Leaving

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The financial markets reacted violently to the UK's decision to leave the EU and had an impact on several variables, but overall things went as could be expected and we can even say in an orderly fashion. As expected, the pound plummeted (11%), consistent with a current account deficit and a low growth outlook. The euro also depreciated (4%) while other safe haven currencies, like the dollar, Swiss franc and, above all, the yen, appreciated. Peripheral debt yields were contained, although we must bear in mind that the ECB has intervened through its asset purchasing program. Market volatility indices have surged to levels last seen during the crisis at the start of the year related to doubts about China, but nowhere near those seen in the most recent crises such as Greece or Lehman Brothers. However, where we have seen sharper than expected drops is in some stock markets, especially in the European banking sector. Nevertheless, in general, it seems that the willingness of central banks to intervene if necessary has ameliorated the negative reactions.

On the political front, however, we have seen more confusion than expected. The two main political parties in the UK and the negotiation strategy with Europe have been thrown into chaos. This has raised a lot of uncertainty about the economy and will probably halt investment plans for several months, which could lead to a recession in the short term.

The EU member states and the community institutions reacted properly, making it clear that they would stand firm on two points during negotiations: first, they will not start talks until the UK has made an official request (by invoking the now famous article 50) and, second, that the EU is not willing to negotiate an a la carte model in which the UK can cherry pick the policies it prefers (like the one Switzerland has, for example). This implies very few concessions to the UK, thereby preventing future maneuvering to obtain further concessions and, above all, sending a message to other countries in Europe that may want to follow suit, tempted by the idea of withdrawing from all or part of the European project.

The UK should try to limit the damage and pursue a “Norwegian solution”, allowing it to remain very close to Europe, which would give it access to the single market and the European passport for the financial sector, even though it means having to make contributions to the EU budget and European immigration policy, which was rejected by the Brexiteers. The EU's priority is to prevent political contagion, given that the likelihood of economic contagion, in principle, isn't high. To achieve that objective the EU will have to follow the rules in its negotiations and revitalize its integration plans. The statement from Germany and France after the foreign ministers' meeting this week was positive in this regard, given that it suggest new policy directions for security, defense and immigration, but also advances toward a fiscal union, a matter that has been sidelined for a long time now.