The $200bn cost of Brexit

Blog post by Chief Economist Dr Gregor Irwin, 29 July 2016

Almost four weeks on from the vote to leave the EU and the FTSE 250 has edged back up to just 0.4% below where it started before the polls closed, while the FTSE 100 has surged by 6.5% (all values are at the close of markets on 27 July). This is an impressive turnaround from the day after the vote when the FTSE 100 dropped by 3% and the FTSE 250 by over 7%.

Does this mean that all is well in the UK economy and Brexit is not that big a deal after all? Probably not. The pound has lost over 11% against the dollar during this time. This means the dollar value of the FTSE 100 is down by 5.6% and the FTSE 250 by 11.7%. Based on market capitalisations on 23 June, that adds up to almost $200bn. During the same period, the benchmark S&P 500 has actually risen by 2.5%.

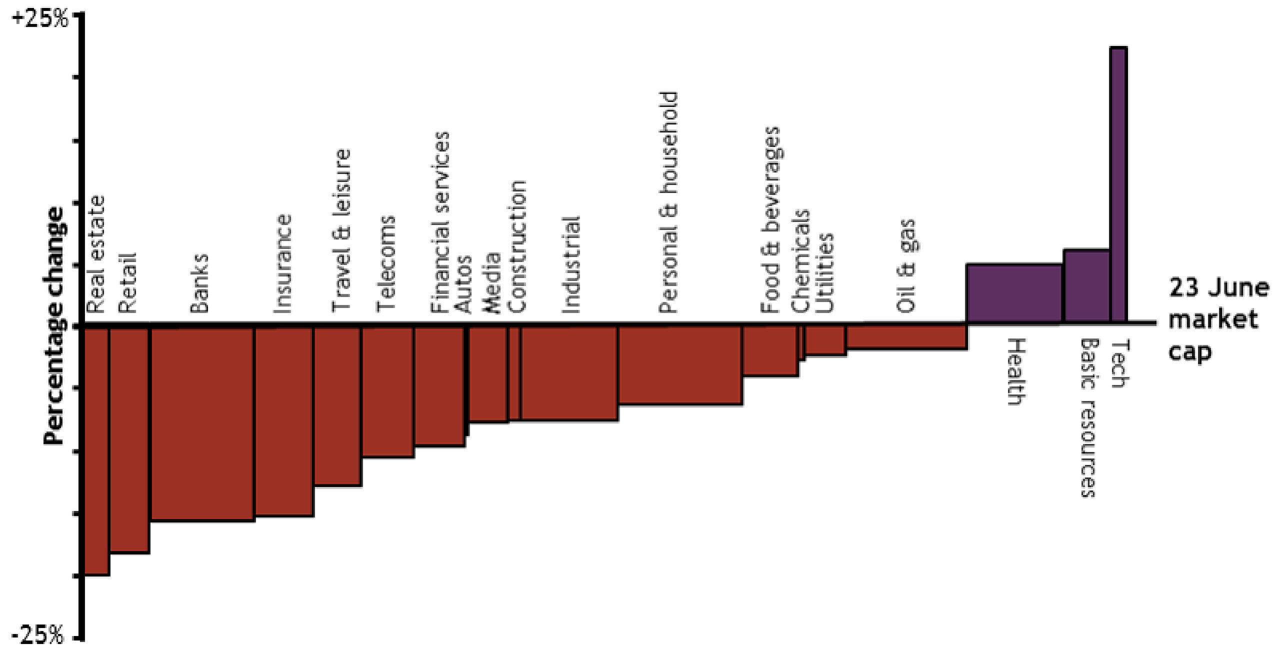

Fig 1. Change in dollar value of FTSE 350 market capitalisation by sector, 23 June to 27 July

It is pretty crude, particularly as Brexit is not the only economic development since 23 June, but it is reasonable to conclude that the current UK equities price tag for Brexit is somewhere around $200bn. Moreover, this figure has been reasonably stable since the abrupt termination of the Conservative leadership contest which saw Theresa May become prime minister a little over two weeks ago.

The pain has not been distributed evenly. While the bigger percentage drop has been suffered by the mid-cap FTSE 250, which is made up of mostly UK-facing stocks, its total market capitalisation is not much more than a fifth of the more international FTSE 100, which accounts for over two thirds of the total loss.

The variation across sectors is more revealing. The figure below illustrates this for the FTSE 100 and 250 combined. The horizontal axis shows the dollar market capitalisation of each sector on 23 June. The vertical axis shows the percentage gain or loss in value for each sector since then. The area of each box therefore shows the dollar gain or loss in market capitalisation for each sector. The real estate sector has seen the biggest percentage fall, but it is relatively small compared to banks or insurance, which is why the red box for each of these sectors is much bigger.

The figure shows that few sectors are likely to escape the consequences of Brexit. Those that have performed the best, to the right of the chart, all have substantial foreign currency earnings. The best performing sector – tech – has been boosted by the £24bn acquisition of ARM, which has seen its share price jump.

The worst performing stocks are either those most focused on the UK economy – such as real estate and retail – or those that may suffer most from the UK becoming a less attractive European base – such as firms in financial services. Banks and insurance companies are probably also weighed down by the expectation that interest rates will stay low for longer in the UK, which will damage profitability.

This chart is far from telling the whole story about Brexit. The $200bn price tag is for UK equities, not the UK economy. It is worth noting just how small the slither representing the auto sector is, essentially because most of the sector in the UK is foreign owned and listed overseas. The risks to the sector – if tariff-free exports to and from the EU are not maintained – are substantial nonetheless.