Press Release

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Contact	Tilly Parke, media relations manager, PwC Tel: 020 7804 8761| Mobile: 07843 372663 Email: tilly.parke@uk.pwc.com
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The potential economic impact of Brexit for London, the UK and Europe

- PwC's real GDP growth projections for the UK revised down
- Potential loss of passporting a challenge for London
- Ireland and Cyprus are the most exposed EU countries from a trade perspective

UK:
Following the vote to leave the EU, the UK economy is expected to face challenges in the short term, with high levels of uncertainty leading to a slowdown in business investment and lower GDP growth. In light of this, PwC has revised down its main scenario real GDP growth projection for the UK to 1.6% and 0.6% per annum in 2016 and 2017 respectively, down from 1.9% and 2.3%. Quarter-on-quarter growth could fall to around zero in the last quarter of this year and the first quarter of 2017, but the UK would narrowly avoid a recession. Growth would then gradually pick up later in 2017 and beyond.

Richard Boxshall, senior economist at PwC, said:

> "Our projections assume that the Bank of England will loosen monetary policy over the summer. It is likely that the interest rate will be cut further, but given it is already close to zero, this could also be accompanied by an extension of the quantitative easing programme involving purchases of government and corporate bonds. There could also be credit easing measures such as extending the Bank of England's Funding for Lending Scheme in addition to the already announced cuts in countercyclical capital buffers for UK banks. We also expect public borrowing to be allowed to rise in response to lower economic growth."

London:
The UK's vote to leave the EU has put London's position as a leading international financial centre under the spotlight. To assess the potential impact that Brexit could have on London as a financial hub, PwC developed a financial services attractiveness indicator. This analysis shows that London currently ranks top of the European list, considerably ahead of Dublin and Luxembourg in 2nd and 3rd place (see Figure 1). There are, however, some things that are not picked up in the indicator, such as the appeal of different cities and regions as a place to live, which can also contribute to the attractiveness of a financial centre.

Fig 1: London is currently the most attractive of the major European financial centres – but can it retain this position after Brexit?

	Connectivity	Law	Business environment	People	Critical mass	Financial market infrastructure	
Financial Services Attractiveness Indicator	Market access (1 for passporting, 1 for reserve currency)	Strength of legal rights (0 = weak, 12 = strong)	Ease of doing business ranking	Employment (15-64) with tertiary education (%)	Domestic credit to private sector (% of GDP)	Activities auxiliary to FS as a % of total GVA	Index score (0-100)
Weighting	*30%*	*14%*	*14%*	*14%*	*14%*	*14%*	
London	2	🟢	🟢	🟢	🟢	🔴	**68.8**
Dublin	2	🟢	🟢	🟢	🔴	🔴	**61.4**
Luxembourg	2	🔴	🔴	🟢	🔴	🟢	**52.1**
Paris	2	🔴	🔴	🟢	🔴	🔴	**49.4**
Vienna	2	🔴	🟢	🔴	🔴	🔴	**48.0**
Amsterdam	2	🔴	🔴	🔴	🟢	🔴	**47.8**
Frankfurt	2	🟢	🟢	🔴	🔴	🔴	**47.6**
Stockholm	1	🟢	🟢	🟢	🟢	🔴	**45.1**
Warsaw	1	🟢	🔴	🔴	🔴	🔴	**29.7**

🟢 Above average of the 9 financial centres 🔴 Below average of the 9 financial centres
Note: Strong legal rights mean that parts of the legal system facilitate a high degree of access to credit
Sources: PwC analysis, World Bank, Eurostat

One important factor that contributes to London's success as an international financial centre is its access to the Single Market via passporting for financial services. This applies across the EU, Norway, Iceland and Liechtenstein, and gives UK-based financial institutions unfettered access to the rest of the Single Market.

It seems, at present, that the only way for London to continue to benefit from passporting would be for the UK to join the EEA when it leaves the EU. But given this scenario would probably mean free movement of labour continuing to apply, the UK making a contribution to the EU budget and EU-wide regulations still having to be applied in the UK, this could be a difficult outcome to achieve politically. So, what would losing (some) access to the Single Market mean for London?

PwC's analysis shows that, everything else remaining equal, the loss of passporting could see London lose its place as the EU's strongest financial centre as it would fall into 2nd place in the league table behind Dublin. Its gap with Luxembourg, Paris and other EU cities could also narrow significantly. Though factors such as a change in government policy, the extent of spare capacity which could support an inflow of FS activity or the presence of bodies like the European Securities and Markets Authority (ESMA) in Paris or the European Central Bank (ECB) in Frankfurt, could also see one of the other financial centres PwC has identified emerge as a new star performer.

Richard Boxshall commented:

> "London's position as an international financial centre is not by any means purely dependent on EU passporting. Other factors such as access to skills and a strong and stable legal system should see it remain as a leading global financial hub in the years ahead. But the potential loss of EU market access poses a challenge for many financial services firms. Business leaders based in London should focus their efforts on lobbying UK Government and EU politicians to retain as much EU access as possible, including retaining EU passporting rights."

Europe:
The UK's future trading relationship with the EU is the biggest source of uncertainty following the referendum. The main reason for this uncertainty is the lack of precedent. For example, it is unclear

whether the UK will be able to continue to access to the Single Market as it currently does now, or have to negotiate a free trade agreement, or even have to trade with EU member states under WTO terms.

PwC's analysis identifies the 10 EU countries that export the most to the UK, relative to the size of their economies. Ireland (19.9%) and Cyprus (9.5%) sit at the top of this list. Of the larger European economies, Germany exports the most to the UK relative to the size of its economy (3.7%). France (2.5%) and Italy (1.7%) don't rank within the top 10.

These numbers are relatively modest at the macroeconomic level but could be more material for some industry sectors, so affected businesses in these economies do need to be prepared for different trade arrangements in the future.

Richard Boxshall said:

> "Trade agreements are complex and generally take many years to negotiate, but given the high level of integration that has been built up between UK and EU markets, it is unlikely it would be allowed to fall away completely.
>
> "Businesses need to put the case to governments to make early progress in putting such trade deals in place in a way that is mutually beneficial to businesses in both the UK and other EU countries. But, in the interim, they need to make contingency plans for a range of different outcomes."

For more details, please see this month's Global Economy Watch at www.pwc.com/GEW.

Ends.

Notes for editors.

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