The Brexit Moment of Truth

On Thursday, British voters will finally decide whether their country will continue to be part of the European union—albeit with its own currency and immunity from certain rules—or leave the EU altogether. The vote will be momentous for Europe as a whole, a test of whether the union can hold together in the face of myriad challenges like the Syrian refugee crisis, disparities in wealth and economic health between north and south, and debt problems like those posed by Greece and, worryingly, Spain and Italy. There are strong anti-EU parties in Germany, the Netherlands, Greece, Spain, and Italy which would certainly be emboldened if Britain were to vote to secede from the EU.

How will the vote go? British Prime Minister David Cameron is strongly in favor of staying in the EU, as is much of his Conservative government, the Labour Party, the Liberal Democrats, and the Scottish National Party. Ironically, if there is a "Brexit," then the Scottish people might vote to exit Britain and join the EU on their own.

On the other side, many Conservative members of Parliament are in favor of exiting the EU, along with members of the UK Independence Party, and many lower-wage workers who view EU membership as an attack on British sovereignty.

What's at stake? With an "exit" vote, British companies could lose access to the consolidated European market for duty-free trade and financial services. Some analysts think that London would be unable to function as Europe's de facto financial center if Britain were no longer a part of Europe's union. And U.S. companies have long seen Britain as the gateway to free trade with the 28 nations in the European Union, which explains why American corporations and Wall Street firms have donated substantial sums to the "stay" campaign. Britain could lose American investment and manufacturing jobs that would move across the channel to mainland Europe.

Add it all up, and the International Monetary Fund has predicted that a Brexit would reduce British economic growth by up to 5.6 percent in the next three years, partly driven by a sharp decline in the British currency. Meanwhile, you may have noticed that the global investment markets have become noticeably choppier in the runup to the vote. The uncertainty created by a British "leave" vote would create still more volatility, which is why Fed Chairperson Janet Yellen has mentioned the referendum overseas as having an influence on the decision of whether or not to raise interest rates in the U.S.

Who will win? The vote is expected to be close, but recently, the oddsmakers in Britain have given 73% odds on a "stay" vote. Another voting machine, the global currency markets, have driven a two-day rise in the value of the British pound that is the seventh-largest since 1971—a clear sign that the most sophisticated global investors expect the European Union to stay intact.

Sources:

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