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EUROPE | NEWS ANALYSIS

For Britain's 'Brexit' Bunch, the Party Just Ended

By PETER S. GOODMAN OCT. 7, 2016

LONDON — For those blithely inclined toward the view that Britain would somehow find a way to sever its relationship with the European Union free of drama or financial consequences — like canceling a car rental reservation, with a tad more paperwork — Friday was a sobering day of reckoning.

As the British pound plunged some 6 percent against the American dollar in the span of two minutes in early trading in Asia, the markets offered a reminder that divorce tends to be messy, expensive and laced with uncertainties. It rarely ends happily.

The selling was so frenzied and swift that those who swap currencies for a living spoke of computerized transactions going haywire, rogue algorithms at work or a data entry error. The drop in the value of the pound appeared excessive, and it soon recovered some losses, though the British currency was down about 17 percent — around 25 cents — since June 23, the day Britain voted to abandon Europe.

More than anything, though, the precipitous drop seemed to attest to an increasingly unmistakable reality: Britain's vote to exit the European Union — Brexit, in common parlance — has put its commercial relationships with the world on uncertain and potentially perilous ground. That poses risks for the British economy, making its money less attractive to hold.

"The world believes that the U.K. is going to be poorer in the future, and find it more expensive to trade," said Paul Johnson, the director of the Institute for Fiscal Studies, an independent research institution in London. "Essentially, the world is betting against the pound." And against the British economy.

The immediate cause of the plunge appeared to be a speech by the French president, François Hollande, on Thursday evening in Paris, in which he endorsed the view that Britain must be forced to swallow unpalatable terms of departure to discourage other European Union members from eyeing the exits.

"The U.K. has decided to do a Brexit, I believe even a hard Brexit," Mr. Hollande said. "Well, then, we must go all the way through the U.K.'s willingness to leave the E.U. We have to have this firmness.

"If not," he continued, "we would jeopardize the fundamental principles of the E.U. Other countries would want to leave the E.U. to get the supposed advantages without the obligations."

Hard Brexit, Soft Brexit, Brexit Over Easy. No one really knows what these terms mean (and the last one is made up). But, crudely, they divide potential outcomes into the ones in which Britain maintains effective inclusion within Europe's single market — a realm sprawling from Ireland to Romania, holding some 500 million people — and the ones in which Britain winds up outside.

Mr. Hollande's line echoed a speech given by Chancellor Angela Merkel of Germany earlier that day.

The week began with an admission from Britain's new Conservative prime minister, Theresa May, that access to the European market is likely to be a casualty of Britain's pursuit of a primary aspiration expressed in the Brexit vote: imposing limits on immigration.

European leaders have been resolute that free movement of people across the borders of member nations is a nonnegotiable cost of admission in the common market.

But Brexiteers had steadfastly maintained the illusion that Britain could have it both ways — that it could retain access to the European market while still controlling immigration. In destroying that idea, the prime minister's admission badly rattled the markets.

The stakes are considerable. Britain ships nearly half its exports to other European Union members. The giants of global banking have turned London into a financial center rivaling New York, using hubs here to extend their reach across the rest of the European market.

Investment has poured into Britain from around the world, as major manufacturers have set up factories so they can sell their wares across Europe without incurring tariffs.

To one degree or another — and no one really knows how much — Brexit puts all of this in play.

Negotiations between Britain and Europe are expected to commence sometime early next year. Whatever settlement results must be ratified by the remaining members of the European Union, meaning that Britain's economic prospects are now tethered to the vagaries of domestic politics in 27 other countries.

None of these risks were unforeseen. During a fractious campaign leading up to the referendum, great reams of paper were released sketching out the potential effects on the British economy should voters opt to leave. Reports varied on details and degree, but they nearly unanimously concluded that Brexit would entail economic pain.

The British Treasury surveyed the trading arrangements the government might strike with Europe after a Brexit vote and concluded it could lop some 6.2 percent off the gross domestic product by 2030. That would leave the average household worse off by about 4,300 pounds a year (at the current, depressed exchange rate, about $5,300).

But those campaigning to leave dismissed such talk as fearmongering. They described a swashbuckling and reinvigorated Britain that would break free from a stagnating Europe — the land of unemployed children moving in with their parents — to instead focus on improving trade with faster-growing countries like China, India and the United States.

Since the vote, those who urged leaving Europe have pointed to the facts that the sun still rises and the earth still spins to declare validation.

Even as the pound has fallen against the dollar, consumer spending has generally held up along with employment. Economic growth has yet to be hit. Boutiques and high-end restaurants in London remain packed.

Some have focused on the upsides of a declining pound, which makes British exports cheaper on world markets and renders Britain a more affordable tourist destination.

But this misses the fact that nearly one-third of the goods and services consumed in Britain are imported. In dollar terms, the price of those goods and services is spiking. Eventually, economists assume, this inflation will work its way through the economy, further depressing growth by crimping consumer spending and potentially sowing unemployment.

During the campaign, those in favor of leaving offered assurance that, whatever resulted, Britain would ultimately secure a beneficial trade deal with Europe. Germany sells vast quantities of cars to British consumers, giving it every incentive to keep trade flowing unimpeded by tariffs. As the largest economy in the union, Germany would hold the cards.

But in her speech on Thursday, Ms. Merkel took direct aim at that argument, telling a gathering of industry leaders that any wavering on the principle of free movement of people would pose "a systemic challenge for the entire European Union."

The sudden plummeting of the pound appeared to signal that investors were absorbing the intricacies of this dynamic, and seeing through the Brexiteers' claims that Britain could impose limits on immigration while also negotiating a settlement with Europe that would maintain access to the common market.

Boris Johnson, the former London mayor who campaigned for leaving the European Union and is now foreign secretary, managed last week to maintain the government line while simultaneously making fun of the charade.

“Our policy is having our cake and eating it,” he told the British tabloid, The Sun.

But on Sunday, as Prime Minister May addressed a gathering of her governing Conservative Party in Birmingham, she essentially dumped the cake in the bin.

“We have voted to leave the European Union and become a fully independent, sovereign country,” Mrs. May declared. “We will do what independent, sovereign countries do. We will decide for ourselves how we control immigration.”

In short, a “hard Brexit” appeared to be in Britain’s future.

“Somehow, a whole combination of people were in denial up until now,” said Adam S. Posen, a former member of the rate-setting committee at the Bank of England, and now president of the Peterson Institute for International Economics in Washington.

“There were the people who thought Brexit would be reversed,” he continued. “There were the people who delusionally thought there would be a soft Brexit, and all the northern Europeans would be nice to them. And there were people who believed that this crew in charge of the British negotiations were somehow going to strike a good deal. All of the delusions have run out of material.”

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