EXECUTIVE BOARD MEETING

SM/18/250
Correction 2

November 9, 2018

To: Members of the Executive Board

From: The Acting Secretary

Subject: **United Kingdom—Selected Issues**

Board Action:	The attached correction to SM/18/250 (10/26/18) has been provided by the staff:
Typographical Errors	**Page 3**
Questions:	Ms. Iakova, EUR (ext. 35365) Mr. Chen, EUR (ext. 34746) Mr. Arregui, EUR (ext. 38456)

BREXIT: SECTORAL IMPACT AND POLICIES[1]

This paper estimates the long-run economic impact of Brexit on the United Kingdom under two distinct assumptions for the post-Brexit relationship between the United Kingdom and the European Union. These illustrative scenarios entail different degrees of higher trade costs, a more restricted EU migration regime, and reduced foreign inward investment. A standard multi-country and multi-sector computable general equilibrium model is used to quantify the impact of higher trade barriers. The impact from reduced EU migration and inward FDI is based on previous studies. We find that in a scenario representing a typical Free Trade Agreement the level of output is likely to fall by between about 2½ and 4 percent relative to a no-Brexit scenario, with an average of about 3 percent. In a scenario in which the UK and EU trade under WTO rules the level of output is likely to fall by between about 5 and 8 percent relative to a no-Brexit scenario, with an average of about 6 percent. There is substantial sectoral heterogeneity in the impact, and regions with higher concentrations of the more affected sectors are likely to confront greater losses. The empirical analysis suggests the speed of sectoral labor relocation across sectors has been relatively low in the UK. Irrespective of these empirical estimates, policies, such as retraining, would be critical to facilitate faster adjustment of the economy to the post-Brexit equilibrium thereby helping to mini~~z~~mize~~ine~~ the associated costs to individuals and in aggregate.

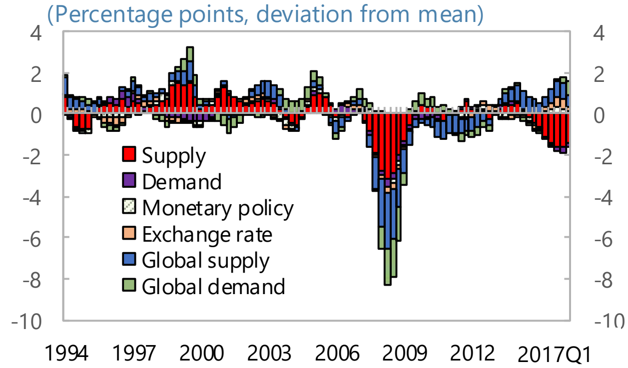
A. Introduction

1. The United Kingdom is in the process of negotiating a framework for the new trading relationship with the European Union. On June 23, 2016, the UK voted to leave the EU and pursue new trading arrangements with the EU and the rest of the world. Two years after the referendum, uncertainty about the shape of the future post-Brexit trade arrangement persists.

2. This uncertainty has already weighed on growth. Business investment since the referendum has been lower than expected in the current growth context (Górnicka, 2018), and consumption remains weak. Net exports have benefited from the sharp sterling depreciation after the referendum while the trading relationship with the EU remains unchanged, offsetting some of the weakness in domestic demand. The growth slowdown also reflects supply side factors including reduced net migration inflow and shallower capital accumulation.

Decomposition of Growth

(Percentage points, deviation from mean)



Sources: IMF staff calculations.

Note: Estimated using a structural VAR following Forbes and others (2015).

[1] Prepared by Jiaqian Chen.