The Impact of Brexit on the UK's Stock Market

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Introduction

Brexit introduced unprecedented political and economic uncertainty, causing sharp fluctuations in the UK's financial markets. This research examines how major Brexit events affected short-term volatility in the FTSE 100 index, exploring links between political shocks, trading activity, and investor behavior. By analyzing pre- and post-Brexit data, the research provides insights into how geopolitical events influence market efficiency and risk, offering implications for investors and policymakers navigating politically uncertain environments.

Objective

Key Objectives

1. Assess the short-term effects of major Brexit events on the FTSE 100 market volatility.
2. Evaluate the relationship between trading volume, turnover, and market volatility in the context of Brexit-related uncertainty.
3. Analyze whether Brexit-related market shocks have a delayed (lagged) impact on volatility.

Research Questions

1. How have major Brexit events influenced short-term market volatility in the UK's stock market?
2. Does Brexit delay affect market volatility, or are reactions immediate?
3. What role do trading volume and turnover play in moderating volatility during periods of Brexit-related uncertainty?

Methodology

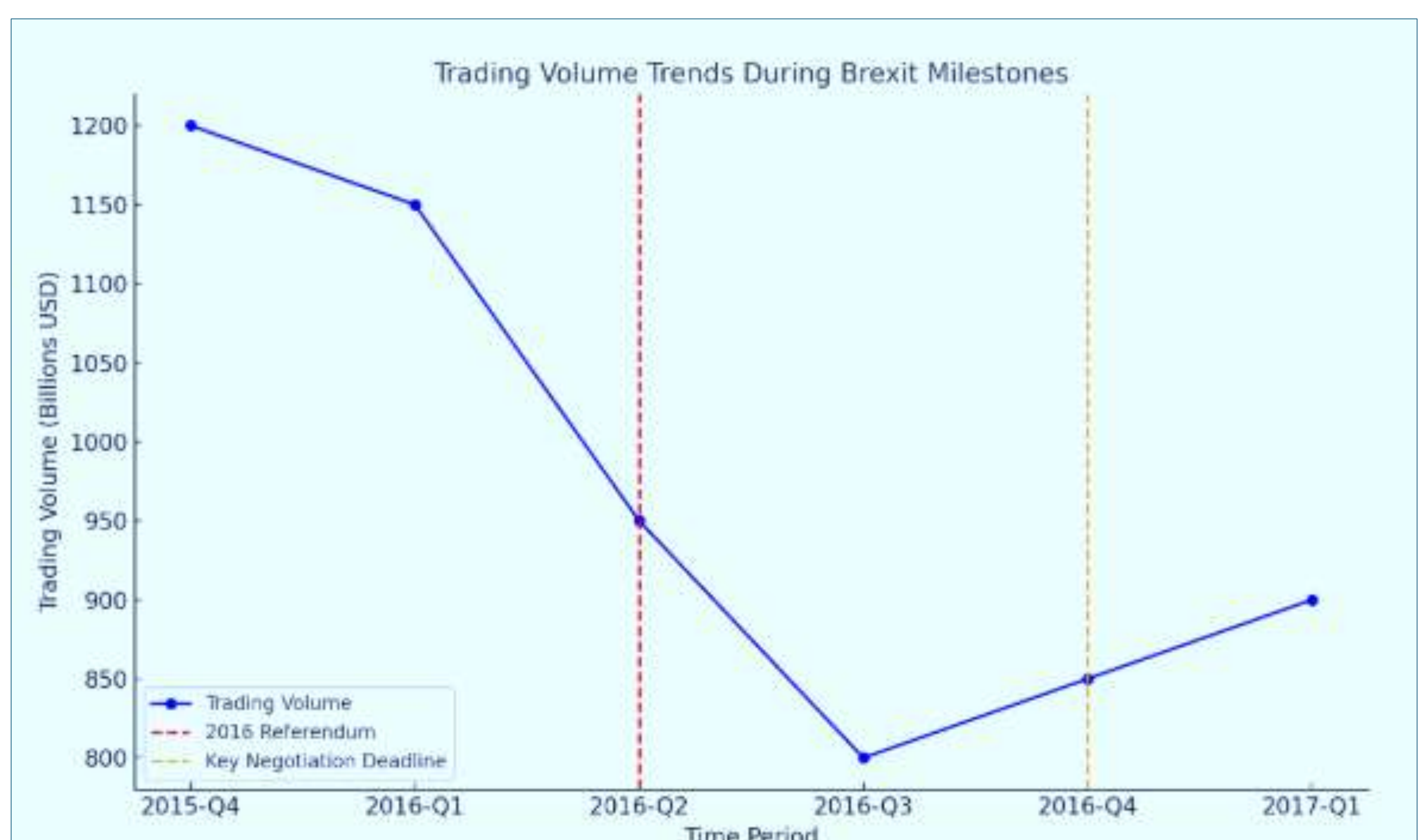
01 **Event-Based Econometric Analysis:** Applied multiple linear regression to assess the impact of major Brexit events on FTSE 100 volatility.

02 **Lagged Variables:** Incorporated lagged Brexit event dummies to capture delayed investor reactions.

03 **Robustness Measures:** Used robust standard errors to correct for heteroskedasticity and ensure reliable estimates.

04 **Interaction Effects:** Tested interaction terms between Brexit events and trading activity to explore conditional volatility impacts.

05 **Data Scope:** Analyzed longitudinal daily data (2015-2021) from Refinitiv, including FTSE 100 returns, GBP/USD exchange rates, and trading volume.



Key Findings

1. **Brexit Events** → Higher Volatility: Major Brexit announcements significantly increased short-term volatility, especially the day after the event (lagged investor reaction).
2. **Currency Impact** → GBP/USD exchange rate changes had no significant effect on volatility, suggesting markets decoupled from currency shocks during political uncertainty.
3. **Trading Activity Effects:**
   - High Volume → Higher volatility (linked to panic or speculative trading).
   - High Turnover → Lower volatility (indicating liquidity and market stability).

Discussion

1. **Brexit Effect:** Major Brexit events caused short-term volatility spikes with delayed investor reactions, challenging EMH and supporting Behavioral Finance (loss aversion, herding).
2. **Trading Dynamics:** High trading volume increased volatility, while high turnover reduced it, indicating liquidity-driven stability.
3. **Other Insights:** GBP/USD exchange rate had no significant impact; findings suggest event-aware risk strategies and clear policy communication are essential.

Conclusion

1. Brexit created a unique stress test for UK financial markets, exposing inefficiencies and behavioral biases under political uncertainty.
2. Market reactions were delayed, challenging the Efficient Market Hypothesis (EMH), while overreaction, loss aversion, and herding amplified volatility beyond fundamentals.
3. Liquidity helped stabilize markets; high turnover reduced volatility, whereas surges in trading volume coincided with speculative activity.
4. These findings underscore the importance of incorporating behavioral factors into financial models and suggest implementing event-aware risk strategies and transparent policy communication to effectively manage geopolitical shocks.