Immediate financial market movements post-Referendum

Equities

As trading opened on 24 June, in the wake of the announcement that the UK had voted to leave the European Union, the FTSE 100 dropped by 8 per cent initially, to close the day down by 3.1 per cent (figure 1). However, by the following Wednesday the index had fully regained its post-Referendum losses in sterling terms and on 11 July closed at its highest value since August last year. Volatility, which had peaked a week before the referendum, is now at its lowest level this year.

This recovery reflects the large number of companies in the 100 index which are diversified by having operations outside the UK, and have gained from having earnings denominated in currencies other than sterling. The 250 index by contrast is composed of a higher number of domestic companies, and the drop in this index in response to the vote was deeper and has not seen the same recovery. Bank stocks listed in the UK fell even more sharply, and credit default swap spreads on major UK banks increased (table 1). Many property-related equities were also affected in a similar manner.

Sterling

Conversely the fall in the value of the pound since the vote to leave has seen no reversal over the past weeks. As of 14 July the pound was down 9 per cent on a trade-weighted basis and 8, 10 and 10 per cent against the euro, dollar and yen respectively. Since the referendum short-term sterling option volatility has decreased markedly (figure 2).

The fall in sterling reflects a weaker outlook for the UK economy, uncertainty around the nature of the UK's future relationship with the EU, an increase in the relative risk premium (see the UK text in this *Review*), and expectations of looser monetary policy.

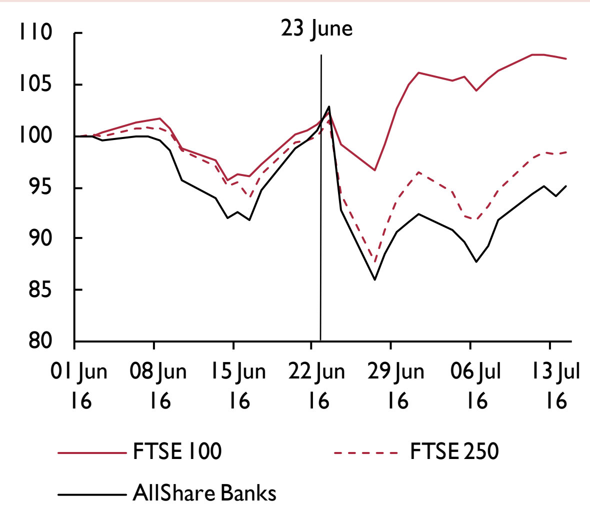
Table 1. Summary table

Measure	% ch 24 June	% ch to 14 July
FTSE 100	–3.1%	5.0%
FTSE 250	–7.2%	–3.1%
FTSE 350	–3.9%	3.6%
FTSE AllShare	–3.8%	3.5%
FTSE AIM	–3.2%	–0.5%
FTSE AllShare Banks	–9.8%	–7.5%
Germany DAX 30	–6.8%	–1.8%
France CAC 40	–8.0%	–1.8%
RBS CDS spread	36.8%*	22.5%
Barclays CDS spread	31.1%*	36.3%
Lloyds CDS spread	39.8%*	16.2%
£ yen	–11.1%	–10.3%
£ dollar	–8.0%	–10.0%
£ euro	–6.0%	–8.0%
£ trade weighted	–6.8%	–8.7%
Sterling 1M volatility	20.7%	–22.7%
Sterling 1Y volatility	26.8%	14.4%
UK OIS 24 month	–0.44**	–0.49**
LIBOR 3M	–0.03**	–0.09**
UK 10Y bond yield	–0.29**	–0.59**
DE 10Y bond yield	–0.16**	–0.2**
FR 10Y bond yield	–0.06**	–0.25**
IT 10Y bond yield	0.15**	–0.19**
ES 10Y bond yield	0.17**	–0.3**
UK corporate bond index, yield, all maturities	–0.1**	–0.63**

Source: Datastream.

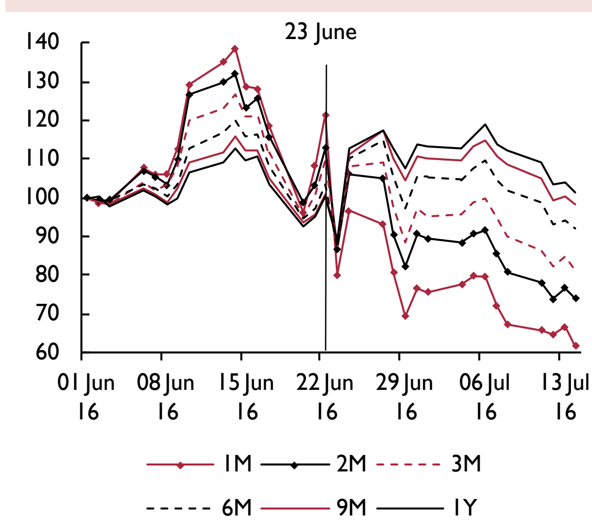
Notes: All changes from close on 23 June 2016. * change to 27 June: ** basis point.

Figure 1. UK equity indices, 1 June 2016=100



Source: FTSE.

Figure 2. Sterling volatility, 1 June 2016=100



Source: Thomson Reuters.

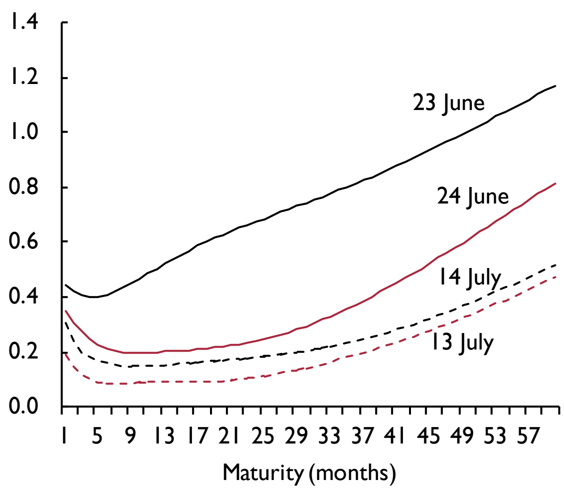
Immediate financial market movements post-Referendum (continued)

Interest rates

Figure 3 shows how far interest rate expectations have fallen since the referendum vote. Whereas pre-referendum market expectations were for the first interest rate rise to occur around the middle of 2017, as of 13 July the base rate was not expected to rise above 50 basis points until June 2021.

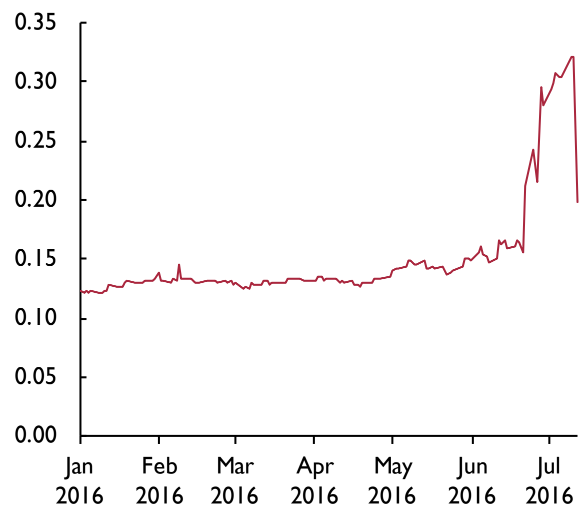
On 14 July the Monetary Policy Committee voted 8–1 to hold the benchmark interest rate at 0.5 per cent, contrary to market expectations which had priced in a more than 80 per cent chance of monetary policy being eased. However, the Bank signalled strongly that a rate cut can be expected at the next meeting on 4 August, coinciding with the publication of the quarterly *Inflation Report*. Expectations of interest rates rose slightly in response to this announcement but still reflect an expectation that rates will be held at record lows for the next few years. The pound regained around 1 cent against the euro and dollar and stock market indices rose, but the effects were muted given that the outlook is still for a monetary policy loosening in the near future.

Figure 3. OIS forward curve



Source: Bank of England.

Figure 4. LIBOR 3 months – OIS spot rate 3 months



Source: Bank of England, IBA.

The falls in OIS rates on 24 June were not matched by equal falls in the LIBOR, causing a large increase in the spread in the weeks following the referendum (figure 4). However the spread fell sharply on 14 July as spot rates jumped up after interest rates were unexpectedly held at 0.5 per cent.

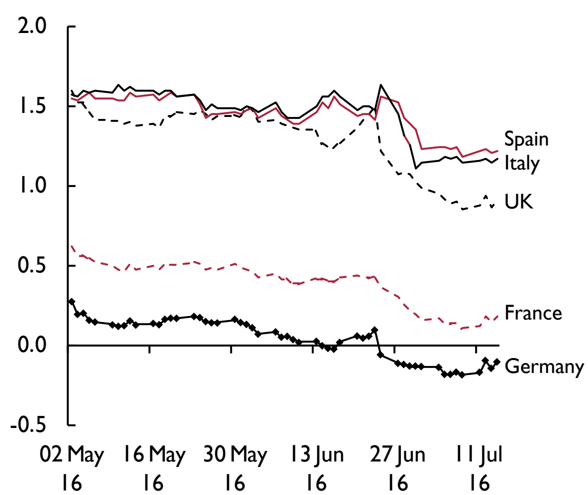
Government bonds

Sovereign bond yields fell the day after the referendum as investors sought safe assets (figure 5), with the German 10-year bond yield dipping below zero and the Swiss bond yield (not shown) now negative all the way up to 50-year maturities. UK yields fell by more than in the Euro Area, reflecting both a fall in the expected path of policy rates and a fall in government risk premia. Italian and Spanish bond yields initially rose on 24 June, perhaps over concerns about their sovereign debt in the event of contagion to the Euro Area from a UK slowdown, but have subsequently fallen to below pre-referendum levels.

NOTE: All data considered is up to 14 July.

This box was prepared by Jessica Baker.

Figure 5. 10-year sovereign bond yields



Source: Datastream.