

Br-Asia

Brexit feels a long way from Asia, but are there any implications of a no-deal exit for our region? In short, yes.



Countdown to chaos?

According to some media sources, one way or another, we should get a good idea by tomorrow whether the EU and UK negotiators have come up with a Brexit deal. If so, markets will briefly rejoice. But before the sound of champagne (or sparkling Kent wine) corks popping dies away, the hard question of "will it pass parliament?" needs to be answered and this highlights a huge problem that has been there from the very start of these negotiations.

Whatever deal the EU agrees to allow the UK to have (don't kid yourself that the UK has much say in this), has to be sufficiently bad that no one else in the EU would want to take it. If so, then won't it be insufficiently "good" for parliament to accept? You would think so, wouldn't you? Which raises the possibility of either a no deal exit, or, as some are beginning to suggest, a second-round referendum. Because no matter what the politicians say, no one specified the sort of Brexit that is likely to emerge, deal or no deal.

For more detail on how the Brexit saga is progressing (or rather, not progressing) take a look at [James Smith's Brexit Blog](#). But what of Asia? Who here (apart from me) even cares what happens to the UK?

There's more to Brexit than a potential UK disaster

To listen to some commentators, you would think that Brexit involved only one country, the UK. The reality is, it involves at least 27 other countries (the other EU nations) and a bad Brexit will hurt trade, economic growth and employment to varying degrees across the whole region. Ireland is most exposed in terms of trade, but Belgium and the Netherlands are also well in the frame, and judging by the noises out of Munich, Germany's car-makers are none too happy with the prospect of a bad Brexit deal either.

The UK's nearest neighbours across the Channel will probably be content to see their rival in a thousand year love-hate relationship humbled by a bad exit. But with thousands of French jobs reliant on Briton's love of French food, climate and countryside, that schadenfreude may not last long.

One thing does seem evident, a bad Brexit is not good for the euro - so by definition, is positive for the dollar.

Stronger USD means weaker Asian FX

A hefty boost to the US dollar is not in the interests of much of Asia. For one thing, it will tend to reduce Asian FX strength, raising the prices of imports and inflation, and putting central banks back on watch to tighten policy - just as they were earlier in the year. Tighter policy rates most likely mean weaker domestic economic growth. And as we move into 2019, with elections in the Philippines, India, and Indonesia, some of our region's more vulnerable economies to economic and market volatility could see spillover from economic weakness with upsets at the ballot boxes that could spillover into financial markets.

Nor should we relax just because the UK is only a small percentage of any of our region's export destinations. Sure - if we only focus on the UK, the threat seems small. But the EU as a whole is a similar economic size to the US. [EU data for 2017](#) showed the region accounted for 32% of all Asian exports, just behind the US (34.5%). EU growth already looks rather tepid by comparison with the beginning of the year. Couple a further EU slowdown with the US fiscal stimulus turning to a drag, and you have a fairly downbeat global growth backdrop - add in some lagged inflation effects from earlier capacity overshoots, and you have in addition a toxic environment for risk assets too, with not much room for central banks outside the US to respond.

These are not base case forecasts, merely downside scenarios. And some of these downbeat outcomes could emerge even if the UK and EU do cement a workable exit deal over the next few days. But a bad exit will push the balance of probabilities in the direction of a nastier global economic outcome, and I for one would rather be stacking the chips the other way if possible.

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