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Brexit - Economic Impact for Switzerland

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Few things are certain in the wake of the referendum held on Thursday 23 June. True, Brexit won with a majority, but exit has not yet been formally triggered. Before the UK government sends official notification that it is leaving the EU under Article 50 of the Lisbon treaty, nothing will have changed in law.

Still, it is virtually certain that some form of change is on its way, and until the nature of this change becomes clearer, uncertainty and market volatility will remain high.

Market reaction

The Brexit shock shares some common features with the collapse of Lehman Brothers in 2008. That was an economic shock, which threatened the solvency of the banking system and triggered a credit crunch. Brexit is a political shock. Its impact on the economy is less direct, at least in the short term, and will make itself felt through financial markets and the knock-on effects on business and consumer confidence.

Financial market participants have reacted strongly to the referendum results, which saw Sterling's largest drop ever against the US dollar, hitting a 30-year low. Other asset prices also swung wildly. Volatility will likely continue to dominate the near future.

Why did global markets react so strongly to this event in the UK? The answer is that investors hate uncertainty, and the referendum results have created considerable uncertainty—not just about the economic outlook for the UK, but also for the rest of Europe. As a political event, it indicates the power of protectionism and anti-immigration sentiment, viewpoints that have become increasingly prevalent in Europe and the United States in recent months. Thus, investors are also worried about the future of globalisation.

Impact on the UK economy

Foreign investors may take fright and hold back on investing in the UK. As the UK needs overseas capital to cover its current account deficit, such a buyers' strike would further weaken the pound.

Consumer spending makes up two-thirds of British GDP, so for a full-blown recession, consumers would need to stop spending, as they did in 2009-10. Unfortunately, the combination of uncertainty and a squeeze on spending power due to high inflation and weaker earnings could well prove toxic, yielding precisely this effect.

But in terms of the fundamentals, based on international measures of competitiveness, the UK seems in decent shape. The UK ranks in the top tier of the competitiveness league tables produced by the World Bank, the World Economic Forum and the Heritage Foundation, alongside countries like Switzerland, the Netherlands, Denmark and Australia. This competitive strength speaks to the flexibility and resilience that will be vital as the UK navigates what lies ahead.

Impact on the EU

The Brexit vote is as much of a shock for the EU as it is for the UK. The sharp fall in Continental European equity markets shortly after the results came out testified to the depth of concern about possible knock-on effects. Britain exiting the EU represents the greatest political setback to the EU in its 65-year history. The decision comes at a time when the EU is coping with a migration crisis, the ongoing crisis in Greece, a sovereign debt crisis in some countries while trying to bolster the euro area against future shocks. After a period of rapid economic and political integration in the '90s and '00s, Europe is experiencing much slower, more divergent growth and a loss of political momentum.

More extreme, anti-establishment political parties are gaining ground in various countries. The immediate worry is the risk of a domino effect that would see eurosceptic parties elsewhere in the EU demand their own referenda. Recent research, conducted by Deloitte and the German employers' organisation BDI, showed that 66% of German businesses believe a British exit would lead to other exits in the EU.

A complicating factor for any UK negotiations with the EU is that a series of national elections will be held in 2017, most crucially in the Netherlands (March 2017), France (April to May 2017) and Germany (August to October 2017).

The UK vote for departure from the EU also raises questions about the future direction of the trade bloc. Without the UK, the EU loses a significant supporter of free trade and free-market policies. Analysis by Open Europe, a think tank, suggests that the UK's exit from the EU will tilt the balance of power in the EU under Qualified Majority Voting significantly towards a more protectionist, less free-market, approach.

Impact on Switzerland

While the EU is Switzerland’s largest trading partner, the UK is among the most significant trading partners, also compounded through indirect effects. For example, the UK is a very important trading partner for Germany; Brexit would hurt the German economy and, by extension, Swiss trade with Germany. Lower growth abroad is likely to result in lower foreign demand for Swiss goods and services.

It is likely that the repercussions of the vote will tie up considerable resources in Brussels for some time to come. This will affect the resolution of issues affecting Switzerland, such as the mass immigration initiative, as these slip further down the list of priorities.

Brexit’s biggest impact on Switzerland is increasing upward pressure on the Swiss franc. The Swiss National Bank (SNB) was prepared to respond to this, and has so far kept the volatility under control. The key question is how long the SNB’s intervention will be needed, and to what degree?

The situation is challenging for Switzerland but it is not new. Switzerland is no stranger to the burden of a strong currency. Swiss-based companies have been used to this for decades, and the challenges of coping with a strong Swiss franc have been particularly thorny over the last eight years. Most of them have dealt with the problem successfully, and can draw on the lessons learned to overcome the current challenges.

As it will take at least two years before Britain’s exit from the EU is completed and new rules and regulations are in place, companies will have time to get organised and prepare for the new reality. It is recommended that this time be used for strategic analysis and adjustments.

Negative long-term consequences should be limited if Brexit is executed smoothly. The biggest risk is political, but the wish of all parties concerned to minimise risk and uncertainties could see necessary and important long-term reform in the EU.

Impact on companies

The immediate political, market and economic events over the next few weeks and months are difficult to predict or control. In this highly uncertain environment, companies need to focus on managing the financial impacts and communicating with a broad range of stakeholders, both internal and external.

Below are six steps that we believe are critical for firms to consider now that the UK has voted to leave the EU.

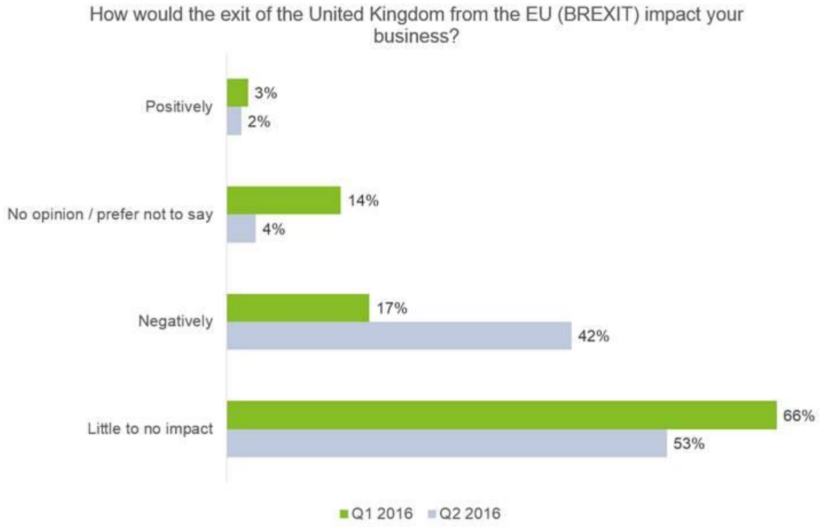
1. Be ready to respond at very short notice to information requests from stakeholders, both in the UK and elsewhere, about the impact of market volatility on balance sheets and customers/counterparties.
2. Broaden and deepen scenario analysis and contingency planning.
3. Develop carefully thought out and consistent communications to internal and external stakeholders.
4. Consider how future strategies might be affected, positively or negatively, by the terms of the UK's exit from the EU.
5. Begin to work through detailed plans and timelines for any relocation strategies that may need to be implemented.
6. Consider the appetite for buying "insurance" against possible outcomes that could seriously undermine your business model.

Dealing with an uncertain outlook

For some firms, particularly those that use the UK as a hub to access other EU Member States, the future terms of UK access to the Single Market will be fundamental to their strategy and business models. For many of these firms, "waiting and seeing" until the outlook becomes clear will be untenable, given the lengthy lead times associated with moving substantial blocks of business and, potentially, people. These firms face a period of decision-making under significant uncertainty. Operating successfully in this environment will require meticulous planning, including scenario analysis and contingency planning, the identification of triggers to activate specific elements of contingency plans and, in some cases, early decision-making to secure maximum flexibility and keep options open in the future.

Expected Brexit impact on Swiss companies

Results from the Deloitte Swiss CFO Survey; survey period: 30 May – 23 June 2016; 115 participants



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