Brexit could derail US recovery

UK role in America's anti-globalisation rhetoric

by Desmond Lachman in Washington

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A vote for British departure from the European Union on 23 June could derail the US economic recovery and further ratchet up anti-globalisation rhetoric in the run-up to November's presidential election.

Washington policy-making circles appear complacent about the outcome, but this is unjustified. The referendum is taking place at a highly inauspicious time for both the UK and the global economy. As Mark Carney, the governor of the Bank of England, has reminded us, the UK is running one of its largest external current account deficits in the post-war period, making it uncomfortably dependent for financing on the 'kindness of strangers'. At the same time, Britain is riven by strong separatist tendencies, especially in Scotland, where the electorate on the whole wishes to remain in Europe.

The global economy is poorly placed to withstand a blow from 'Brexit'. China's economy is slowing, while emerging market economies are suffering from low international commodity prices and a reversal in international capital flows. Both Europe and Japan are struggling to counter deflation. The Bank of Japan and the European Central Bank are attempting to weaken their currencies to boost export growth.

Having committed the UK to a referendum, David Cameron, the British prime minister, is correctly warning that a vote to leave would be a leap in the dark – not least because of the heightened investor uncertainty that would inevitably accompany the expected two-year period in which the UK renegotiates its relations with Europe. Having been spurned, the EU would be highly unlikely to grant the UK favourable terms in those negotiations.

In the event of a British departure, the UK should brace itself for a full-blown sterling crisis which would seriously cloud the country's economic prospects and offset any possible long-term benefits from leaving the Union. In a climate of heightened uncertainty, investors would balk at financing Britain's gaping external current account deficit, especially at a time when important parts of the City of London could be relocating to European capitals following the loss of their 'financial passport'. More serious still, the UK should brace itself for calls for another Scottish independence referendum which could presage the UK's dissolution.

The last thing the global economy needs is the collapse of one of the world's major currencies, which could trigger an outright currency war and rising trade barriers. This is especially dangerous in the context of a heated US presidential election campaign in which rhetoric against trade and globalisation has already been shrill. Emerging market economies similarly do not need an event that heightens global risk aversion and exacerbates their capital outflow problems.

Any attempt by US policy-makers to influence the UK's EU referendum is likely to prove counterproductive. Seemingly all they can usefully do is pray that the UK electorate has the good sense to vote against taking an inordinate risk with Britain's economic future.

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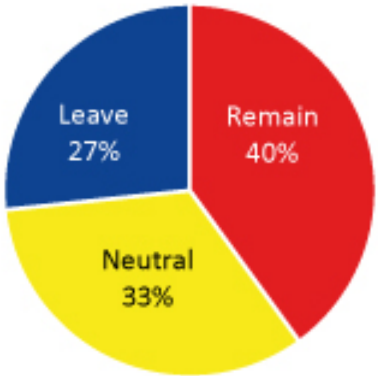

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