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Brexit and its consequences for Europe

„Asa no Kai“

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1 Introduction

- Dear ladies and gentlemen, I would like to thank you for this warm welcome to our breakfast briefing this morning. I am honoured to have the opportunity to speak to you and hope this can serve as an opener for vibrant and inspiring discussions afterwards.
- Of course, I would also like to thank the members of the Japanese-German Business Association and members of the Bundesbank's Representative Office in Tokyo for organising this meeting.
- The recent removal of trade barriers between Japan and the EU through the EU and Japan's Economic Partnership Agreement is evidence of ever closer cooperation and collaboration between two strong economic blocs. While ties between Europe and Asia become closer, we in Europe, however, seem to fight against centrifugal forces within our own ranks. I believe that you are all aware of the political mess that Brexit has created over the past few weeks.
- At this point, Brexit is due to happen in two days. After lengthy negotiations and extensions, both sides are "tired of infighting and political games", to put it in Mrs May's words. While the departure

of the United Kingdom from the EU is to my utmost regret, I must agree with Mrs May that the days of political games need to come to a close. However, it is quite clear that the situation has occurred because the UK is obviously not able to say what it wants. Citizens of the European Union, the UK and the rest of the world need some degree of certainty about their future rights and duties. And also market participants cannot forever cling to a lifeline of contingency measures provided by the European Commission.

- For this, I would like to use this opportunity today to talk to you about the immediate and long-term consequences Brexit will have. My focus will lie on the relationship of the EU with the UK post-Brexit but, given Japan's close economic alliance with the EU, the outcome of the Brexit nightmare will surely be followed with suspense in Japan as well.

2 Brexit and its overall economic impact

- Economically speaking, it was surprising to observe that the UK came to terms quite comfortably in the immediate aftermath of the Brexit vote. The economic fallout that had been predicted for the second quarter of 2016 and 2017 had to be revised.
- But figures today look much different: According to the Bank of England, the "Brexit fog", causing short term volatility in economic indicators, have put the UK at a 25% risk of recession in 2019 and a growth rate that is at its worst level since the financial crisis.

Although, a weaker European and global economy adds to this pessimistic forecast, the uncertainty regarding the UK's departure from the EU has negative consequences for the UK's economic growth as well.¹

- Should the UK “crash out” of the EU without a deal, at least half of UK firms will not be ready. Although many companies have intensified their contingency planning as no-deal has become the most likely scenario in the past month, the economy as a whole is said to be not prepared for a no-deal Brexit without transition.
- Such a disruption will undoubtedly be harmful for the UK economy. As for the long-term ramification, this will primarily depend on how the UK government intends to remediate this disruption for its own industries in the short-term, and more importantly, this will depend on how the future relationship between the EU and the UK will be defined.
- While these figures predict rainy days for the United Kingdom, one should not forget that Brexit creates losers on both sides of the negotiation table. On our side, we will surely face complications in future that challenge us in a different and new way. Brexit reverses a well-functioning economic relationship – that is the UK in the EU – and forces us to replace it with a solution that might be less efficient, less established, and less comfortable.

¹ <https://www.bankofengland.co.uk/-/media/boe/files/inflation-report/2019/february/inflation-report-transcript-february-2019>

- But I dare say that the German and overall European economy has been quite aware of Brexit and its potential impact. Simulations of the long-term effects show that even if Brexit dampened economic output in the UK considerably, the effects in the euro area and in Germany would be far milder. Regrettable though Brexit may be, the long-term economic fallout should be manageable for us.
- This, in turn, might come to the relief of those among you that have feared a dampening impact on the effect of the newly established trade agreement between the EU and Japan. The EU market will remain a strong trading partner throughout Brexit, to the benefit to both Japan and the EU.

3 Brexit and the financial sector

- The positive outlook that I have drawn for the economic future of the EU should not give anyone a false sense of confidence, neglecting necessary provisions in order to steer through a changing environment.
- In many areas of the Anglo-European economic relationship, legislators have granted contingency measures to allow for a smooth transition. For instance, with regard to the post-trade universe a transition period of 12 months after an unorderly exit of the UK from the EU shall allow European market participants to continue using UK-based central counterparties; with regard to central securities depositories a 24-months-long transition period

is foreseen. In a similar vein, the British legislator has also announced temporary recognition regimes.

- However, I should emphasise the temporary nature of any contingency measure or transition period. Once over, market participants will find themselves confronted with the same problem all over again. It is therefore absolutely vital that any transition period is treated as such and that long-term arrangements for the UK outside of the EU are sought.
- But a handful of contingency measures that prevent sudden economic fallout of systemic scale cannot tackle the full range of problems the financial sector will face. Let me name an example.
- In absence of the financial passport post-Brexit, UK-based Banks will need to relocate to the EU27 or activate an EU 27-branch through which they can continue providing financial services to the continent. It was at the banks' responsibility to ensure they apply and obtain the necessary licenses in due time, and we have been very vocal about this issue. On the other side of the channel, EU-based banks will similarly have to find alternative solutions to access the UK market.

4 An outlook

- Ladies and gentlemen, things have changed and will keep changing as we start accustoming ourselves to a new reality without the UK in our economic and political bloc. So as Brexit

looms closer, I find myself repeating the same words I have uttered many months ago: Preparation is key.

- For anyone that has not made appropriate arrangements, it is past time to actively engage in making these arrangements. And to everyone that is still in the process of finalising arrangements I strongly advise authorities and market participants to quickly tie up loose ends that might still exist at this point.
- But also for those that think they have done their fair share of preparation and consider themselves “ready for the storm”: The future remains unforeseeable and Brexit does irrevocably change the financial landscape in Europe, to what extent remains to be seen. I think Brexit has demanded a lot of flexibility from market participants and legislators, and everyone needs to maintain this flexibility in order to constantly adapt to the evolving relationship of the UK with the EU.
- As we now near the end of the Brexit marathon, I would therefore like to expand on the key message that I have been conveying: preparation is key, but within these preparations we need to remain flexible. In my sense, being prepared for an uncertain outcome always means being able to respond to unforeseen circumstances.

5 Conclusion

- Ladies and gentlemen, as a European I need to stay optimistic. Let me therefore close on a more hopeful note.

- In all sadness and uncertainty that accompanies Brexit, I might even consider Brexit a chance for Europe. Since its creation, the European Union has proven itself on multiple occasions that it is able to overcome obstacles as a Union. The European Union is growing and maturing with each task and challenge.
- Some Brexiteers might have bet on the lack of unanimity with which the EU sometimes appears to be governed. I believe that the Brexit showdown in the past few months has proven the exact opposite: when it comes to protecting Europe as a whole or a Member State to the outside, the European Union is indeed able to perform as a Union. No one, neither inside nor outside of the EU, should underestimate that.
- And I am quite convinced that we should not easily give up the political “fruits” of the past. We should not be chasing rainbows and we should never forget the foundation on which the European Union was built.
- Thank you for your attention.

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