

Don't Fear a "Hard Brexit"

Brian S. Wesbury – Chief Economist
Robert Stein, CFA – Dep. Chief Economist
Strider Elass – Senior Economist

The clock is winding down, and the United Kingdom has some major decisions to make. Should it stay in the European Union or should it go? If it goes, under what terms? Some analysts and investors are concerned about a "Hard Brexit," in which the UK supposedly plunges into chaos as they crash out of the EU without an agreement. According to the pouting pundits, this would throw the UK into a deep recession and send the British pound plummeting, taking world equity prices down steeply.

Count us skeptical.

The EU and the Euro currency are separate issues. The Euro has been a boon to the countries that have adopted it, and it would be a major mistake for these countries to leave (with the exception of Germany and maybe France). But leaving the EU is a completely different ballgame. Any harm to the UK's economy would be relatively mild, and any related drop in equities would be a great buying opportunity.

It's not like there would be no trade between the UK and the EU after a Hard Brexit. Trade rules would simply shift to the rules that apply between the EU and other countries under the World Trade Organization, like those that apply to EU-US trade or between the EU and China or Japan.

But the EU would be under enormous pressure to lower tariffs and cut a new deal with the UK. In 2017, the rest of the European Union ran a roughly \$90 billion trade surplus with the UK. So if a Hard Brexit makes it tougher for the rest of the EU to export to the UK, every national capital in the EU would be flooded with lobbyists asking to cut a deal. Meanwhile, leaving the EU means the UK would have the freedom to make free trade deals with the US and Canada, and any other country it wanted, without having to wait for the EU. Yes, a Hard Brexit

risks some financial jobs, but the same argument was used when the UK decided not to join the Euro currency-bloc, after which London kept its role as Europe's financial center.

But there's another basic reason why a Hard Brexit would be in the long-term interests of the UK, and it comes down to political philosophy and human nature. Let's imagine for a moment that the EU were always and everywhere dedicated to free markets and nothing else. Even in that instance, we would argue that, as much as we would like the policies it was pursuing, the UK should leave.

Why? Because any organization powerful enough to over-rule the democratic process in the UK regarding economic laws and regulations – even in favor of free markets – is also powerful enough to impose anti-free market policies as well. And, over time, since men are not angels and power corrupts, any international body with such power would gravitate toward policies that aggrandize the international political elite, comprised of elected officials remote from the people who elect them, anonymous regulation-writing bureaucrats, and judges who tend to impose their own personal cultural preferences on the rest of the continent.

In fact, the EU has already issued rules that stifle competition, like setting a standard minimum Value-Added Tax rate for all members at 15%.

Don't get us wrong, we wholeheartedly support the liberalization of trade the EU has developed through much of Europe. And the downside risk of Brexit is that it would lead to the UK experimenting with protectionism. But we are confident such policies, if followed, would make the British people suffer, and would ultimately be rejected at the polls.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
2-26 / 9:00 am	Housing Starts – Dec	1.253 Mil	1.253 Mil		1.256 Mil
2-27 / 7:30 am	Factory Orders – Dec	0.5%	-0.5%		-0.6%
2-28 / 7:30 am	Initial Claims – Feb 23	220K	224K		216K
7:30 am	Q4 GDP Second Report	2.3%	2.0%		3.4%
7:30 am	Q4 GDP Chain Price Index	1.7%	1.6%		1.8%
8:45 am	Chicago PMI – Feb	57.5	59.4		56.7
3-1 / 7:30 am	Personal Income – Dec	+0.4%	+0.4%		+0.2%
7:30 am	Personal Income – Jan	+0.3%	+0.4%		NA
7:30 am	Personal Spending – Dec	-0.2%	-0.2%		+0.4%
9:00 am	ISM Index – Feb	55.6	56.0		56.6
9:00 am	U. Mich Consumer Sentiment- Feb	95.8	95.5		95.5
afternoon	Total Car/Truck Sales – Feb	16.8 Mil	16.6 Mil		16.6 Mil
afternoon	Domestic Car/Truck Sales – Feb	13.0 Mil	12.8 Mil		12.9 Mil