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POSSIBLE REPERCUSSIONS OF THE UK REFERENDUM ON THE FORECASTING SCENARIO

The outcome of the recent UK referendum on leaving the European Union has created a situation whose macroeconomic effects, especially over the long term, are difficult to judge as they will be greatly influenced by the future policy decisions of the EU and its Member States. Much will depend on how the European integration process is affected, as it could suffer a setback if scepticism about the common project dominates, or it could instead gain momentum in order to contain the risk of economic and political fragmentation.

The UK will have to negotiate new trade agreements, a process that is likely to be lengthy and of uncertain outcome (see the box 'The implications of the referendum for relations between the United Kingdom and the European Union' in Chapter 1), and which could have significant repercussions for the British economy as well as for the euro area, albeit to a more limited extent. Over the short and medium term, the Italian economy is expected to feel the backlash of this transition through various channels: trade links with the UK; increased financial market volatility; the widespread rise in economic uncertainty; and the ripple effect on the banking system.

The day after the referendum the financial markets reacted strongly. Significant drops were posted in stock indices in particular (notably for the banking sector since its profitability is judged to be exceptionally vulnerable to the effects of Brexit) and sterling depreciated sharply; there was a very modest increase in the yields on the government securities of the most vulnerable countries; commodity prices fell and those of the reputedly safest assets increased.

The effect on the financial markets was, however, largely reabsorbed in subsequent weeks. Compared with the average values observed in the week prior to the referendum, the latest data (updated to 8 July) indicate that share prices have fallen by around 6 per cent in Italy; the yields on ten-year government bonds have decreased by 25 basis points; the euro has appreciated by just over 8 per cent against sterling and depreciated by 2 per cent against the dollar (remaining almost unchanged in effective terms); the price of oil has fallen by about 7 per cent.

The impact of these changes on Italy's GDP is essentially nil.

Nevertheless, there is still the risk of further repercussions from the British referendum over the next few months, which could lead to a contraction in economic activity in the UK that would undermine international trade and firms' decision-making.

Professional forecasters and the international institutions generally estimate that the costs in terms of lower economic growth for the United Kingdom – which will also depend on the timeframe and expected results of negotiations on new trade agreements – could be considerable, though difficult to quantify. Most analysts forecast a possible decline in the UK's GDP of 2 to 5 percentage points, spread over the next few years. Should the level of UK imports fall by 10 percentage points (a figure compatible with the uppermost part of the range of estimates made by the leading analysts), the reduction in foreign demand for Italian products would be around 1 per cent given the direct trade links between Italy and the UK (see the box 'Trade and financial relations between Italy and the United Kingdom') and the indirect links with areas that trade with the UK. The impact on Italy's GDP would be negative, at around a quarter of a percentage point, spread over the three years 2016-18. Furthermore, there could be a drop in investment by firms that export to these markets.

Greater risks could arise in extreme scenarios that envisage a tightening of financial market conditions; more widespread unfavourable expectations about the future of the EU; heightened pressure on bank securities or greater risks to financial stability, which, unless countered by economic policy action, could spread to credit supply as banks become less able to raise funds on the financial markets.

In the event of a lasting increase in the spread between Italian and German government bond yields like the one observed in the summer of 2015 when negotiations between the Greek government and the EU reached a climax (equal to around 35 basis points on ten-year bonds), Italy's GDP could be about 0.2 percentage points lower at the end of the 2016-18 period.

The extent of the effects of a loss of confidence and greater tensions in the banking sector, which has been considerable in the recent past, is difficult to judge. An increase in uncertainty and a drop in business confidence of the dimension observed during the sovereign debt crisis (when the business confidence index fell by around 19 per cent and the uncertainty inferred from firms' assessments rose by a similar amount) when reflected in investments would cause Italy's GDP to fall by about 1 percentage point. A credit crunch of similar severity to that recorded during the sovereign debt crisis (when the indicator of credit tightening drawn from the bank lending survey, which is currently negative, rose to a record high of 0.5; see Figure A in the box 'Credit supply and demand') could have an analogous effect.

If resolute use is made of the wide range of monetary policy tools now available, including the securities purchase programme and the targeted longer-term refinancing operations, they could help to substantially avert these risks, the size of which also depends on macroprudential and budgetary policy responses and on the European authorities' success in quelling fears about EU cohesion.