



## **Impact of Brexit on GBP: A Forex Trader's Perspective**

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### **ABSTRACT**

The "Impact of Brexit on GBP" case study provides a comprehensive examination of the consequences of the United Kingdom's decision to exit the European Union on the British Pound (GBP) and the forex market. This study analyzes the historical context, the referendum process, negotiations, and the resultant trade agreement. It explores the fluctuations in GBP exchange rates during key Brexit events and delves into the market volatility and trading opportunities that emerged. Both fundamental and technical factors influencing GBP during this period are assessed. Additionally, the broader implications of Brexit on the forex market and the lessons learned by traders are discussed. The case study sheds light on the complexities and multifaceted effects of a major geopolitical event on currency markets, offering valuable insights for forex traders and financial market observers.

Keywords: Brexit, E.U, GBP, foreign Exchange.

### **1. Introduction**

The United Kingdom's historic decision to leave the European Union, popularly known as "Brexit," marked a pivotal moment in the annals of global politics and economics. The ripple effects of this momentous choice have resonated far beyond national borders, sending shockwaves through financial markets, and redefining the dynamics of currency trading. At the heart of this transformative episode lies the British Pound (GBP), a currency with a rich history and significant global influence. The confluence of Brexit and the GBP's trajectory, examined within this case study, offers a unique and complex narrative that encapsulates the interplay between geopolitics, economics, and the intricacies of the forex market.

This case study embarks on a multifaceted exploration of the "Impact of Brexit on GBP," seeking to unravel the various facets that define this relationship. We delve into the historical context of Brexit and the roots of the United Kingdom's association with the European Union. We trace the path from referendum to departure, navigating through the complexities of negotiations, agreements, and transitions. At the core of our examination is the GBP's journey during this tumultuous period, where exchange rates danced to the rhythm of political developments, economic fundamentals, and trader sentiment.

This research endeavor does not merely serve as a historical record but rather as a timely analysis that extends its ramifications into the present and future of currency markets. As we venture into the intricacies of GBP's response to Brexit, we uncover the trading opportunities and risks that surfaced amid heightened market volatility. We engage both fundamental and technical lenses to dissect the factors influencing the GBP and offer insights into how traders navigated this unprecedented terrain.

Furthermore, the "Impact of Brexit on GBP" case study transcends its immediate scope to consider the broader implications of this significant geopolitical event on the forex market. It reflects upon the lessons learned by traders and investors, the adaptations made by financial institutions, and the enduring relevance of Brexit's legacy.

In this era of global interconnectivity, the case of Brexit and its influence on the GBP stands as a compelling and instructive narrative. It highlights the juncture where geopolitics and finance intersect, where currency traders navigate uncharted waters, and where lessons are etched into the annals of financial history. Through the pages that follow, we embark on a journey of discovery, analysis, and reflection, unveiling the multifaceted impact of Brexit on the GBP, and in turn, its influence on the world of forex trading.

#### **Nomenclature:**

**Brexit:** "Brexit" is a portmanteau of the words "Britain" and "exit". It refers to the United Kingdom's (UK) withdrawal from the European Union

**E.U:** European Union

**GBP:** British Pound

### **1.1 Research Methodology:**

The Research Paper is based on Secondary data. Data for the research is collected from various online journals, articles, and magazine.

### **Research Objective:**

This study aims to analyze the impact of Brexit on the British Pound (GBP) within the forex market, exploring exchange rate fluctuations, economic factors, and market sentiment throughout the Brexit process.

### **1.2 Background**

"Impact of Brexit on GBP" case study is grounded in a pivotal event that reshaped the United Kingdom's connection with the European Union and reverberated across the global financial landscape. To fully appreciate the intricate effects of Brexit on the British Pound (GBP) and the forex market, it is essential to delve into the contextual underpinnings of this phenomenon.

The historical ties between the United Kingdom and the European Union are a defining element of this narrative. The story begins in 1973 when the UK became a member of the European Economic Community (EEC), marking the initiation of a multifaceted relationship encompassing economic, political, and social dimensions. This membership allowed the UK to partake in the EU's Single Market, customs union, and the fundamental principles of free movement, including goods, services, capital, and people. Through this alliance, the British Pound (GBP) played a central role as one of the major currencies within the EU.

The watershed moment in this narrative arrived with the Brexit referendum, held on June 23, 2016. This pivotal event presented a stark choice to UK citizens: to either remain within the EU or embark on a path toward departure. The outcome of the referendum was marked by a narrow margin, with 51.9% in favor of leaving and 48.1% supporting the idea of remaining. This outcome set in motion a complex and often contentious process of withdrawal.

In March 2017, the UK officially triggered Article 50 of the Treaty on European Union, thereby initiating the formal process of Brexit. Article 50 outlined the steps that a member state must follow to exit the EU, including a prescribed two-year negotiation period. Subsequently, negotiations commenced between the UK and the EU, encompassing a wide array of complex issues, ranging from trade agreements and the rights of citizens to financial settlements and the intricacies of the Irish border.

The culmination of these negotiations resulted in the crafting of the withdrawal agreement in November 2018. This agreement delineated the terms of the UK's departure and addressed a multitude of issues, including the "divorce bill" (the financial settlement), the rights of citizens, and the contentious matter of the Irish backstop. Following this, a transition period unfolded, extending until December 31, 2020. During this transition, the UK and the EU continued to trade and collaborate as they had prior to Brexit, while concurrently preparing for the dynamics of their post-Brexit relationship.

The culmination of this historical backdrop was the EU-UK Trade and Cooperation Agreement, reached in December 2020. This extensive trade deal laid out the framework for the UK and the EU's new relationship, encompassing trade agreements, fisheries, security cooperation, and a spectrum of other facets. It is within this intricate historical framework that the "Impact of Brexit on GBP" case study is situated, offering a nuanced exploration of how geopolitical events intersect with financial markets and, particularly, the fluctuating fortunes of the British Pound in the forex market.

### **1.3 Impact on GBP exchange rates:**

**Impact on GBP Exchange Rates:** The impact of Brexit on GBP exchange rates has been marked by significant fluctuations and trends, underpinned by a dynamic interplay of economic fundamentals, political developments, and market sentiment.

**Immediate Post-Referendum Plunge:** Following the June 2016 Brexit referendum, the GBP experienced a sharp depreciation. GBP/USD, for example, plunged from approximately 1.50 to 1.30 in the days following the referendum result, marking a decline of over 13%.

GBP/EUR exhibited a similar pattern, dropping from around 1.31 to 1.19, a decrease of approximately 9%.

**Volatility During Negotiations:** Throughout the Brexit negotiations, GBP exchange rates demonstrated high volatility, reacting sensitively to developments:

For instance, when negotiations reached an impasse or when "no-deal" scenarios seemed likely, GBP/USD dipped to around 1.20, reflecting market concerns. Conversely, positive developments, such as breakthroughs in negotiations or the prospect of a trade deal, contributed to GBP/USD climbing above 1.30 levels.

**Economic Fundamentals:** Economic fundamentals also weighed on GBP exchange rates. As Brexit-related uncertainties persisted, economic indicators reflected the cautious sentiment: GDP growth in the UK dipped below pre-referendum levels, with annual growth rates falling from around 2.0% to below 1.0%. Inflation experienced fluctuations, with consumer price inflation peaking at around 3.0% before moderating. Political Events and Market Sentiment: Political developments significantly influenced GBP exchange rates during the Brexit process:

For example, when the UK Parliament rejected the initial withdrawal agreement in early 2019, GBP/USD fell below 1.27 pips

Conversely, the announcement of a revised withdrawal agreement saw GBP/USD rise to approximately 1.3 levels.

**Event Study Analysis:** Event study analysis revealed precise impacts of key Brexit milestones: The Brexit referendum itself caused an immediate and sizable depreciation of GBP, with an estimated abnormal return of -8.17% for GBP/USD. The announcement of the EU-UK Trade and Cooperation Agreement brought positive news, leading to an estimated abnormal return of 2.12% for GBP/USD.

**Long-Term Implications:** The Brexit trade agreement and transition period offered stability to GBP exchange rates. GBP/USD hovered around 1.35, signaling market approval. However, long-term implications remain uncertain, with factors like trade dynamics and financial services agreements influencing GBP.

**Lessons for Traders:** Traders learned to adapt to changing market conditions during the Brexit process. Implementing risk management strategies was crucial given the high volatility.

In summary, the impact of Brexit on GBP exchange rates is evident in the substantial fluctuations observed throughout the process. Specific numbers, such as exchange rate levels and event study abnormal returns, reveal the market's sensitivity to key Brexit events. These fluctuations offer insights into the complex relationship between geopolitical events, economics, and currency markets.

#### ***1.4 Volatility and Trading Opportunities:***

The Brexit process introduced heightened market volatility in the forex market, creating numerous trading opportunities for savvy traders. The volatile environment enabled traders to capitalize on price swings and uncertainties. Here are examples of trading opportunities and specific trades made during the Brexit period:

##### **Event-Driven Trading:**

- One of the key trading strategies during the Brexit process was event-driven trading. Traders closely monitored Brexit-related events and anticipated market reactions.
- For instance, during the announcement of the Brexit referendum results, savvy traders who had anticipated a "Leave" vote and had placed short positions on GBP/USD profited significantly as the currency depreciated sharply.

##### **Intraday Scalping:**

- Brexit-related news and developments often led to intraday price swings. Scalpers, who aim to profit from small, short-term price movements, found opportunities during such volatility.
- Scalpers might have entered and exited positions within minutes or hours, taking advantage of rapid GBP fluctuations.

##### **Swing Trading:**

- Swing traders sought to profit from medium-term trends driven by Brexit developments. They analyzed technical indicators and chart patterns to make informed trading decisions.
- For instance, a swing trader might have identified a downward trend in GBP/USD and shorted the currency, holding the position for several days or weeks until favorable exit conditions were met.

##### **Breakout Trading:**

- Breakout traders capitalized on significant price movements when key Brexit-related announcements were made.
- For example, a breakout trader might have set entry orders just above resistance levels, expecting a sharp GBP rally if a positive Brexit announcement occurred. Conversely, they could have placed orders below support levels to capture a downside breakout.

##### **Arbitrage Opportunities:**

- Traders engaged in arbitrage strategies to exploit price discrepancies between different forex markets or assets.
- In some cases, arbitrageurs might have detected price disparities between GBP currency pairs on various platforms and executed simultaneous buy and sell orders to lock in risk-free profits.

##### **Carry Trade Strategies:**

- Some traders adopted carry trade strategies, taking advantage of interest rate differentials between currencies. They often funded positions in high-yield currencies and shorted the GBP. This approach allowed traders to earn interest differentials while benefiting from any GBP depreciation.

##### **Specific Trades and Outcomes:**

1. **The Brexit Referendum:** On the day of the Brexit referendum, traders who correctly anticipated a "Leave" outcome shorted GBP/USD, leading to substantial profits as the pair dropped by over 1,000 pips within hours.
2. **October 2019 Breakthrough:** When a breakthrough was announced in Brexit negotiations in October 2019, GBP/USD surged by more than 5%. Traders who had long positions benefitted from this rally, closing their trades at favorable levels.
3. **March 2020 COVID-19 Impact:** Amid the COVID-19 pandemic, GBP/USD witnessed a sharp decline. Traders who shorted GBP/USD before the pandemic and the ensuing market crash profited from this downturn.
4. **December 2020 Trade Agreement:** The announcement of the EU-UK Trade and Cooperation Agreement led to a GBP rally. Traders who had long positions in GBP/USD during this period capitalized on the positive sentiment, closing their trades at higher levels.

In conclusion, Brexit-related market volatility created a dynamic environment for forex traders. A range of trading strategies, from event-driven to carry trade, presented opportunities to profit from GBP exchange rate fluctuations. Traders who correctly analyzed Brexit developments and executed well-timed trades reaped significant rewards during this transformative period.

### 1.5 Fundamental Factors:

#### Economic Indicators:

- **GDP Growth:** The uncertainty and potential disruptions associated with Brexit had a tangible impact on the UK's economic performance. GDP growth rates fluctuated during the Brexit process, reflecting the cautious sentiment among businesses and investors. A decline in GDP growth rates signaled economic uncertainty, and GBP often depreciated in response.
- **Inflation:** Inflation rates in the UK exhibited fluctuations throughout the Brexit process. Factors such as exchange rate movements, trade conditions, and consumer confidence influenced inflation. High inflation could lead to interest rate hikes by the Bank of England, potentially boosting GBP. Conversely, low inflation signaled economic concerns and could weigh on GBP.
- **Interest Rates:** The Bank of England's monetary policy decisions had a direct impact on GBP. Traders closely monitored interest rate changes, as higher rates attracted foreign capital and strengthened GBP, while rate cuts or a dovish policy stance could lead to depreciation.

#### Political Developments:

- **Parliamentary Votes:** Parliamentary votes on Brexit-related matters, particularly those related to the withdrawal agreement, were closely monitored. Votes rejecting the agreement or indicating political gridlock tended to lead to GBP depreciation, reflecting the heightened risk of a "no-deal" scenario.
- **Trade Negotiations:** Progress in trade negotiations had a significant impact on GBP. Positive developments, such as the announcement of a trade deal or improved trade conditions, buoyed GBP exchange rates. Conversely, setbacks and concerns about trade agreements resulted in depreciation.
- **Political Sentiment:** Political figures' statements and sentiment often influenced the currency market. Optimistic comments regarding the progression of Brexit negotiations could lead to GBP gains, while pessimistic rhetoric might lead to losses.

#### Market Sentiment:

- **Risk-On vs. Risk-Off:** Market sentiment shifted between "risk-on" and "risk-off" modes based on Brexit developments. Positive news or resolutions typically prompted a "risk-on" sentiment, attracting investment to GBP and boosting the currency. Conversely, political uncertainty or a "no-deal" scenario triggered a "risk-off" sentiment, leading to GBP depreciation.
- **Trader Positioning:** Traders' positioning and sentiment played a crucial role. A buildup of long or short positions could lead to short-term fluctuations in GBP as traders reacted to market dynamics and news events.
- **Market Reaction to Events:** Events like the Brexit referendum results or the announcement of major agreements sparked immediate market reactions. Traders who correctly interpreted the implications of these events profited by taking positions aligned with the market response.

#### Currency Market Dynamics:

- Economic indicators, political developments, and sentiment collectively influenced GBP exchange rates during the Brexit process.
- When economic fundamentals signaled uncertainty or weakness, GBP tended to depreciate. Conversely, positive economic data, particularly in the context of trade dynamics, could strengthen GBP.
- Political developments, especially those related to the withdrawal agreement and trade negotiations, had a direct and significant impact on GBP. Political gridlock or unfavorable outcomes could lead to GBP depreciation.

- Market sentiment played a pivotal role in currency market dynamics. Shifts between "risk-on" and "risk-off" sentiment were common during Brexit events. Traders who correctly gauged and reacted to these shifts profited from short-term price swings.
- Overall, the complex interplay of economic indicators, political events, and market sentiment created a dynamic environment for forex traders, offering opportunities to profit from GBP exchange rate fluctuations based on the fundamental factors at play.

### 1.6 Technical Analysis during the Brexit Period:

#### Identifying Key Levels:

- Support and Resistance: Traders used technical analysis to identify crucial support and resistance levels in GBP pairs. These levels were often aligned with significant price turning points during the Brexit process.
- Round Numbers: Round numbers, such as psychological price levels, were often viewed as key reference points. For instance, GBP/USD trading near 1.3000 or 1.3500 was significant during Brexit developments.

#### Recognizing Chart Patterns:

- Head and Shoulders: Traders frequently observed head and shoulders patterns, which could signal trend reversals. If a head and shoulders pattern formed during a period of Brexit-related uncertainty, it was seen as a bearish signal.
- Flags and Pennants: Flags and pennants, which represent consolidation patterns, were carefully monitored. Breakouts from these patterns, especially during significant Brexit events, were of great interest to traders.

#### Identifying Trends:

- Trendlines: Traders drew trendlines to identify and track trends in GBP pairs. An ascending trendline indicated an upward trend, while a descending trendline indicated a downtrend. Trendlines often helped traders make informed decisions about their positions.
- Moving Averages: Exponential moving averages (EMAs) and simple moving averages (SMAs) were used to identify trends and crossovers. The "golden cross" (short-term EMA crossing above a long-term EMA) and the "death cross" (short-term EMA crossing below a long-term EMA) were considered signals of potential bullish or bearish trends.

#### How Traders Used Technical Analysis:

- **Entry and Exit Points:** Traders used technical analysis to determine entry and exit points for their trades. For example, if GBP/USD was approaching a well-defined resistance level, traders might consider selling positions or setting stop-loss orders at that level.
- **Risk Management:** Technical analysis helped traders assess risk and set appropriate stop-loss orders. By identifying key levels and patterns, traders could establish levels at which their trade thesis would be invalidated.
- **Confirmation of Fundamental Analysis:** Technical analysis often complemented fundamental analysis. Traders combined technical signals with Brexit-related news events to make more informed decisions.

Fig. 1 – GBPUSD Dips on Brexit i.e., 1 Feb 2020



### 1.7 Impact on Forex market:

Brexit had a profound impact on the forex market, affecting currency pairs beyond just GBP. Here's a detailed examination of how Brexit influenced the forex market as a whole, correlations between GBP and other major currency pairs, and central bank and institutional responses:

#### Impact on Forex Market as a Whole:

- **Heightened Volatility:** The forex market experienced increased volatility during the Brexit process. Uncertainty surrounding Brexit-related events and their potential global economic implications led to larger price swings across multiple currency pairs, impacting both major and minor currencies.
- **Risk-On/Risk-Off Sentiment:** Brexit developments often triggered shifts between "risk-on" and "risk-off" sentiment in the forex market. Positive news related to Brexit led to a "risk-on" environment, favoring higher-yielding and riskier currencies. Negative developments, on the other hand, caused traders to flock to safe-haven currencies like the US Dollar (USD) and the Japanese Yen (JPY).
- **Global Trade Implications:** The forex market reacted to Brexit's potential consequences for global trade. Changes in trade agreements between the UK and the EU, as well as the UK's pursuit of new trade deals, influenced exchange rates for currencies like the Euro (EUR), the US Dollar (USD), and commodity currencies such as the Australian Dollar (AUD) and the Canadian Dollar (CAD).

#### **Correlations Between GBP and Other Major Currency Pairs:**

- **GBP/USD:** The GBP/USD pair exhibited a strong inverse correlation with the GBP/EUR pair during the Brexit period. When GBP/USD weakened due to Brexit-related concerns, GBP/EUR often strengthened, reflecting the relative impact of Brexit on the UK and the Eurozone.
- **GBP/EUR:** GBP/EUR exhibited a positive correlation with risk sentiment. Positive Brexit developments or reduced uncertainty could lead to both currencies strengthening against safe-haven currencies. However, political tensions between the UK and the EU at times caused negative correlations.
- **GBP/JPY:** The GBP/JPY pair often exhibited a high level of volatility during Brexit-related events, reflecting market risk sentiment. As traders shifted between risk-on and risk-off modes, GBP/JPY experienced significant fluctuations.

#### **Central Banks and Institutional Responses:**

- **Bank of England (BoE):** The Bank of England closely monitored Brexit and made policy decisions accordingly. To mitigate economic risks associated with Brexit, the BoE maintained a flexible monetary policy stance. It adjusted interest rates, keeping them low, and implemented quantitative easing measures to provide stability in the financial markets.
- **European Central Bank (ECB):** The ECB also closely monitored Brexit developments. The uncertainty created by Brexit influenced ECB policies. To support the Eurozone's economy amid the risks posed by Brexit, the ECB implemented accommodative monetary policies, such as negative interest rates and asset purchase programs.
- **Institutional Responses:** Financial institutions and multinational corporations adjusted their currency strategies in response to Brexit. Hedging strategies were implemented to mitigate the impact of exchange rate fluctuations on financial statements. Institutions often increased their use of currency derivatives to manage Brexit-related risks.

In summary, Brexit had a far-reaching impact on the forex market, influencing volatility, risk sentiment, and trade dynamics. Correlations between GBP and other major currency pairs shifted in response to Brexit-related events. Central banks, such as the Bank of England and the European Central Bank, implemented policies to address the economic challenges posed by Brexit, while institutions adapted their strategies to manage currency risk. The ongoing repercussions of Brexit continue to shape the forex market's landscape, emphasizing the profound and enduring impact of geopolitical events on currency trading.

## **2. Conclusions:**

1. **Brexit's Profound Influence on GBP:** The research underscores the profound impact of Brexit on the British Pound (GBP). The currency experienced significant fluctuations, with its value closely tied to the tumultuous Brexit process. The immediate post-referendum depreciation, subsequent volatility, and post-trade deal stability all highlight the direct and lasting influence of geopolitical events on currency markets.
2. **Dynamic Interplay of Factors:** The study reveals the dynamic interplay of economic fundamentals, political developments, and market sentiment in shaping GBP exchange rates during Brexit. Economic indicators, including GDP growth, inflation, and interest rates, played a crucial role in reflecting the cautious sentiment among businesses and investors. Political events, parliamentary votes, and trade negotiations had a direct and significant impact on GBP, with progress leading to appreciation and setbacks to depreciation. Market sentiment shifted between "risk-on" and "risk-off" modes, reflecting traders' reactions to political developments and news events.
3. **Technical Analysis and Trading Opportunities:** Traders adeptly used technical analysis to identify key levels, patterns, and trends in GBP pairs during the Brexit period. They relied on this analysis to make informed decisions, manage risk, and complement their fundamental analysis. The study highlights examples of traders capitalizing on Brexit-related trading opportunities through strategies such as intraday scalping, swing trading, and breakout trading.
4. **GBP's Influence on Other Major Currency Pairs:** The research discusses the correlations between GBP and other major currency pairs. GBP exhibited inverse correlations with safe-haven currencies like the US Dollar (USD) and the Japanese Yen (JPY) during risk-off sentiment, while demonstrating positive correlations with riskier currencies during risk-on sentiment. GBP's relationship with the Euro (EUR) was

influenced by political developments and shifts in risk sentiment, often resulting in both currencies responding to positive or negative Brexit news.

5. **Central Bank and Institutional Responses:** Central banks, particularly the Bank of England (BoE) and the European Central Bank (ECB), played a pivotal role in mitigating economic risks associated with Brexit. Both institutions implemented accommodative monetary policies to provide stability and support their respective economies. Meanwhile, financial institutions and multinational corporations adopted hedging strategies and increased their use of currency derivatives to manage Brexit-related currency risks.
6. **Ongoing Implications and Research:** The research highlights that the repercussions of Brexit continue to influence the forex market. The ongoing implications include trade dynamics, financial services agreements, and regulatory changes that affect currency markets. This suggests that the influence of geopolitical events on the forex market is enduring and complex, emphasizing the importance of continued research in this field.

In conclusion, the "Impact of Brexit on GBP" case study provides a comprehensive analysis of the multifaceted effects of Brexit on the British Pound and the forex market. It underscores the significance of considering economic fundamentals, political developments, market sentiment, technical analysis, and institutional responses when studying the intersection of geopolitics and currency trading. The study also emphasizes the continued relevance of Brexit's influence on forex markets, providing valuable insights for traders, investors, and financial market observers.

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