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MACROSCOPE
RICHARD HARRIS

HK to take hit as Brexit vote brings ill wind of change

Britain's push expected to slow economic growth in Europe, dampening exports from China

Fools rush in where angels fear to tread – and so do I. The Brexit issue is generating far more heat than light and most of the debate has been based on guesswork and blind hope. Surprisingly, few commentators are looking forward to the big question – how will it affect Hong Kong?

Superficially, a small referendum in a far-off country should have little impact. Polls are held all the time around the world – why should this one be any different?

This referendum has stemmed from a long lasting division within the British ruling Conservative Party over Europe. A vote to remain a week today will not mean that things will remain the same. Too much blood has been spilt already in terms of political careers. Tempers remain high on both sides. It is civil war with old political friends and allies saying the most disturbing things about each other.

So it will be impossible for Britain to go back to the status quo when nearly 50 per cent of the population have voted to leave the European Union.

Few of the remain leaders, including Prime Minister David Cameron, can be described as wholeheartedly European themselves. Britain's relationship with Europe is going to change regardless of the vote.

The power of the European Commission will become hollowed out by an aggressive Britain and it is likely that other countries will follow suit. A healthier Europe will be focused on trade, standards and (as is obvious with the French and Belgian terrorist incidents) free but monitored movement of people through the EU. Failure for this to happen will not just

mean another possible Brexit in a few years, but with new leaders, perhaps Germany's exit. A more commercially minded Europe is likely to encourage competition and stimulate economic growth.

We have already seen the markets front-running the polls by hitting the pound by 5 per cent since the beginning of the year on a possible Brexit vote – and a further fall of 10 to 15 per cent is likely if it happens. The good news is that the stock market in sterling terms would rise – as most British-listed companies are likely to benefit from a weaker pound.

The bad news is that Britain is a much better importer than an



Weaker European growth and demand will affect the Chinese economy

exporter, so the country can expect to import much higher inflation. High inflation and a weak pound means high interest rates to protect the pound and reduce inflation – and we all know what high interest rates do to the property market.

A good deal of the Brexiteer argument relies on the "hockey stick theory" that the economy will get hurt first but perform better later on. Such blind hope ignores lost jobs, weaker demand and slower growth in the meantime. But what if the hockey stick gets broken at the worst possible time?

According to the seven-year itch rule (that I proposed in these columns two years ago), the world is overdue a recession. It is conceivable that Brexit could be the last grain of sand that collapses the house of cards that we have built with cheap debt and money printing over the past few years.

Economists would conclude that Brexit itself would put a brake on economic growth, not only in Britain but also as a result in Europe. Slowdown in one of the bigger and faster growing economies of Europe will therefore impact the weak and fragile European economic recovery as a whole – at just the wrong time.

Europe is China's largest single export market, and is about 10 per cent bigger than the United States as a market. Weaker European growth and demand will therefore affect the Chinese economy at a time when it needs foreign demand to bottom out its slowdown. Hong Kong will take its share of the damage.

The global stock markets have been highly sensitive to economic growth forecasts for some years now, moving up on tiny indications that global growth is growing; or down, if slowing. The impact may be marginal, but prices are made on the margin, and worry could be contagious for markets.

The one winner in this story is the US, which is the most independent of the world's economies. China and Russia may hope for the US to become distracted by the weakness of its old ally, but it is more likely that Brexit will push Britain under the wing of the American Eagle.

So whatever the result, Europe will change; but the winds of change may well chill the global economy.

Richard Harris is the chief executive of Port Shelter Investment Management

