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The Brexit Effect on Foreign Exchange

It has been just over five years since the UK voted to leave the EU, and the world has changed dramatically since June 2016. The global pandemic has not helped UK businesses much one way or another either since the end of the transition period.

At the start of 2021, sterling was 15% weaker relative to the euro than it was on the eve on the referendum of the vote for the UK to leave. There are multiple reasons as to why currency moves, but over the last five years one of the main factors of the fluctuation of currency rates is because of trade frictions between the UK and the EU. The increase in the uncertainly and persistent political instability resulted in financial institutions looking to sell off the pound, and as a result the value of the pound became weaker.

Brexit has created a significant amount of uncertainty in the foreign exchange market, however, the fall in the value of sterling occurred before Brexit had actually taken place. In contrast, exchange rate movements were relatively minor when the UK actually left the EU and the transition period ending at the end of 2020.

One immediate consequence of a fall in sterling is that foreign goods, services and assets become more expensive for UK residents. This results in higher levels of inflation and a higher cost of living.

But a weaker currency can be beneficial since it can make exports more competitive by reducing the cost of domestic goods and services to residents of other countries. This can potentially have positive consequences for the country's trade deficit and aggregate economic growth.

If we cast out eyes back to just before the Brexit vote, sterling was held up at just over €1.40 against the euro and $1.50 against the US dollar, and we have seen sterling fall to a low of €1.0608 and $1.1485 over the last 12 months. This really shows how much of a hit sterling has taken.

Most importantly is that businesses understand the true effect of currency movements, and the risk to their bottom line. It's very easy for a business to just look at the currency figure, €1.10 or €1.15, but not really comprehend what the sterling cost equates to for the business.

If we look at the last 12 months, we have seen sterling move by 9%, so for a business importing €500,000 from the EU, their costs have fluctuated by £40,975. Currency movements can easily wipe out a large proportion of profit in a deal, or worse case, profit for the whole business if not managed correctly.

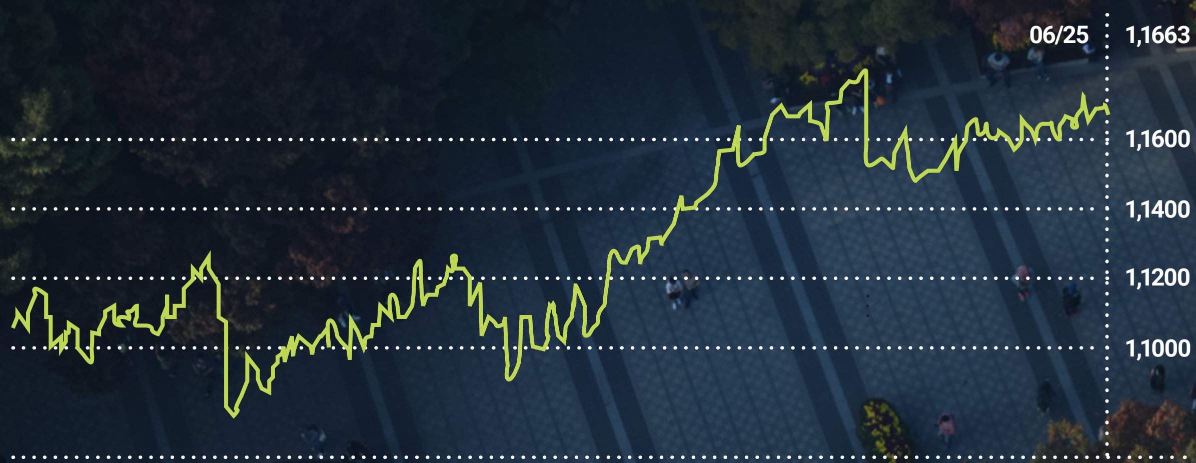
Helping businesses keep an eye on risks associated with the financial markets and to plan ahead as the world eases out of Covid-19 restrictions and into a post-Brexit landscape, our strategic partner moneycorp offers a number of tools to assist with international payments and foreign exchange.

We do still see some signs that the Pound will continue to recover, but the road will be a long one, with many bumps along the way.

The UK has, and continues to be a huge success in regards to the vaccine rollout, and with the end of lockdown and restrictions (hopefully) just around the corner, we should see UK businesses reopen fully and the economy start to really enter full recover mode.

In addition, we continue to wait to see what the road map will be for the Bank of England before they start to raise Interest Rates, will it be end of 2022, before then, or even after, no one knows, so this all continues to add to the uncertainty on the value of the Pound.

To conclude, Brexit will continue to affect forex trading even though the transition period has now ended. The latest chapter in the saga will see many more developments related to the economy and trade deals.



*Source -Bloomberg

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