

## BOX 1

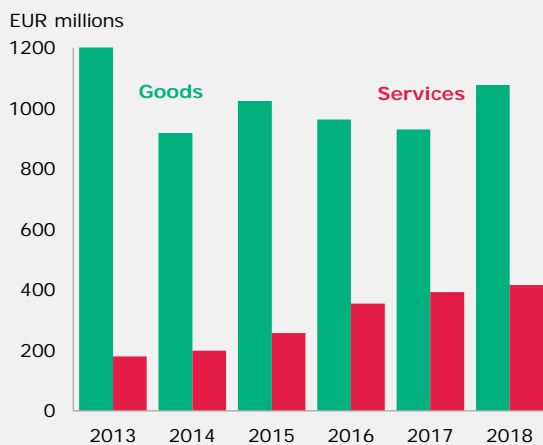
### THE IMPACT OF BREXIT ON LITHUANIA'S ECONOMY

**Although due to political turmoil in the UK only a prophet could predict the outcome of Brexit, the UK leaving the EU on 31 October – either with or without an agreement – is one of the possible scenarios.** The major concern for the euro area is a high probability of a no-deal Brexit<sup>7</sup>. The IMF and the EC still consider an agreement between the EU and the UK and a gradual transition to new arrangements as the main Brexit scenario and project the annual growth of the UK economy to stand respectively at 1.3% and 1.8%. Although due to stockpiling ahead of the original Brexit date the UK's economic growth exceeded expectations in the first quarter of 2019, it contracted by 0.2% in the second quarter. According to the assessments of the IMF and the Peterson Institute for International Economics<sup>8</sup>, a no-deal Brexit could lead to a recession in the UK. Such an outcome would also have negative effects on Lithuania's economy.

**The UK is an important Lithuania's export partner.** In 2018, Lithuania exported over €1 billion worth of goods to the UK (3.8% of total exports of goods), mainly industrial ones – chemical, furniture, timber and plastic products (see Chart A). Lithuanian exports of services to the UK amounted to €415.5 million (4.2% of total exports of services), soaring by 131% over five years. Transport services account for more than half of services exported to the UK; therefore, this sector is likely to be most affected by Brexit – not only because of possibly shrinking external demand but also due to such disruptions as queues at the border and additional customs procedures (see Chart B).

#### Lithuania is exporting increasingly more services to the UK.

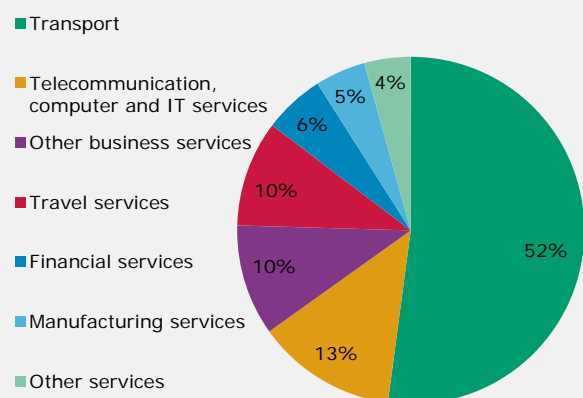
Chart A. Development of Lithuanian exports of goods and services to the UK



Source: Statistics Lithuania.

#### Transport services account for more than half of Lithuanian exports of services to the UK.

Chart B. Lithuanian exports of services to the UK in 2018 (by type of service)



Sources: Statistics Lithuania and Bank of Lithuania calculations.

**Lithuanian immigrants in the UK would feel negative implications of Brexit through a deteriorated economic situation and changes in the legal regulation.** The UK has long been the main migration direction for Lithuanian citizens, with almost half of all emigrants from Lithuania living in this

<sup>7</sup> **Hard Brexit:** the UK gives up membership of the EU single market and can trade freely with its European partners without any tariff restrictions. Drawing up independent trade agreements will take time and force the country to apply less favourable WTO rules.

**No-deal Brexit:** unlike a hard Brexit which could include some type of agreement with the EU and a potential transition period to negotiate free trade deals, a no-deal Brexit presents no cushion whatsoever and its damage to the UK economy would be the most severe.

**Soft Brexit** is the least damaging path: the UK remains closely aligned with the EU by retaining some form of the bloc's single market. The EU requires that access to the single market should be maintained if all its principles are respected, including the free movement of people (Norway case). However, the UK is not willing to compromise on immigration.

<sup>8</sup> Latorre, M. C., Olekseyuk, Z., Yonezawa, H., and Robinson, S. (2019). [Brexit: Everyone Loses, but Britain Loses the Most](#) // Peterson Institute for International Economics Working Paper 19-5.

country. The end of free movement of EU citizens in the event of a no-deal Brexit would increase the chances that Lithuanian citizens residing in the UK who have failed to apply for settled status in due time may be deprived of their right to stay in the country. Lithuanian citizens who would legally stay in the UK would probably face an increased threat of job losses: in addition to the above-mentioned transport services sector, it is particularly relevant to persons working in the industrial and agricultural sectors, as it would be significantly more difficult to export their production. As much as two thirds of UK agricultural products are exported to the EU, while 90% of seasonal agricultural workers come to the country from Eastern Europe. The depreciating pound would also erode euro savings of Lithuanian emigrants, which, in turn, would cut their remittances to Lithuania, accounting for more than 18% of all foreign remittances received in Lithuania in 2018.

**The UK's withdrawal from the EU without an agreement would have other macroeconomic implications in Lithuania as well.** Its impact would be felt not only because of Lithuania's direct and indirect trade links with UK businesses, partly resulting from Lithuania's intensive trade with other EU countries the UK is an important trade partner of, but also because of elevated economic and financial uncertainties. They would particularly intensify in the UK where companies would find it extremely difficult to develop investment, along with a pick-up in various risk premia and an increase in the cost of borrowing. Amid the worsening financial situation of households and higher borrowing costs, real estate prices in the UK are likely to drop. Financial environment indicators would also be affected in other countries or regions, including the euro area. The deteriorating international environment and increased uncertainty would bring down prices of equity instruments in the euro area and push up costs of corporate and household borrowing. This situation would negatively affect confidence indicators and, consequently, internal demand in Lithuania.

**The deteriorated international environment and heightened uncertainty surrounding a no-deal Brexit would weigh on economic activity in Lithuania. The Bank of Lithuania estimates that under such circumstances over the next three years Lithuania's real GDP would increase by 0.8 percentage point less than in case of a soft Brexit.**