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THE BREXIT CONUNDRUM

BRACING FOR A NO-DEAL BREXIT

It may negatively impact the UK economy and world markets but the local market may absorb the volatility

Former British foreign secretary Boris Johnson had once said the next British prime minister must deliver a "proper" Brexit. REUTERS PIC

IN the NST Leader on Monday, the scary prospect of Boris Johnson becoming the next United Kingdom prime minister was broached upon.

Boris has avowed that if he does become the next PM, which in all likelihood he will given his pole position in the race for the leadership of the ruling Conservative Party, he will flounce Britain out of the European Union (EU), come what come may.

After more than two years of tortuous negotiations since Britain voted in a referendum to exit from the EU, Theresa May, the then, and now caretaker, prime minister had obtained the EU's endorsement for the UK to remain in its customs union and single market.

Under this soft Brexit, a "hard border" between the Republic of Ireland (which is in the EU) and Northern Ireland (which is part of the UK) will eventually be erected with different customs, regulatory and food-safety regimes on both sides of the divide. This "hard border" has been the bone of contention among the hardline Brexiteers who fear that a permanent border would derail the delicate peace across the divide.

The EU is unlikely to bend over backwards to entertain Boris' fantasy of wringing better terms of exit. There is little chemistry between them for the reason that Boris — the face of the Brexit campaign during the 2016 referendum — has always been critical of the EU right from the time of his early career as a journalist. For another, any further concessions from the EU will require, as a quid pro quo, a climbdown from the UK's reluctance to accept the free movement of people.

As such, a hard or no-deal Brexit, where the UK exits from the EU's single market, appears inevitable. What then will be the fallout for the Malaysia economy come October 2019?

First, the UK economy. Bereft of its participation in the EU's customs union, a hard Brexit will impact negatively on the UK economy. A recession is a clear possibility. The Organisation for Economic Cooperation and Development (OECD), a rich-country club, predicts the UK to grow just under one per cent this year and the next. Investments and businesses have already started to migrate from the UK to the EU to avoid new cross-border regulations.

The World Trade Organisation tariffs that will now kick in for the UK will further reduce its output and demand. This will mean greater unemployment, lower tax revenues and more austerity.

Malaysia, meanwhile, may face a drop in its exports to the UK. Fortunately, we have grown less reliant on its market for our exports. Our share of exports to the UK has fallen gradually over the last two decades. In 1995, it was 4.4 per cent. Today it is about 0.2 per cent. Similarly, our share of exports to the EU has shrunk from 14 per cent in 1995 to 10 per cent last year. Given the diminished importance of these markets, the impact of Brexit on Malaysia's exports would be relatively insignificant.

However, the much-feared recession in the UK upon Brexit may dent the growth of a fragile world economy; more so, the Eurozone which absorbs roughly half of all the UK's exports and comprises about half of all the UK's imports.

Delays at borders and a loss of access to each other's markets can disrupt cross-border supply chains. Furthermore, the EU's economy is shaky given the uncertainty of its trade with the US and the marked softening of the Chinese economy, largely due to the latter's trade spat with the United States. India too has joined the tit-for-tat tariff hikes on US imports.

The OECD estimates that the combined effect of all these factors would be to dampen the EU growth rate to about one per cent this year and the next, leading to a decline in world growth to about three per cent this year. If Brexit does dampen world growth, then Malaysian exports might feel the brunt of a hard Brexit.

After the referendum verdict in 2016, the British pound plunged to its 30-year lows. The sharp fall was a foretaste of what is to come upon Brexit. Accordingly, analysts reckon that a hard Brexit will cause the pound to lose around 10 per cent of its value, if not more. If so, exporters will be hard pressed to raise their prices to compensate for the pound's depreciation. Price rises will make our exports less competitive in the UK market, unless of course exporters can increase their quality and efficiency to absorb the currency loss.

The pound's fall in value will make property investment in the UK more attractive. The student property market will be especially alluring as UK education remains the preferred choice among Malaysians, more so with a cheaper pound.

As global financial markets are integrated, a hard Brexit will roil not only European financial markets but also other world markets. However, Bank Negara Malaysia appears confident that the local market, flushed with ample liquidity, can absorb the impact of this volatility. These impacts are largely short-term consequences. Trade and investment policy and markets have a great capacity to adapt to changes over the long-term.

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