US

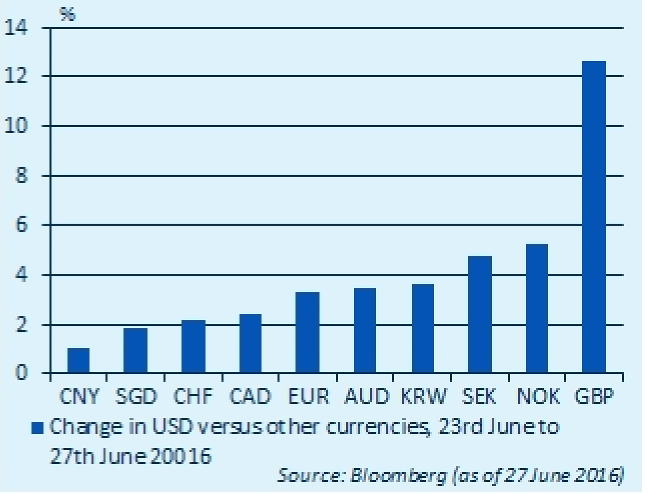
Brexit lessons for the US

Many Americans that were following the UK referendum campaign watched the events unfold with a mixture of curiosity and confusion. The seriousness of the result is clearer now after voters' decision to exit the EU initially wiped 3.6% off the S&P 500 and sent the US dollar soaring (see Chart 2). As the world's most powerful economy, it is tempting to argue that Brexit will have few implications for the US. That would be premature; the vote has important economic and political ramifications, as well as lessons that politicians and policymakers will need to heed as they confront their own challenges.

The most immediate consequence of the referendum result will be to reduce the chances of the Federal Reserve (Fed) lifting interest rates again this year. Fed officials had already been backtracking on their earlier intentions to lift rates following the recent deterioration in labour market conditions and will now want to see how economies, markets and other policymakers react to the sharp rise in political uncertainty before committing to tighter policy. Certainly, the abrupt rise in the US dollar will not have been welcome, while officials will also be wary of another bout of financial stress and a further moderation in global growth. Unless markets take Brexit in their stride over the coming weeks, December is now the earliest another rate will be considered. Brexit also has repercussions for diplomatic relations. **The US has strong alliances with both the UK and the large continental European countries; increased tensions between them as they confront an array of serious geopolitical challenges over the next few years will not be welcome**. In addition, Brexit has dealt another blow to the global trade liberalisation agenda already reeling from the backlash to the Transpacific Trade Partnership (TTP) within the US and further complicates negotiations over the Transatlantic Trade and Investment Partnership (TTIP), which were faltering even before the UK's rejection of the EU.

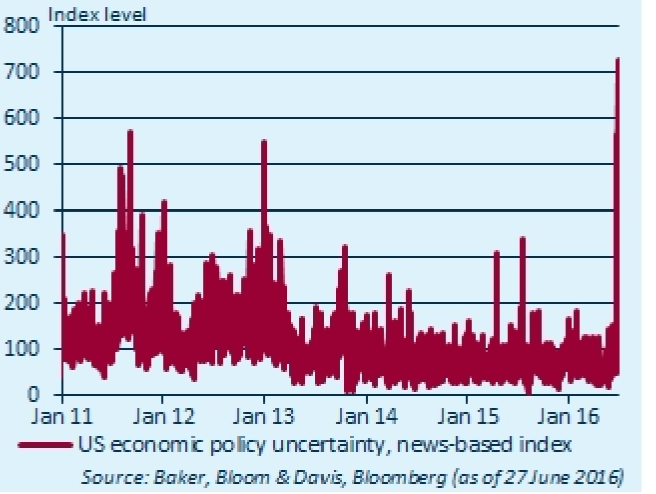
There are also important lessons to be drawn from the Brexit vote. Like the UK and other advanced economies, US voters' trust in political elites and the policy establishment has ebbed. After decades of widening inequality, the recovery from the financial crisis has been historically weak, leaving middle-class households more financially vulnerable and insecure. As the primaries have shown, many voters are attracted to populist candidates promising radical policy changes. Economically speaking, the optimal response to rising populist anger and disillusionment is to implement policies that address its root economic and social causes. For example, there is mounting evidence that, although trade liberalisation has boosted aggregate incomes, it has also undermined wages and job security for lower skilled workers more than its architects originally envisaged. **Good policy would implement counteractive measures that compensate the losers from globalisation and make sure they are retrained for jobs that are now in higher demand**. Neither of the candidates currently seem willing to engage with the complexity of this issue. Despite the populist turn in politics, measures of domestic political risk and policy uncertainty had remained at relatively subdued levels until the Brexit shock (see Chart 3). This could worsen as we approach the election in November.

Chart 2: Political currency



Source: Bloomberg (as of 27 June 2016)

Chart 3: Uncertainty rises



Source: Baker, Bloom & Davis, Bloomberg (as of 27 June 2016)