Pound sterling smashed after Brexit

It has been less than three weeks since the UK voted to leave the European Union, and markets are still under shock. This is an outcome that was not expected.

GBP has been hit hard. The weeks leading into the vote were erratic, markets were very active with a lot of large moves as heavy players were protecting themselves for the worst. Ongoing changes in UK opinion polls did not help and pushed GBP volatility to levels comparable to those of the 2008 financial crisis. The pound sterling against the US dollar has been smacked hard nearly every day since, falling roughly 17% from a high of 1.50 the day before the vote to just below 1.28 last week.

The UK has already been downgraded by two rating agencies since the vote. Standard & Poor's took away UK's last triple A rating, Fitch agency also downgraded them and Moody's said it might cut their rating soon. The UK has now entered a period of great uncertainty.

Right now, markets are following very closely the political situation. Theresa May looks ready to take on her new role, and although she did vote remain, seems willing to pull the Article-50 trigger and lead her country into the Brexit negotiations. The sooner the better, as the government needs a credible plan B with new free trade agreements. Now that the second EU referendum (petition signed by more than 4.1 million people) has been rejected by the government, we might see them move very soon.

Markets are also watching closely the Bank of England. Governor Marc Carney has appeared several times already showing they are being as proactive as they can. They have already lowered bank countercyclical capital buffer from 0.5% to 0%, making available additional GBP 150 billion for banks to lend to companies and households. The Bank of England could even cut interest rate on the GBP as soon as this week. Governor Carney has been explicit already about easing this summer, markets expect the bank rate to fall close to zero within the next couple of months and more quantitative easing is also expected to follow.

There has been a lot of talk around the future of the city as financial capital of Europe. Will the financial community actually relocate out of London? Six of the biggest UK commercial property funds have suspended trading in their funds last week when large numbers of investors tried to pull their money out. So while the Financial conduct Authority might be downplaying the issue, investors fear is real as these six funds are huge. They represent around GBP 15 billion, half the UK market. A spill over effect to other parts of the financial system would be disastrous. The Bank of England is already said to be working on numerous emergency measures to smooth out the panic.

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At the moment the uncertainty is still so great, we are already hearing the opposition parties calling for a general election, so the question is whether fund managers, central banks and reserve managers in general will want to be overweight GBP until there is more clarity on all these issues. Most retracements are still being met with strong selling interest, and markets will want to see the BOE outcome this week and this will ignite the next GBP move.

To see this GBP stay above current 1.30 levels, markets will want to see the new UK Prime minister seriously start the negotiations with the EU, which must begin on a positive note with good free trade agreements on their way. Interestingly, Chancellor Osborne is on his way to Washington next week to set the scene for the ramping up of trade with the US. Markets would not want to see Scotland get out of the UK either.

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For now, hopes are high with Theresa May stating she will pursue Brexit, but negotiations have not begun yet. If the EU makes things difficult for the UK to set an example to other EU members thinking of an exit, then we might get some surprises. Her support is strong today but won't be as strong if things get sour at home. Although chances are thin, the pound would benefit greatly from any kind of hesitation from the new UK prime minister on Brexit. Should they postpone the process in any way or find a loophole to stay in the EU with some sort win-win situation, the GBP would rise to the sky.