Brexit becomes reality – markets under pressure

Peter Szopo

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Yesterday's referendum in the UK surprised with a narrow majority in favour of Brexit. According to the latest results, 51.8% voted for the Brexit, i.e. the exit from the EU. Polls and betting odds had been suggesting a majority in favour of remaining ("Bremain") in the EU.

As expected, Brexit is triggering a massive negative reaction in financial markets this morning, not the least since in the days leading up to the referendum the development of the British pound, of equity volatility, and of European and British equity indices had indicated that the majority of investors was anticipating a rejection of the Brexit.

Pound and euro down against the US dollar

The British pound and the euro are sliding significantly against the US dollar, the yen, and the Swiss franc. Even in the first hours when the victory of the Brexit camp was becoming more likely, the pound lost 10% and the euro 4% vis-à-vis the US dollar.

Massive corrections on the equity markets

A massive correction on the equity markets is under way, in conjunction with a drastic increase of volatility indicators. The Japanese market has shed 8% this morning, while for British and European equities, double-digit losses are likely.

Bonds and gold benefit from flight to safety

We expect the spreads of bonds from the European periphery to widen, whereas the yields of German and British government bonds and US Treasury bonds will be falling and heading towards, or below, zero in the foreseeable future. Gold should benefit from this situation, as it usually does in states of shock. In a first reaction gold futures already gained USD 80 per troy ounce.

Economic and political consequences are difficult to predict

The exit of the UK is a break in European post-war history – for the country itself, and also for the European Union. The economic and political consequences are difficult to predict due to the uncertainties about the future political constellation in the UK, about the question of what trade agreements between the UK and Europe will replace the EU treaties, and about the effects on the future of the European Union. Therefore we expect the markets to remain in risk-off mode in the medium term even after the immediate reaction today. Consequently, risky investments will remain under pressure. Economic policy measures, especially from the central banks will be able to alleviate some of the negative effects, but they will not be able to completely avoid negative fallout on the UK and the European economy and on markets.

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Peter Szopo has worked as chief equity strategist at the Erste Asset Management since March 2015. Before he already worked as a consultant for equity fund management at Erste Asset Management for Central and Eastern European equity markets. From November 2009 to April 2013, he was head of the research department at Alfa Bank in Moscow.

After his research work at WIFO (Austrian Institute of Economic Research) from 1978 to 1990, he worked as a securities specialist in various management functions at internationally renowned investment banks. During this time he held the position of Head of Research at such institutions as Creditanstalt Investmentbank, UniCredit Bank Austria, Robert Fleming Securities, and at Bank Sal. Oppenheim.

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