Cutting through the Brexit clutter

Globalisation, immigration, low wages, de-industrialisation – all of these have been blamed as root causes of Brexit. But essentially, Brexit was the expression of the will of British people to take back control; of their borders (controlling immigration), of their judicial system (ending the oversight of the European Court of Justice) and of their political destiny (withdrawing from the influence of Brussels on UK decisions).

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Communities left behind

Underlying this, it is widely acknowledged that the vote to leave the EU was a signal that the prevailing economic, political and social establishment in the UK was not benefiting everyone justly.

There are communities in Britain who felt left behind by globalisation and who see at least as many risks from free trade and free movement of people as upsides. These are similar concerns of Eurosceptic and nationalist parties in other parts of Europe who have grown in popularity and influence, and who will play a key role in determining Europe's political future.

Rohitesh Dhawan, director, Global Brexit Centre of Excellence at KPMG International says that Brexit has shaken up political establishments in the most unprecedented ways.

"In Britain, it has seen the resignation of one prime minister and the appointment of a new one; new ministries (the department for exiting the EU); a shuffle of cabinet portfolios; and a slew of parliamentary, constitutional and judicial debates at a pace not seen for many years.

Knock on effect in the EU

In the EU, Brexit has brought into sharp focus; the rise of populist and Eurosceptic sentiments; the difficulties in pooling sovereignties of the remaining 27 member states; and a questioning of the relevance of European values, which called into question the very future of the EU as we know it today."

Dhawan says the fact that the UK avoided an immediate economic crisis does not tell us much about the future. "Many of those in the 'stay' campaign predicted economic doom for the UK post-Brexit, but that has not happened yet. In fact, the economy grew 2% in 2016 and we predict it will continue that pace in 2017.

However, the pound has devalued since the Brexit vote and currently remains approximately 20% lower against most major currencies. Longer term forecasts of the UK economy also vary greatly as they depend on the nature of the future deal between the UK and EU."

He predicts that the economic impact of Brexit on the EU will be less severe than on the UK. "The EU is a more important market to the UK than is the case vice versa. Major European economies so far have also held up strongly – with confidence in the Euro area at an 18-month high – hiring at a nine-year high, and French business activity at a five-year high. But it is important to remember that there is much political uncertainty in the EU, which could affect economic prospects over the next few years, and upcoming elections in France, Germany and the Netherlands in 2017 are some of the most important events to watch."

Potential to destablise trans-Atlantic markets

This will undoubtedly have an effect on the global economy. "Brexit has the potential to de-stabilise the European financial system, and to some extent the trans-Atlantic system because of the New York-London financial axis. This is due to the restructuring of banking, insurance, asset management and related professional and business support services and infrastructure once the UK leaves the European single market.

However, the global financial system appears to be resilient enough to absorb this shock and adjust to the new normal. The regulations put in place after the 2008 financial crisis to manage risks in the financial system would have certainly helped in this regard."

South African ripples

While it can be tempting to think of Brexit as a British or European issue that does not affect the tip of the African continent, Dhawan warns of the impact it will have on businesses with a base in the UK.

"South African banks, investment managers and insurance companies that have a base in London and serve European clients or make investments on behalf of South African clients in Europe from that base in London, may be affected. After the UK officially leaves the EU, these companies may no longer be able to automatically do these activities from London and may need to setup a European entity.

Many South Africans also have UK passports through their ancestry and have thus automatically had the right to work in the EU. Post-Brexit, they may no longer be able to do so."

The biggest impact for South Africa will, however, be on our trade agreements with the EU, which also applies to the UK. KPMG in South Africa's chief economist, Lullu Krugel says that once the UK leaves, it will not be part of that trade agreements anymore and all trade agreements will have to be renegotiated with both the UK and the EU.

“As a block, the EU is South Africa’s most significant trading partner and within the EU, the UK is the single largest contributor to that export and import market. It is a destination for, amongst others, vehicles and vehicle components, resources such as platinum, gold and diamonds, machinery and equipment and coal products. In addition, within the EU, the UK has traditionally played a supporting role for South Africa, in particular in the agricultural sector.

So, firstly, if growth in the UK slows down, demand for products listed above from South Africa, might be negatively impacted. In addition, until there is some clarity around the trade agreements, South Africa (and for that matter, any country trading with the EU) will have to live with some uncertainty regarding the structure of its future trade agreements. Quite a substantial number of these agreements will have to be renegotiated and not all conditions might turn out to be more favourable than the current status.”

Article 50

While March 2017 will see the triggering of Article 50, which officially starts the process of UK’s withdrawal from the EU, it may take years for the new normal between the UK and the EU to be established. Without first triggering this clause, the UK cannot formally negotiate any terms with the EU about its departure. After it is triggered, the UK will have up to two years to negotiate the terms of its departure, although in actual fact, that time period may only be around 18 months because of the legislative procedures of the EU required to formally adopt the final outcome.

Theresa May has made it clear that the UK will not be seeking access to the single market, thus suggesting a ‘hard’ Brexit, since the position of the EU has been that the UK cannot cherry-pick from the Four Freedoms: the freedom of movement of goods, people, services and capital over borders.

While a deal that maintains a strong UK and a strong Europe is in everyone’s interests, this tension could lead to difficult negotiations and both sides needing to trade-off concessions in getting to an overarching deal. One thing is for sure; the next two years will set the development course of these two regions like none other in living memory.