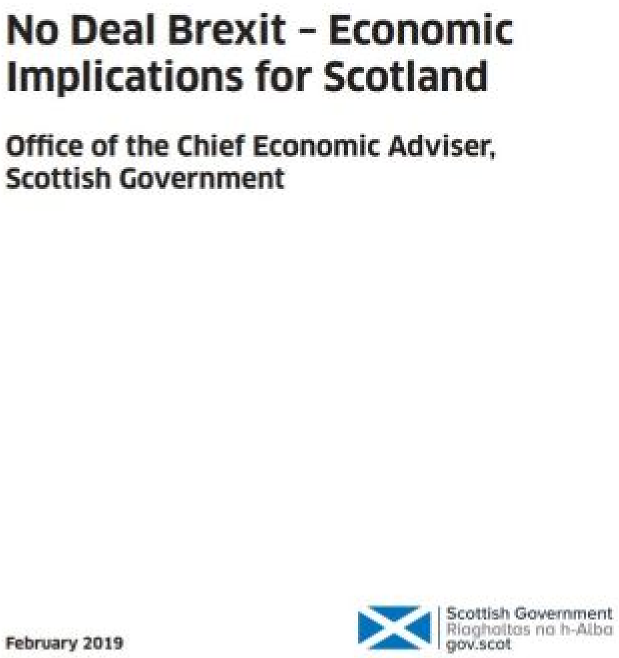
Will a 'no deal' Brexit wipe £11bn off Scotland's economy in under a year?

Today the Scottish Government's Chief Economist published analysis of the potential impact of a 'no deal' outcome on Scotland's economy.


No Deal Brexit – Economic Implications for Scotland

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One scenario presented projects that our economy could shrink by up to 7% (equivalent to around £11bn being wiped from our economy) in less than a year.

We've been asked by a number of people for our take, so we thought that it would be helpful to provide a quick summary here.

The fact that the report has been released by the Scottish Government's Chief Economist – an independent civil servant – is clearly aimed at injecting as much credibility into the debate as possible. This is the second time in as many weeks that the Chief Economist has warned of the possible economic consequences of a no-deal Brexit, which tells us something about how nervous policymakers in St Andrew's House are about the current risks.

The numbers are indeed eye watering, with a rise in unemployment of 100,000 and a loss in output of some £11bn.

A few words of caution on interpretation.

It's important to note that these headline figures of job losses and loss of output are not predictions or forecasts of what will happen. But instead, they are simply scenarios of what 'could' happen if a series of 'worst case' chain reactions are set off across the Scottish economy. The government doesn't attach any probabilities to how likely this 'worst case' is.

Unfortunately, there is simply no precedent for such an immediate 'shock' to an open economy such as the UK that economic modellers can fall back on to inform what is likely to happen if no agreement is reached before the 29th March.

As a result, extreme care has to be taken in comparing these 'illustrative scenarios', particularly if relating them to past experiences (e.g. previous recessions). Other scenarios are of course possible.

Following on from this, it's also important to note that, the results obtained are essentially whatever the modeller 'inputs' into the model in terms of 'shocks'. The illustrative contraction of 2.5% to 7% in GDP is a direct result of particular assumptions used by the Scottish Government on the scale of the hit to business investment, exports, import prices, migration, uncertainty etc etc. All of these assumptions are necessarily educated guesswork. Add all the 'worst case' scenarios for each of these elements and you end up with an economy that shrinks by an eye-watering £11bn figure.

This is not to say that the assumptions used are wrong, indeed some may seem them as conservative. The point is simply that – whilst there is consensus that the outcome will be challenging – the scale and duration of any impact is highly uncertain.

The modelling is very similar to that produced by the Bank of England back in November for their 'stress-test' analysis of the banking system. Unlike the Bank, today's Scottish Government report doesn't model what might happen if a deal *was* reached. The Bank called this an 'Economic Partnership' scenario. In this scenario, growth was projected to pick-up and be slightly higher than current forecasts.

Finally, it's important to note that the modelling assumes no policy response from government, the Bank of England or European Union. In reality, should the UK economy suffer a major dislocation in the aftermath of a 'no deal' Brexit then there will no doubt be a major monetary and fiscal intervention. Again, what form this will take and its scale is uncertain. But once more this means that comparisons of such modelling of a 'no deal' with past events – e.g. the financial crisis – need to be viewed with caution (one assumes no discretionary policy response, the other had a massive injection of monetary and government support).

There are some who will no doubt criticise today’s report for scaremongering. And as we point out, such analysis does have to be approached with a degree of caution. But at the very least, it does re-emphasise the scale of the risk that policymakers in Scotland are preparing for under a ‘no-deal’ scenario. Finally, it’s important to remember that tomorrow marks 5 weeks to go until the UK leaves the EU.