Looming hard Brexit pushes Pound further down

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New British Prime Minister Boris Johnson is preparing Britain for an unregulated withdrawal from the European Union. Theresa May's successor has formed his government team from Brexit hardliners for the most part, and in case there are no further negotiations and concessions on the part of the EU, the UK will leave the Union on 31 October of this year without its own contractual regulation of future relations, London says.

A hard Brexit has long been described as the most economically unfavourable outcome for the first EU withdrawal in history, but now this worst-case scenario could indeed become a reality.

The UK is already feeling the massive consequences of the economic uncertainty caused by the Brexit –particularly evident in the exchange rate of the British Pound, for one.

Historical lows

The economic risks posed by the Brexit are strongly impacting the value of the British currency. Immediately after the Brexit vote in June 2016, the Pound had fallen to its lowest level in over 30 years. After a narrow majority of 51.9 per cent for the withdrawal, it dipped below the USD 1.35 mark.

More than three years and three heads of government later, the Pound's exchange rate in the lay at USD 1.21 last week.

Since the vote, the Pound has depreciated by slightly more than 13 per cent against the euro, falling by 2.8 per cent in the past 12 months alone. The exchange rate has a strong impact on equity investments and investment products traded in the financial metropolis of London.

On the stock market, however, the currency's significant losses are countered by a fundamentally positive trend. The London Stock Exchange's leading index FTSE-100, for example, has risen by more than a fifth since June 2016. While a lower Pound rate makes British products outside the Kingdom more attractive, it will be more expensive for Britons to buy from the eurozone, for example.

However, the decisive factor for the further development of economic relations with the UK will not be exchange rate effects but trade barriers. A hard Brexit would raise expectations of increased legal uncertainties, customs duties and red tape.

hard brexit exchange rate gbp - eur

Countermeasures in fiscal and monetary policy

Even the new government in London seems to be convinced of this: last week an additional GBP 2.1bn were estimated for hard Brexit preparations, bringing the total the Ministry of Finance has budgeted for the current financial year in order to be prepared for a no-deal Brexit up to GBP 4.2bn.

434 million Pounds are to be used to ensure medical care through additional freight capacity, warehouses and stocks. One of the big issues will likely be the border between EU member Ireland and the British province of Northern Ireland, where border controls threaten to slow down and make the transport of goods more expensive.

Meanwhile, the Bank of England does not want to automatically change its interest rate policy in reaction to a hard Brexit, said BoE Governor Mark Carney at a hearing in Parliament in late June.

The British monetary authorities recently unanimously left the key interest rate unchanged at 0.75 per cent, while stressing that a "gradual and limited" tightening of the monetary policy would be necessary in order to achieve their inflation target in the coming years.

However, an interest rate hike would be subject to the proviso that the Brexit succeeds smoothly – an assumption that is currently becoming, if anything, less probable. In addition to supply and demand, the BoE's Brexit reaction should take the Pound exchange rate into account, Carney said.

Legal note:

Prognoses are no reliable indicator for future performance.

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