Brexit No U.K. Recession Trigger

While potentially damaging longer-run U.K. and European growth prospects, the vote for Brexit is unlikely to unleash an immediate recession.

Fear and Foreboding  Fears have flared that the U.K. is sliding into recession following the vote in favor of Brexit, but ECRI’s cyclical indicators are not flagging an imminent economic contraction. The reason is that, at this stage of the economic cycle, the U.K. economy is not susceptible to recessionary shocks.

The vote for Brexit certainly came as a surprise to most, but the full fallout remains unclear. It is the resultant uncertainty that has been roiling the markets, and could well damage growth prospects further.

To be clear, the U.K. has been in a growth rate cycle (GRC) downturn since late 2014, as first flagged by the U.K. Long Leading Index (UKLLI) as far back as early 2014 (ICO, February 2014). Indeed, at the end of 2015, we reiterated that the economic slowdown was “poised to persist” (ICO Focus, December 2015). However, UKLLI growth has subsequently risen a bit and edged up in its latest reading (Chart 1, top line). Following that improvement from last year’s lows, U.K. Coincident Index (UKCI) growth has also ticked up above its lowest reading since the spring of 2013 (bottom line).

As the chart shows, in recent years GRC downturns (orange shaded areas) degenerated into recessions (gray shaded areas) when UKLLI growth was in negative territory for a relatively sustained period and UKCI growth followed suit. Thus, in 2010-11, UKLLI growth turned down and then stayed below zero for seven months, falling below -2%, at a time when UKCI growth was still weak and therefore fell back into negative territory in short order. Then, in early 2012, a brief drop in UKLLI growth below zero that was not driven by pervasive weakness in its components was

Chart 1: U.K. Long Leading and Coincident Indexes, Growth Rates (%)

Gray shaded areas represent U.K. business cycle recessions and orange shaded areas represent U.K. growth rate cycle downturns.

If recent developments further reduce long-term trend growth, they will make economies more recession-prone.

Those recessions will still be triggered by exogenous shocks that arrive when they enter a cyclical window of vulnerability, but no major economy is ready to be tipped into recession just yet.