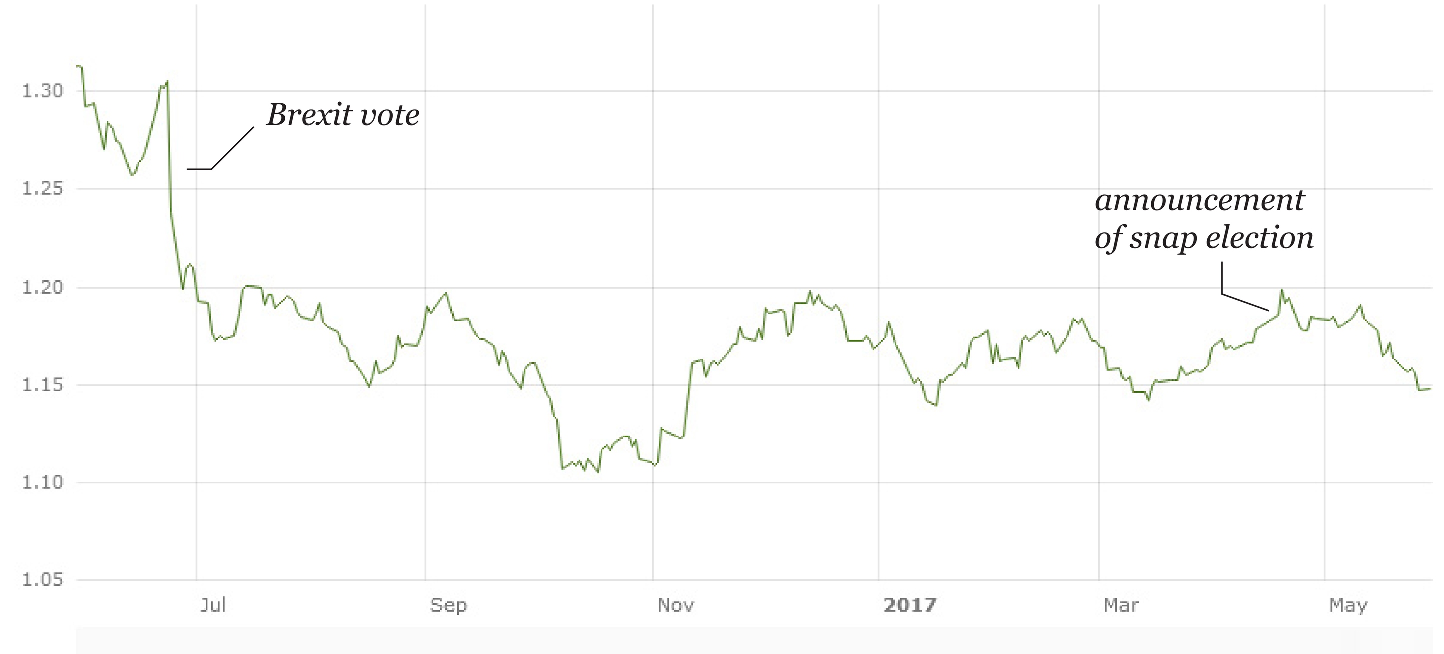
“Brexit Slowdown” vs “Doom-mongering”: How Consumers Feel the Economic Consequences of Brexit

by Lena Nüchter

The Fall of the Pound

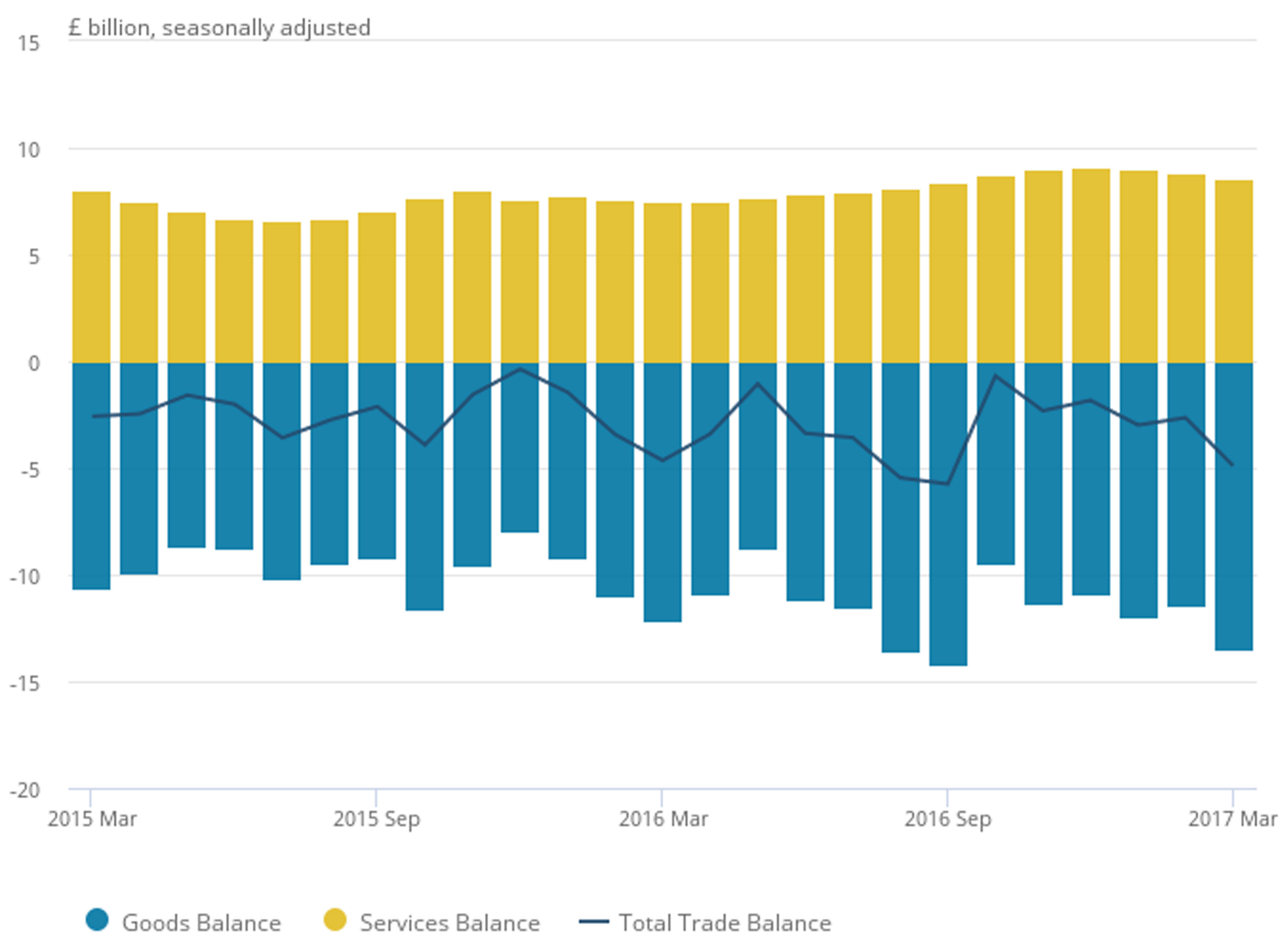
The value of the pound is determined entirely by market forces. It is affected by the UK's balance of payments, the strength of its economy, and its political stability. Unanticipated political events can lead to short-term fluctuations:[1] since the polls predicted a Remain vote before the referendum, the **Brexit vote** on 23 June 2016 resulted in a steep fall of the pound to a 31-year low - the biggest slump ever to occur in a single day.[2] On the contrary, Theresa May's surprise announcement of a **snap election** on 18 April 2017 has boosted the currency to a four-month high against the euro, because May is likely to emerge from the election with a more stable majority in Parliament.[3]



GBP vs. EUR. © European Central Bank ECB

The UK's Trade Deficit

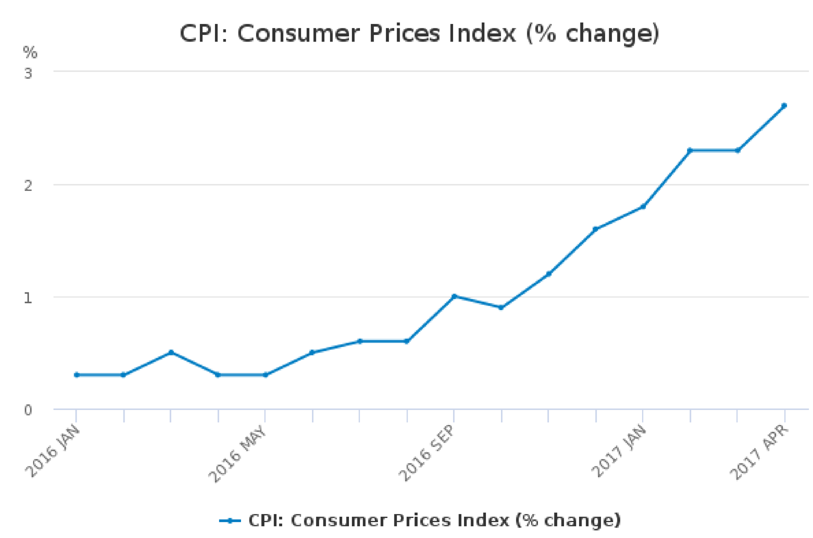
The trade balance records the difference in value between the goods and services imported into the UK, and the goods and services exported from it. Traditionally, the UK has a **surplus of services** being exported; but this is outweighed by a larger **deficit in goods** -- it imports more goods than it exports. Thus, it has a considerable **overall trade deficit**. As of March 2017, the surplus of services was £ 8.5 billion, while a deficit in goods of £ -13.4 billion meant an overall trade deficit of £ 4.9 billion for March alone.[6] While the cheaper pound has raised expectations of growing exports, much of the narrowing of the trade deficit in the last quarter of 2016 was due to increased exports of 'erratic' commodities like non-monetary gold, which tend to fluctuate unreliably and thus disguise larger trends. Exports of non-erratic goods have indeed grown because of the cheaper pound, but the trade deficit has continued to widen because the weak pound has also made imports more expensive.[7]



Balance of UK Trade, March 2017. © Office for National Statistics

Consumer Price Inflation

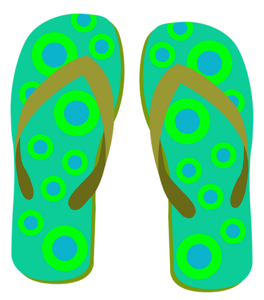
Consumer Price Inflation is calculated by comparing the price of the same 'shopping bag' full of the most important commodities of an average UK household over the years. This results in the **Consumer Price Index (CPI)**, which gives a percentage value for rising or falling prices. In the UK, inflation would ideally be at 2% or below, but it has been rising steadily in the past months and has now climbed to **2,7% in April** 2017. The inflation rate reflects **global trends** like rising and falling fuel prices, but it is also influenced by the **weaker pound**, as that makes imports more expensive. Transport costs as well as rising clothing and electricity prices have contributed significantly to the latest increase in the rate; and consumers are beginning to feel the rising living costs. However, if we look at the bigger picture (yellow line), we can see that while inflation has been rising steadily, it is still a long way from the 5,2% it had reached during the financial crisis of 2008.[11]



CPI Percentage Change Jan 2016-Apr 2017. © ONS

CPI (yellow line) 12-month rates, Apr 2007-Apr 2017. © ONS

What does that mean?



Holidays abroad have become more expensive for Britons as the pound has weakened against foreign currencies. In August 2016, a glass of wine in an Italian bar was effectively **53% more expensive** than in the year before.[4]

Conversely, the **British tourism industry** benefits: foreign visitors are coming to the UK in greater numbers. Tourism from the United States, for example, has increased by almost 20% compared to last year. Retail sales have also gone up, as tourists take advantage of the cheap pound and **spend roughly 15% more** than in the previous year.[5]

Will there be a crisis?

This year's global and domestic conditions make it especially difficult for economists to make predictions, according to a survey conducted by the Financial Times. Most of them see UK growth slowing because of **uncertainty** about the outcome of the negotiations between the UK and the EU, and the overall effects of Brexit.[8]

Since wages are growing significantly slower than inflation, consumers will begin to feel the bite of **rising living costs** more keenly and consumption growth is likely to slow. However, the low level of the pound is expected to have a positive effect on exports -- and after a period of caution after the referendum, some UK companies are beginning to invest more to meet **rising demand** at home and abroad.[9] This will contribute positively to the overall growth of the UK economy.

Overall, the Bank of England makes a cautiously optimistic forecast: while incomes and household consumption will be weighed down by inflation, the weak pound and an expected rise in global growth will support trade. Investment will grow, but remain under the long-term average.[10] If this forecast is accurate, the UK will **feel the consequences of Brexit**, but will **evade an outright crisis**.

What does that mean?

The negative effects of inflation are numerous. For example, it

- **lessens purchasing power**, since goods get more expensive but wages often stay the same
- **eats up savings** if interest rates stay low
- **makes borrowing money more expensive** if interest rates are raised
- may make a country **uncompetitive internationally** because of high prices

The average **household shopping** bill went **up £21.31** in the first quarter of 2017,[12] because a number of companies have raised prices to cushion the effects of the weaker pound. Often, the hike is due to rising import prices for ingredients.

The price rise is **not limited to groceries**: for example, the iPhone 7 Plus went up £100. Apple products are now more expensive in the UK. While apps have gone up by more than 25%, iPhones have seen increases of up to £100 and older models of MacBooks are now available for around £300 more than before.[13]