Far-reaching implications of Brexit decision

The UK's decision to leave the EU – so-called "Brexit" - by a narrow majority of 52% to 48% in a referendum on 23 June is already being felt in currency markets and stock exchanges around the world. The short term economic effects are already evident – a slowdown in growth, certainly in the UK which might even dip back into recession, and also in the wider EU economy.

The UK plays an important role in the EU. Whether it is the share in total population, total GDP or FDI, Britain ranks in the top three countries and Brexit has significant implications for the whole continent. The UK is also the EU's largest importer of timber from tropical countries by a significant margin.

The political impact of the referendum result has been profound in the UK, leading to the immediate resignation of the UK Prime Minister while both the party of government and official opposition has descended into turmoil and a rancorous debate over what should come next. The survival of the UK as a political entity is itself threatened as the nationalist First Minister of Scotland, which voted overwhelmingly to remain in the EU, is now seeking a new referendum on leaving the UK so that an independent Scotland may be free to remain as part of the EU.

Divisions have emerged within the EU between those Member States and EU institutions that believe the UK should initiate the so-called "Article 50" procedures (set out in the EU's 2007 Lisbon Treaty) for withdrawal within a matter of days to avoid prolonging uncertainty, and those prepared to give the UK breathing space to allow a newly appointed government to work through the implications and plan for an orderly departure.

Speculation about when, and if, the UK will leave the EU

There is still speculation that the UK may never actually leave the EU. An on-line petition has been signed by more than 2.5 million people calling for a re-run of the referendum on grounds that less than 60% voted to leave and turnout was less than 75%. The legal basis for this petition is dubious since the terms agreed for the referendum in advance were that the decision required a simple majority of those voting and not a super-majority of the voting population as a whole.

A more convincing legal argument is that, as the UK is constituted as a parliamentary democracy, MPs must still vote to implement the referendum result which, from a legal perspective, is only "advisory". A majority of MPs may yet vote against the parliamentary motion to repeal the 1972 European Communities Act, by which it voted to take the UK into the EU, and thereby prevent the UK leaving.

At this stage, the latter scenario seems unlikely. It would be highly divisive and likely to create even deeper political conflict and prolong the uncertainty. The statements issued so far by both the UK government and jointly by the leaders of the EU Member States, assume that the UK will now act on the referendum result and leave the EU within the two-year timeframe required once the Article 50 procedure is initiated - a move now widely expected sometime between September and November this year.

It is possible the situation will change – negotiations with the EU might prove too difficult, or the economy might slide to such an extent, or the divisions between the various constituent parts of the UK become so great - that British MPs vote to try to halt the process at some stage. In that event of course, it's unlikely that the rest of the EU would be sympathetic to back-tracking, and the UK's political and financial position would almost certainly be weakened within the trading block.

Uncertainty leads to sharp economic downturn

In economic terms, the overwhelming issue is uncertainty. There are already signs that this is leading UK businesses and external investors to delay decisions until there is greater clarity and there is some settling in volatility of currencies and share-prices.

For timber importers in the UK, weakening of pound sterling to a 30-year low against the US dollar, and a 30% fall in the share value of the largest UK house builders following the referendum – are certain to result in a big decrease in buying. Whether this is short term or long term depends heavily on the progress of the challenging political processes now underway and the extent to which the wider economy is able to ride the storm.

A key issue for the longer term is the eventual terms of any trade deal between the EU and the UK. Once the UK initiates Article 50, there would be a two-year window in which the country will maintain unfettered market access to the EU as it negotiated an exit. After that, the terms of trade will be set in a new agreement.

The UK will be pushing for the best possible deal with the EU and one which is almost certainly unrealisable. The UK is likely to ask for continued participation in the EU free market without allowing free movement of EU citizens into the UK – an issue which proved highly divisive in the referendum campaign. The UK also wants to contribute significantly less to the EU budget but to continue to participate in development of technical standards and certain other decision making bodies.

The EU has already issued a joint statement to the effect that the UK will not be able to cherry-pick only those aspects of the free market that they like, nor to have continued access without allowing freedom of movement and without paying the full costs of membership.

What is certain is that the starting positions for negotiation are a long way apart and it will be extremely challenging to reach a mutually acceptable agreement. In fact, many EU officials and Member States are calling for the EU to impose tough conditions on UK trade with the EU to discourage leave campaigns in other EU Member States. The UK has some points of leverage, for example with certain German exporting industries that sell a large proportion of product into the UK, but hardly seems to be negotiating from a position of strength.

Likely decrease in bilateral trade between the EU and UK

It seems likely that there will be greater obstacles to UK trade with the rest of the EU in the future and that the value of bilateral flows will decrease. This will hurt the UK economy more than the EU - UK's total exports to the EU are currently equivalent to 13% of UK GDP while the same figure for the EU is just 3%.

The imbalance could become even more pronounced when it is considered that there is likely be a reorientation of inward investment away from the UK to other European countries as it loses its status as a gateway to the single market. There is particular concern in the UK about potential for relocation of European financial firms with offices in London - the financial sector is about 8% of Britain's GDP and the departure of these firms would make a considerable dent in the nation's tax receipts and overall consumption and spending.

The expected decline in UK-EU trade will have less to do with tariffs – which for WTO members are relatively low across many product groups – including timber – than on other factors such as the potential for diverging product standards and a decline in cross-border business integration and investment.

Immigration controls could further slow UK growth

Anticipated tighter controls on immigration into the UK are also expected to negatively affect the national economy, reducing access and increasing costs of labour, both skilled and unskilled. There is a strong consensus in the UK construction sector that Britain's departure from the EU will hit housebuilders' workforces hard and further slow activity in this sector. The fear of serious economic dislocation in this sector is highlighted by surveys just before the referendum which showed that over 85% of UK construction and real estate companies were in favour of remaining part of the EU.

While the UK economy is expected to be particularly badly affected by Brexit, the wider EU economy is also expected to suffer. Trade is the most direct channel through which a Brexit would hit the rest of the EU. Looking at bilateral trade, Ireland and the Netherlands, followed by Belgium seem to be the most exposed Eurozone countries to a Brexit.

A report by Germany's IFO Institute suggests that Brexit may have a dampening effect on the EU's largest economy, even before it happens. The report notes that German economic growth has been robust and was heading towards a real upswing this year. However, that upswing is now expected to be less pronounced, due to the uncertainties many companies feel: "projects that have anything to do with Great Britain will be put on ice - they will wait before realising projects, before they decide to recruit new employees, before they carry out new investment projects".

In another sign of the impact of Brexit on the wider EU economy, company share values in both Italy and Spain fell even further than in the UK in the immediate aftermath of the referendum. These declines were fed less by concern about the direct effects of Brexit on trade flows than by concern about the political implications – particularly the potential for "populist exit contagion" in a number of other EU countries where nationalist anti-EU sentiment has been on the rise in recent years.

Brexit likely to slow tropical imports in the short term

From the perspective of the tropical wood sector, Brexit will have significant implications. The UK is now by far the largest importer of tropical timber in the EU. If all timber-based products are included (primary raw materials, secondary processed products and tertiary products like furniture), in 2015 the UK accounted for around 25% of the total value imported into the EU from tropical countries. This compares to 15% imported into France, the second largest EU market for tropical timber.

UK import value of tropical timber products increased by 32% from €720 million in 2011 to €960 million in 2015. This is in contrast to other leading EU markets for which, during the same period, tropical timber imports were either flat (Belgium) or declining (all others).

The expected economic slowdown in the UK on the back of the uncertainty after the referendum result is therefore likely to have a disproportionately large impact on the EU's imports of timber products from tropical countries. A large part of the recent growth in UK imports of timber products from these countries has been in the form of furniture from Vietnam, Indonesia and Malaysia – a trade now likely to slow in the short to medium term.

Longer term, the prospects for tropical timber products in the UK and the EU will be partly dependent on the speed of underlying economic adjustment and partly on the terms of trade agreed. If UK recovery is relatively swift, there may be longer term advantages for tropical timber producers (and other non-EU timber product suppliers into the UK) if the new arrangements lead to introduction of tariffs or otherwise impede trade in timber products between the UK and continental Europe's large and dominant wood product manufacturing sector. But given the uncertainties, this has to be regarded as highly speculative.

Uncertain policy implications

There are also uncertain policy implications for the timber sector associated with Brexit. UK technical standards for the vast majority of building products are now set at EU level under the terms of the EU Construction Products Regulation. This situation won't change any time soon, particularly as even after the UK has left the EU, UK manufacturers selling any product into the EU will have to continue to abide by EU standards. However, the UK's exit from the EU would open the door to gradual divergence of UK and EU standards for construction and other products.

The same could be said of regulatory requirements like the EU Timber Regulation (EUTR), although again it's unlikely that there will be any significant change in the terms of this regulation in the UK in the foreseeable future. The UK in both the public and private sector has been a leading player amongst EU countries to develop measures like EUTR, provide political and technical support for FLEGT, and promote responsible timber procurement policies. There's no reason to expect Brexit to lead to any reduction in this level of commitment, nor a reduction in co-operation between EU and UK agencies seeking to address these issues.