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The British Are *Leaving*?!

In an unprecedented move, the U.K. has voted to terminate its membership in the European Union after more than 40years. In what many are calling a "*stunning rejection*" of the current political and economic order, British citizens voted 52% to 48% to leave the EU in yesterday's referendum vote, a differential of more than 1million ballots, according to *Bloomberg*. The results prompted Prime Minster David Cameron to resign and sent shock waves through financial markets. The pound dropped to the lowest level in nearly thirty years and European stocks tumbled. Safe havens, on the other hand, such as the yen, the dollar and gold surged.

What's next? According to Cameron, the U.K. will now wait until a new Prime Minister is in place before executing exit talks and invoking Article 50 of the Lisbon Treaty. Details, however, of Britain's departure should be concluded "*quickly*" within two years, according to a spokesperson from German Chancellor Angela Merkel's party.

What is the impact of a Brexit? We are already seeing much of the impact span across financial markets as nervous investors flee from the region. The number one concern of the "*Stay*" camp all along was a potential run on the pound. The Bank of England warned the currency may fall sharply with analysts on Wall Street bracing for as much as a 20% reduction. A continued loss of confidence in the region, furthermore, the BOE warns, could tip the U.K. into recession - an outcome that becomes increasingly probable the more difficult and messy the country's departure. Additionally, if businesses reduce investment or opt to relocate staff outside of the U.K., British business could be disrupted or worse, could result in hundreds of thousands of jobs lost. Finally, according to the U.K. Treasury, the shock of a Brexit will cause severe strain on the budget; policy makers expect to raise taxes and cut spending as a result, to fill the gap.

What does this mean for the Fed? While not an official component of the Fed's dual mandate, global market stability has been a significant factor in determining the appropriate pathway for monetary policy here at home. The uncertainty and volatility resulting from the Brexit will no doubt serve to exacerbate the "*cautious*" stance of the Federal Reserve, taking a near-term rate increase off the table. We have long argued the still-fragile nature of the U.S. economy precluded the Fed from raising rates anytime soon. Against the backdrop of severe volatility in the global marketplace, coupled with uncertainties surrounding the prospects for growth in the U.K. and Europe in the aftermath of a Brexit, the Fed has no other option but to remain sidelined for the foreseeable future. It will take some time – months, if not longer – for the effects of the Brexit to be fully understood and the resulting volatility to subside, as well as for the domestic economy to signal it is back on a sustainable moderate pathway. In other words, get comfortable; rates are going to be sluggishly low for some time.

-Lindsey Piegza, Chief Economist

Glossary

BOE – Bank of England
ECB – European Central Bank
EU – European Union
FOMC – Federal Open Market Committee
U.K. – United Kingdom