

The post-Brexit panorama

Brexit has opened the door to a new phase of financial volatility. In Q2 the trend in risky asset prices has gone through two very different phases. First, prices continued the rally that had started back in February and continued right up until the end of May. Although this expansion was by no means extremely lively or without fluctuation, the underlying trend was of a clear end to the episode of high volatility in the first month and a half of 2016. But as from the beginning of June the market started to encourage doubts regarding its future direction. Investors were particularly affected by a combination of important events in June (OPEC and Federal Reserve meetings, Spanish general election and especially the highly significant referendum on the UK's membership of the EU), warranting a delay before taking financial decisions. As these different events unfolded, investor confidence gradually returned. Given this situation, the UK voting in favour of Brexit took investors by surprise, resulting in sharp losses in the stock markets and risky assets and with capital making tracks for safe havens. So what can we expect now?

Ultimately the economic impact of the Brexit will largely depend on the political response. There are three broad political areas that will shape the economic effects of the Brexit. The first concerns relations between the Union (and the euro area) and the United Kingdom. The most favourable scenario, and also the most logical, is for some middle ground to be found between the EU taking a tough stance to dissuade other European partners from possibly following suit, and a «velvet divorce» that is excessively favourable for the British. This equilibrium will probably be accompanied by reinforced commitment to the European project and the single currency. The second political area is the crystallisation of populist and Eurosceptic groups. We believe the referendum on Italy's constitutional reform in October and the legislative elections in France and Germany in 2017 will confirm that most of these movements are limited in scope. Lastly, the third front concerns the UK's internal political situation. The Prime Minister's announced resignation, around October, and the Scottish position which is notoriously opposed to the Brexit have weakened the country's governability and heightened pressure to reach an agreement that does not constitute a radical break with the current status quo.

The UK will fall into recession but world growth will withstand the shock. CaixaBank Research expects these three political areas to achieve enough equilibrium to avoid any widespread impact on European and global growth. The UK is expected to suffer from a drop in GDP as the high uncertainty prevailing will act as a brake on decisions to invest and consume. Nevertheless this will be a temporary downturn which will gradually diminish as the negotiations begin, presumably at the end of 2016. For the euro area as a whole, the effect is likely to be a modest slowdown in growth while, in the rest of the world, the impact will be even smaller (moderate for the US, which has relatively close ties to the UK; minimal or zero for the rest of the economies). This limited impact in general terms is also due to the fact that the shock of uncertainty has occurred at a time when the economic situation is reasonably benign. Available indicators confirm that the world economy continued to accelerate its rate of growth in Q2, especially in Europe and the US but also in many emerging countries. Another favourable factor is the fact that monetary conditions are still accommodative and central banks are expected to postpone any monetary restriction over the coming months. Moreover, central bankers have repeated their willingness to provide the liquidity that financial institutions may demand at times of financial uncertainty.

Given this situation, Spain should be relatively immune. Apart from tourism (23% of our tourists are British), the country does not have too many direct links with the UK. There had been a notable inertia in growth in activity over the last few months which, had it continued, would have probably led to a positive revision in CaixaBank Research's GDP growth forecast for 2016 (namely 2.8% growth in GDP). Now the effect of the Brexit has neutralised this upward bias in the scenario for 2016, warranting a minimal downward revision in the 2017 growth forecast from 2.4% to 2.2%. In summary, the Spanish economy exemplifies, like few others, the fortune of being in a good position to tackle the storm of uncertainty thanks to its currently favourable macroeconomic situation. The incoming government will have to work to ensure that our economy is also in a comfortable position to face any potential shocks in the future.