

Better the Devil You Know: The Impact of Brexit Political Uncertainty on European Financial Markets

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The paper investigates the market reaction to three different events related to Brexit through an event study analysis, i.e. the announcements of the referendum date (20 February 2016), the referendum result (23 June 2016) and the election of Theresa May as Prime Minister (11 July 2016). We study the impact of these announcements on stock prices of UK companies belonging to export- and import-oriented industries. We also investigate the influence of previous events on stock prices of European companies belonging to the same sectors. Our results show that financial markets did not perceive the announcement of the referendum date and the election of Theresa May as Prime Minister as elements of political uncertainty. However, in the days before the referendum, investors priced it as an uncertain political event. The text analysis conducted on mass media sentiment about Brexit mainly supports the results of our event studies. Stock market performance around the events depends more on industry factors than on firm-specific characteristics, for both UK and EU companies. The only exception

is company size, which positively affects investor reaction. Moreover, Brexit is likely to be an important source of political risk, since political changes and the consequent instability usually negatively affect returns on investment. Stock markets react negatively to political uncertainty in election cycles, and in cases of any kind of change in government policies. Brexit is, in fact, a possible key determinant of market volatility. The market's reaction, soon after the referendum, could also have been boosted by a dominant pro Brexit bias, as testified by the fact only 27% of press articles were pro remain. In fact, on the day of the referendum results, 24 June 2016, the British Pound registered a historic drop to \$1.3229, its lowest level since September 1985. The pound was down as much as 11.1% from the New York close of \$1.4877 on the previous day. This was almost double the next-biggest intraday drop of 5.9% on 24 October 2008, the day when stock markets around the world collapsed during the depths of the financial crisis (Peter Wells, "Historic moves for the pound on Brexit vote". Financial Times, 24 June 2016).