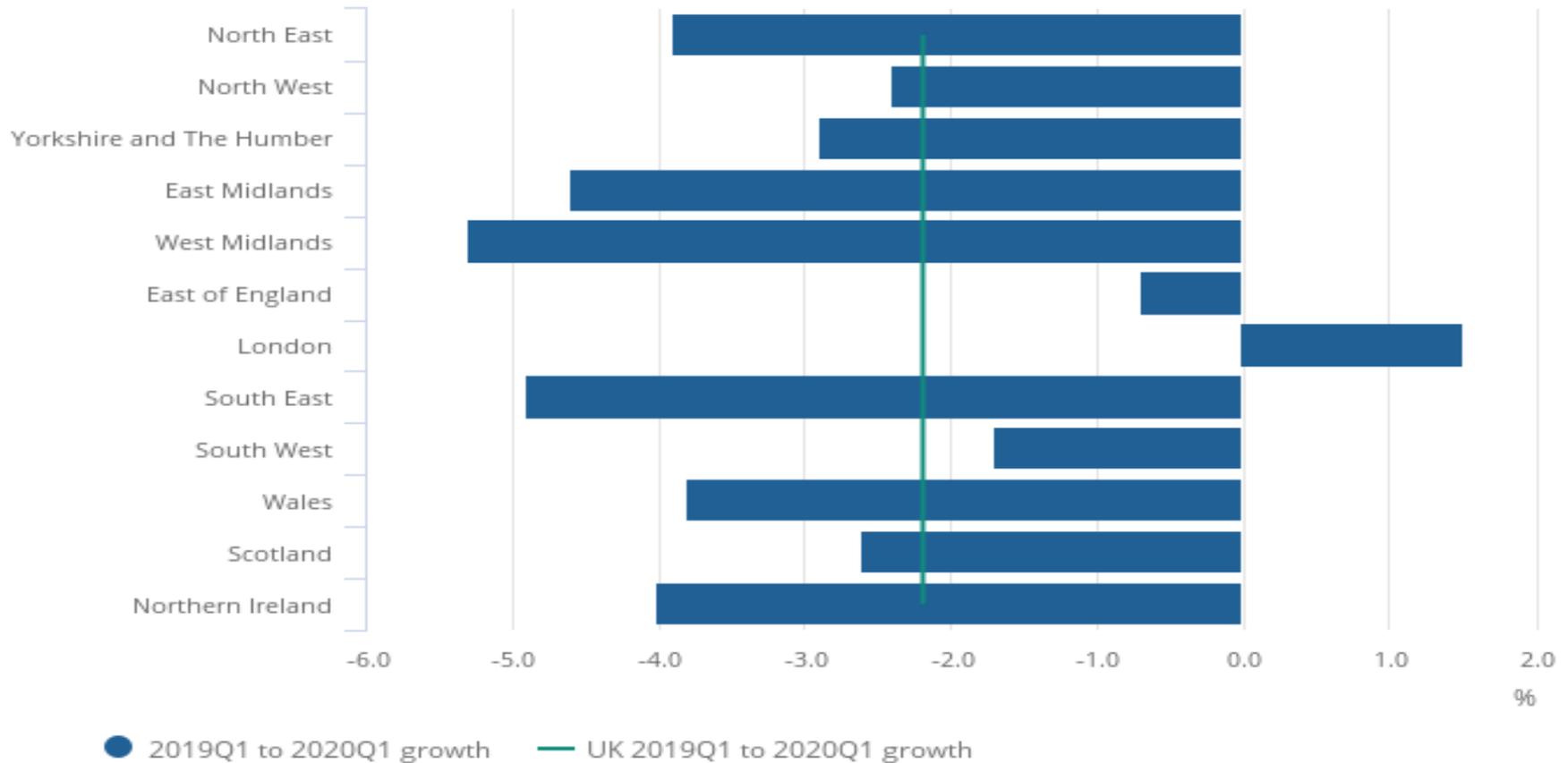


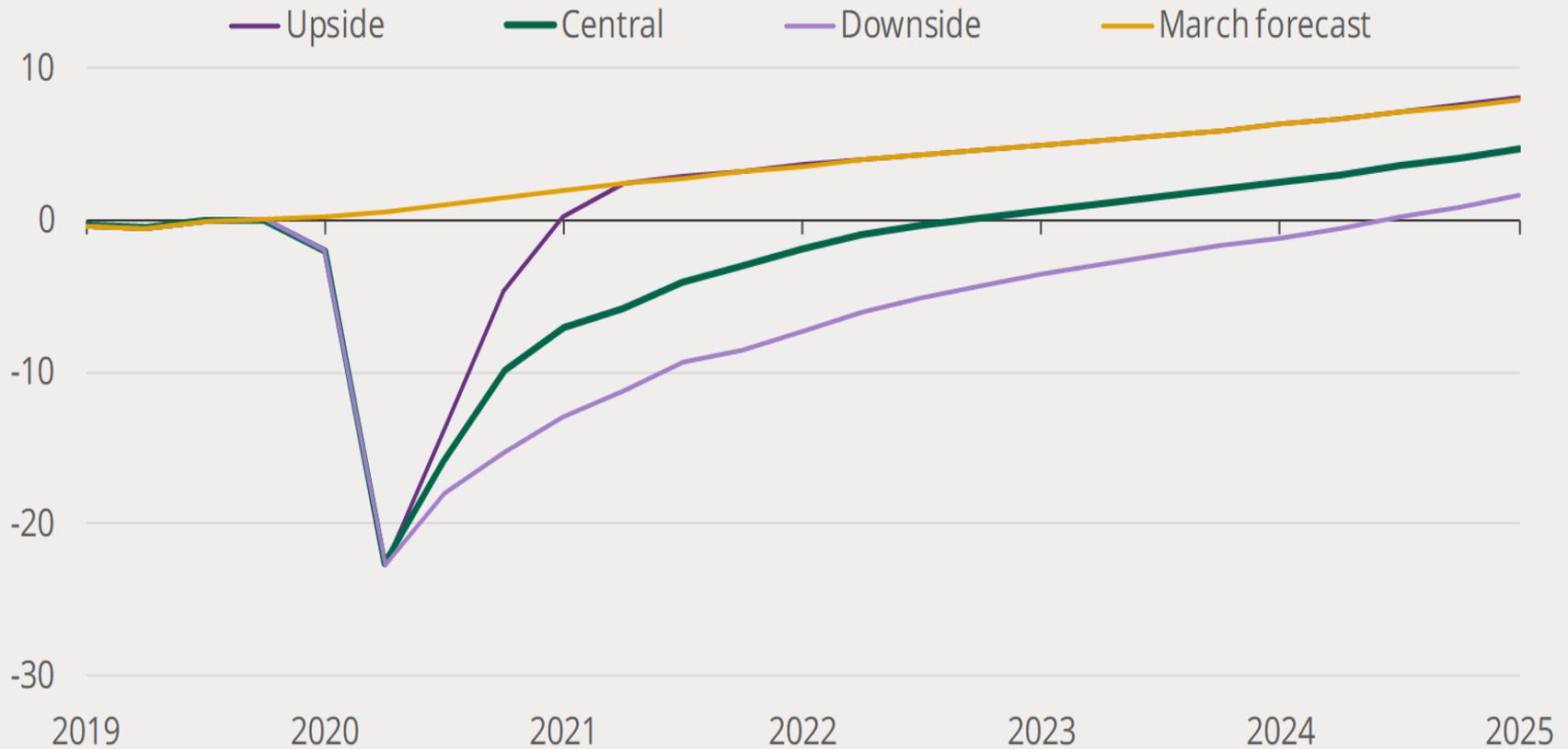
Table 1: Percentage growth in the countries and regions of the UK, seasonally adjusted, Quarter 4 (Oct to Dec) 2019 and Quarter 1 (Jan to Mar) 2020

Country or region	Growth in 2019 Quarter 4 (Oct to Dec)	Growth in 2020 Quarter 1 (Jan to Mar)
North East	-1.3%	-2.7%
North West	0.8%	-2.0%
Yorkshire and The Humber	-0.3%	-3.6%
East Midlands	-0.6%	-4.1%
West Midlands	-0.8%	-3.5%
East of England	-0.2%	-1.5%
London	0.5%	-1.5%
South East	-0.8%	-3.4%
South West	1.0%	-2.8%
Wales	-1.1%	-2.4%

Source: ONS

OBR scenarios for GDP vary greatly

% change with GDP level of Q4 2019 under three OBR scenarios

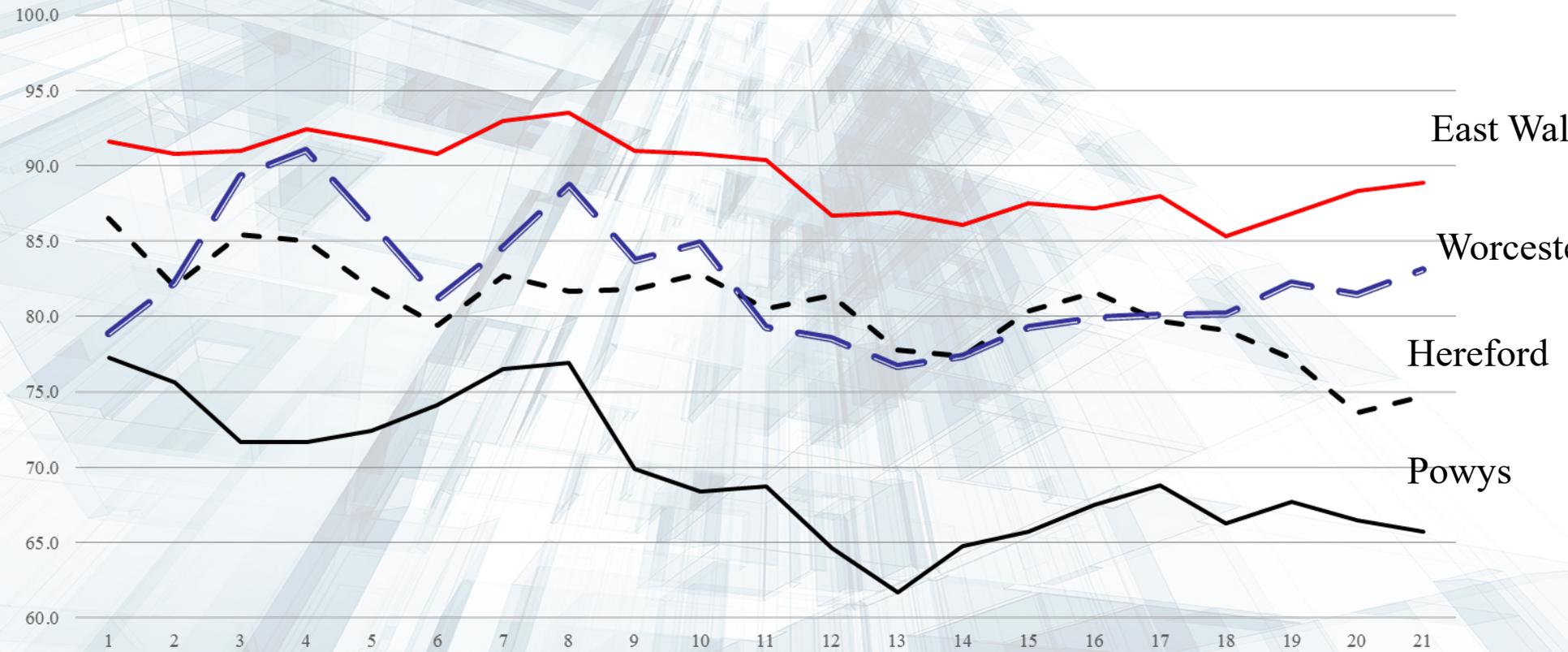


Coming out of the Pandemic

- The impact of the pandemic will still be felt in the UK throughout 2021,
- The UK economy is not likely to be back to pre-COVID levels of GDP (and onto a normal growth trajectory) until the end of 2022.
- Some regions will be hit harder than others.
- This is because Wales and the Borders went into this recession from a position of relative weakness.

GDP per head: East Wales and the Borders

1997-2018
UK = 100



ONS

Relative Decline in GDP/Head: Wales

- GDP per head is a measure of relative prosperity
- In Wales it has been falling for a number of years:
 - e.g. The Welsh economy has fallen from 77% of UK GDP per head in 2000 to 72% today
 - falling as low as 71% in 2009.
- East Wales has performed a little better - falling to 88%

Relative Decline in GDP/Head: Borders

- West Midlands has fallen from 91% of UK GVA to 84% - falling as low as 81% in 2009
- Similarly in the Borders:
 - Herefordshire has fallen from 87% to 75%
 - Worcestershire has been more volatile, but it has not improved it's position and has stayed around 80% of relative GDP
- It is likely that both the West Midlands and Wales will see a bigger fall in GDP than the UK average over the period 2020 to 2022.

Where does Brexit fit? (1)

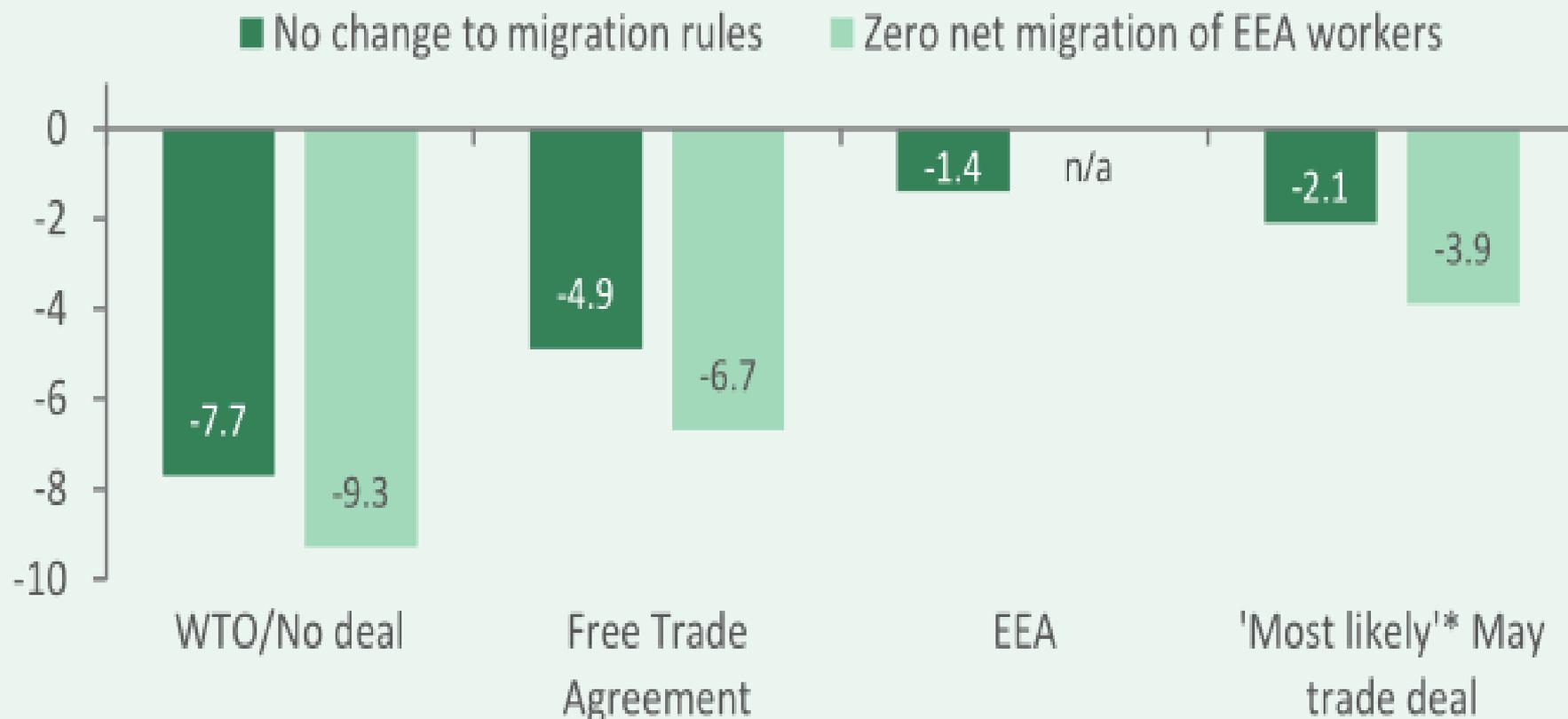
- First of all: being a member of the EU, the Single Market, the Customs Union and the CAP has not prevented Wales and the Borders from falling down the prosperity league tables.
- Also, the UK's prosperity (relative to the rest of the EU) has fallen in the last ten years.
- So membership of the Single Market etc. has not exactly been a silver bullet for raising the level of prosperity - either for the UK or indeed raising the relative position of Wales and the Borders.

Where does Brexit fit? (2)

- Secondly, the predictions for the impact of a **no deal Brexit** on UK GDP now look very tame compared with the COVID recession:
 - e.g. in 2020 UK GDP will all by around 11%.
- The ‘worst case scenario’ for Brexit’s impact on UK GDP was for a 0.6% annual decline over the next 10 years.
- The median forecast was for a smaller hit to GDP.
- So the impact from Brexit is unlikely to be anything like as large as the downturn from the pandemic.

UK long-term GDP impacts under different scenarios

% difference in GDP level in 15 years compared to staying in EU



Source: HM Govt, EU Exit: Long-term economic analysis, Nov 2018

* In view of most analysts

Short term impact of Brexit

- The Bank of England has said there could be a **1% hit to GDP** in Q1 2021 if a ‘no deal’ Brexit leads to significant disruption to trade.
- But that’s compared with a **20% fall** in GDP in Q2 2020.
- Of course, the adjustment costs of Brexit will be not be insignificant
- But these are likely to be short term as companies adjust to the new situation.
- And in the longer term these adjustment costs are likely to become much more subdued.

No 'Cliff Edge'

- But the point to emphasise is that there is **no 'cliff edge'** that the UK is in danger of crashing over on Jan 1st 2021.
- Why is that?
- Brexit is about relatively small changes to our trading arrangements
- These changes have to be contrasted with the **global** pandemic of 2020 and the **global** financial crisis of 2008
- And in any case, international trade is only a (relatively) small part of UK GDP

Impact of Trade on UK GDP

- Most of UK trade – over 55% - already goes to the rest of the world
- Only around 45% goes to the EU.
- So we are already trading on WTO terms for the majority of our trade.
- How much of our GDP is actually traded? Answer – around 30%.
- So 45% times 30% = 13%.
- Only around 13% of UK GDP is tied up with our trade with the EU.

How much trade will be lost?

- If the UK was to lose say 10% or even 20% of this trade (which is possible but unlikely) then it amounts to less than 2% of our GDP.
- Hence there is no ‘cliff edge’.
- But importantly a negotiated Brexit deal would reduce the costs of adjustment, reduce the impact on trade and minimise the long term impact on GDP
- So there is still everything to play for in the Brexit negotiations

Deal or No Deal: Likely Outcome

- The UK is probably heading for a harder version of Brexit than we were expecting in 2016
- We will exit the Single Market and the Customs Union as well as the CAP and CFP
- But there will probably/possibly be some sort of free trade agreement for goods.
- Nothing much will be agreed for services – possibly some sort of ‘equivalence’

After Brexit and the Pandemic

- When the UK economy has exited the EU and escaped the ravages of COVID, it is likely to return to positive growth in 2022.
- Wales and the Borders are also likely to experience positive growth in 2022
 - but probably not as strong as the rest of the UK.
- Raising **regional** prosperity after Brexit will require effective economic strategies:
 - like increased infrastructure spending on road and rail alongside more investment in housing, education and health.
- Longer term, it will require significant investment in skills.

Brexit and Regional Economies

- Responding to the new Brexit regime would be easier if Wales and the Borders had strong, dynamic economies
- It would then be easier to solve some of the pressing social problems in Wales and the Borders that led to the Brexit vote
- The trouble is that investments that were seen as difficult before 2020, will, post Brexit, be even more difficult
- Conclusion:
- The economy of Wales and the Borders is in no better shape than the rest of the UK to race into the ‘economic uplands’ after Brexit – probably in a little worse shape

Medium Term Outlook

1. UK economy to recover slowly in 2021-24
2. If the new policy regime of QE plus Fiscal Expansion is maintained across the world it could mean stronger growth and slowly rising inflation
3. Europe and UK could perform well relative to US up to 2025
4. But, the UK economy could lag EU growth for next few years