Brexit

The Brexit Vote: A Financial Thunderclap With Long-Term Consequences

By Vassilis Fouskas

The Brexit vote was a financial thunderclap for the entire Western chain of globalised finance. The EU and the Eurozone now face an unknown period of disintegration, instability and rebranding.

Financialisation is a policy and a process that began with the end of the dollar-gold parity in the late 1960s. It unleashed money and credit and signalled a shift of transatlantic economies from the (under-performing) "real economic sector" to financial and banking services which, for ease of reference, I would call "fictitious sector". New forms of trade and profiteering emerged with the financialisation of non–financial enterprises being followed by the financialisation of everyday life, especially through the spectacular rise of consumer debt. Britain, under Thatcher, and the USA, under Reagan, spread financialisation into the domestic environment of the states through a set of policies that are commonly referred to as "neo–liberalism" (privatisation of public enterprises, welfare state retrenchment, flexible labour markets etc.).

Neo-liberal financialisation *preceded* the process of European integration *stritu sensu*. The former began in earnest in the late 1970s, whereas the origins of the latter can be traced back in 1986-87 with Jacques Delors' Single European Act, leading to the Maastricht Treaty and the launch of the Euro in 1999. In this transatlantic configuration, the City of London was slated for the role of an offshore stabiliser and facilitator for the Eurozone exchange market, sustaining the operations of assets denominated in dollars and Euros. It was neo-liberal financialisation that laid out the monetary policy framework of the EU and the Eurozone, not vice versa. Dollar, sterling and Euro trading assets were and are fundamental for the reproduction of the Eurozone as a whole and, as a consequence, of the dominance of the German (low-inflation, low–wage, export-led) model in it. Contrary to conventional views that see a split between the City of London and Euro–zone economies, I argue that both markets are closely interlinked and cannot operate as separate or antagonistic entities in conditions of globalised finance. In other words, neo-liberal financialisation has over the last forty years consolidated the inter-dependence of continental European and Anglo-American markets to such a degree that the breaking of any link would have severe consequences upon the entire chain of the regime. Yet, the Brexit vote, and the Greek crisis before, did exactly that. With the Greek debt crisis unresolved and with an Italian banking crisis looming, the long-term implications of the Brexit vote are enormous.

The global/Eurozone membership of the City of London

The EU accounts for almost half of Britain's exports and imports. This corresponds to 15% of the country's GDP. Britain, as part of the EU, negotiates trade agreements through the EU and not as an independent state. This is beneficial to Britain because the EU is a far larger market than the UK and global companies, having UK's "passporting rights", can come and settle in the UK and use the country as a platform for their EU trade and investment operations. The Wall Street itself is able to sell its financial and insurance services across the EU's 28 states without having to ask for regulatory approval from each one of them.

It is in this context that Britain, as an EU member, receives the highest proportion of inward FDI and portfolio investment. Of all countries in the world only the USA has a higher stock of FDI. This is mainly happening because of the particular role of the City of London in the structure of European and global markets, namely the role of the City as a trading platform of financial and banking services. More specifically, the City has become the biggest centre for trading the Euro: it manages one trillion Euros of assets in cross-border funds and it dominates the foreign exchange market, whose daily turnover is about £4

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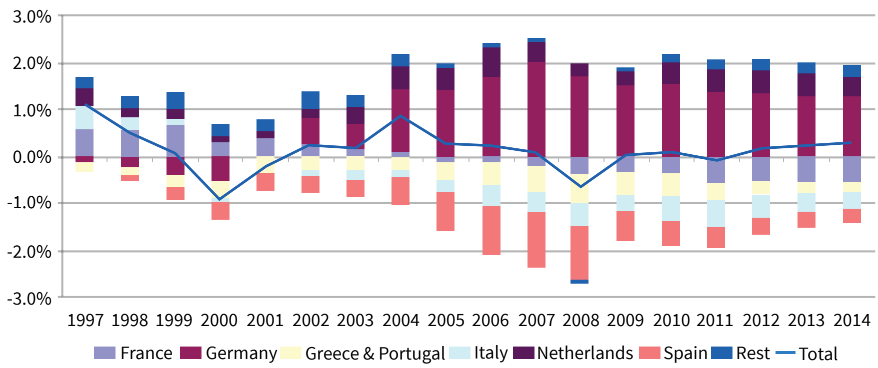
GRAPH 1. Current Account Imbalances in the Eurozone (as a share of eurozone GDP)



Source: IMF WEO Database October 2011

trillion. Foreign investment banks, many of them German and American, over the counter (OCT) operations, insurance companies, shadow banking activity, an army of lawyers and accountants, serve the single European market and some 38,000 people, which is 11% of the City's employees, come from Europe itself. Anglo-European mergers are common. The London Stock Exchange (LSE) and Deutsche Börse (DB) had announced plans to merge in order, among others, to increase the volume of clearing trades conducted in Euros. Thus, Britain, through the operations of the City, is essentially an offshore stabiliser and facilitator of the Eurozone by virtue of its global operations and EU membership. Without Britain and the City of London it is difficult to envisage how the EU will fulfil its stated aim of achieving the comprehensive free trade agreement that is under negotiation with the USA.

Short-term consequences

The Brexit vote battered global financial markets, wiping more than £2,5 trillion off global share-price values in just over two days. The pound collapsed against the dollar and the LSE-DB merger was being questioned by its architects. Credit rating agencies stripped Britain of its top AAA credit rating and the Governor of the Bank of England gave assurances that the Bank is prepared to pump £250 billion into the financial system if needed in order to calm markets and defeat uncertainty. Oil prices had dropped by 6% to below $48 a barrel. Goldman Sachs and JPMorgan Chase were both down 7% following the Brexit vote. Morgan Stanley tumbled 9%. All US-led companies suffered losses: Apple fell 2,5%; Alphabet, Google's holding company, lost 3,5% and Microsoft and Yahoo were each down about 4%. The inflated commercial property market proved to be particularly vulnerable. Fearing relocation of financial and investment firms, £650 million worth of large-scale commercial property ventures were shelved within a week of the Brexit vote. If uncertainty prevails, this can become a more permanent feature pushing large number of sales transacting below book value. This means that firms that borrowed money on the assumption that property prices would continue to rise will be unable to pay off their debts, transplanting the crisis into the banking system.

The global bond market is another immediate casualty of the Brexit vote. With the riskiest assets being sold off, such as equities, investors flew to the safety of bond markets. As a consequence, bond prices went up lowering the yields (bond prices and yields move in an inverse relationship). The indicator here is the German ten-year *Bund* yield: it dropped into a negative territory, hitting 0,12%. Only if this yield consolidates into positive territory one could argue that the risks of the Brexit vote had somewhat been contained. Moreover, fear of Brexit, has prompted car manufacturers, budget airlines and pharmaceutical firms to draft relocation plans. In particular, the Brexit vote undermined China's trade and investment strategy towards Europe. For example, companies such as Huawei, making use of "passporting rights", have invested heavily in Britain in order to extend their reach into the EU-28.

Long-term consequences

The short-to-medium term consequences of the Brexit vote are, to a certain degree, contingent upon the type of agreement that British and EU elites will be in a position to negotiate in the coming years. In this context, and assuming that politics play a diligent role, short-term negative consequences can be contained. But short-to-medium term consequences are epiphenomena of deeper underground structural trends that emerge clearly if a macro–economic analysis is pursued in the context of the crisis of neo-liberal financialisation and the Eurozone crisis. It was the former that caused the latter as it trickled down to the Eurozone's faulty monetary architecture via the banking sector.

The Brexit vote has rekindled Europe's banking crisis, made plans for a pan-European banking union unrealistic and brought the issue of the sovereign debt crisis to the forefront via Italy. In addition, it brought to the fore the Eurozone's imbalances and asymmetries, especially the surpluses

accumulated by its affluent German, Austrian and Dutch core at the expense of the indebted periphery, a systemic/structural trend illustrated by the graph (see graph 1 on previous page).

Italy's debt/GDP ratio runs at 140% and its banks hold more than 350 bn Euros of unperformed loans. Monte dei Paschi di Siena alone, the oldest bank in the world and the weakest in Italy, is in possession of a bad loan book of £39,9 bn. The bank itself is valued less than £1 bn. Italy is a very significant trade partner for the UK and the countries with the highest exposure to British capital will suffer most. Italy apart, these countries are the Netherlands, Belgium, Ireland, Luxemburg, Cyprus and Greece. France and Poland are also exposed to Brexit in specific areas. Germany will suffer too. Poland, in particular, is most exposed through migration and the EU budget. There are almost 750,000 Poles living in the UK. This is the single biggest group of foreign nationals. Their remittances sent back to Poland amount to over £1,1 bn each year. This is a significant boost for the Polish economy.

As demonstrated above, investment and trade patterns across the EU and globally are asymmetric and deeply uneven. Dutch firms have direct investments worth £180 bn in the UK, earning over £9 bn in 2013, which is equivalent to 1,5% of Dutch GDP. Germany has a trade surplus with the UK of over £28 bn. German manufacturers alone export £50 bn to the UK, or 2,4% of GDP. Just imagine what is going to happen to German industry and the global process of financialisation if Britain, outside the EU and forced structurally by asymmetric economic and social necessities, pursued an import-substitution, protectionist policy. This means that all Japanese and German producers will have to relocate, with Britain re-building its own manufacturing base and steadily adopting a new industrial policy, moving away from financialisation/globalisation. Services will cease to be the backbone of the economy and British SMEs will be demanding more financing from local retail banks, such as the British Business Bank. *Ceteris paribus*, leaving the EU will not have an immediate impact on the availability of finance for British SMEs, especially as 83% of British SMEs do not export at all. However, leaving the EU may have a longer term impact given the current account deficit of Britain, which is 5% of its GDP. This means that Britain depends on foreign investors. But if Britain is outside the EU, foreign investors would most certainly ask for a premium, which would be passed on as higher interest rates to SMEs.

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Concluding remarks

The Brexit vote was a financial thunderclap for the entire Western chain of globalised finance. It unleashed the underground disintegrative tendencies of the Eurozone and undermined further the global process of neo-liberal financialisation. This is because of the peculiar role of the City of London as an offshore stabiliser and facilitator not just for globalised finance but also for the Eurozone. In this way, the City reproduces and facilitates Germany's economic supremacy within the EU. If Brexit materialises, that is, if the British and the European elites fail to strike a deal that restores the *status quo ante*, then Europe's financial and banking sector will fragment further, with the EU and the Eurozone facing an unknown period of disintegration, instability and rebranding.

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