



After Brexit - Impact on Currencies

June 2016

On June 23rd, the UK voted to leave the European Union (EU) and UK Prime Minister David Cameron tendered his resignation. Global financial markets were wrong-footed by the decision and gapped down sharply on the news. We expect the Brexit result to have meaningful consequences for currency markets.

US

We believe the effect of Brexit will be broadly supportive of the US dollar and may usher in a renewed wave of US dollar strength. Negative political and economic shocks tend to send investors in search of quality. These flows typically support the US dollar. US assets are often perceived as a source of relative stability in a world with increasing political risks. In addition, we believe the US economy is less likely to be affected by trade and economic shocks generated by Brexit. These factors should keep the US economy and currency well supported in the near future.

Europe

The eurozone is likely to come under considerable political pressure in the coming years. Brexit may cause other nations in the EU or eurozone to attempt to exit the EU. This will be negative for the stability of the euro, in our view. In addition, inflation in the eurozone is already well below the European Central Bank's target (ECB). The additional economic shock due to Brexit may push the ECB to ease policy further. Potential negative effects on the euro would likely be positive for the US dollar.

Asia

Asian economies are facing soft growth and inflation prospects. The combination of slow growth and financial risk is likely to keep significant downward pressure on Asia currencies. Brexit and its consequences could reinforce the reduction in global trade already faced by Asian exporters. For now, Asian policy makers appear to be well in control of the situation. It is possible, however, that an increased flight to quality could adversely pressure Asian currencies since they are typically viewed as more risky.

Conclusion

We expect currency volatility to remain high for the foreseeable future as the markets adjust to higher political and economic risks. Brexit has already caused very large swings in the price of Japanese yen and sterling. Although the swings may decline in magnitude, volatility is likely to remain above average, in our view, until the market obtains more clarity on what the fundamental effects of Brexit are likely to be.

	Tactical Pre-Brexit	Tactical Post-Brexit	Strategic Pre-Brexit	Strategic Post-Brexit	Rationale
USD	Overweight	Overweight	Overweight	Overweight	Short and long-term political dynamics support the US dollar. US dollar may be viewed as a stable store of value amid political uncertainty.
EUR	Neutral	Underweight	Neutral	Underweight	European currencies may come under pressure due to political uncertainty around Brexit, including the risk of copycat referenda. Further ECB easing could also pressure the euro.
Asia	Underweight	Neutral	Underweight	Underweight	Longer-term outlook for soft Asian inflation and growth points to reduced currency valuations. Asian currencies may be viewed as risky amid a flight to quality.

Important

Data is from Invesco as at 30 June 2016, unless otherwise stated.

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