

Why Political Crises Amplify Forex Volatility (and What Traders Can Do About It)

The British pound dropped 8% against the dollar in 24 hours after the Brexit referendum. The Russian ruble lost 50% of its value within days of the 2022 Ukraine invasion. The Turkish lira shed 58% in a single year after President Erdoğan fired three central bank governors.

Political crises go beyond merely influencing currency movements — they outright *detonate* them. Research from 35 countries (January 2000 to June 2024) confirms what traders have long suspected:

- Geopolitical shocks depreciate currencies faster than fundamentals predict
- Countries integrated into global value chains experience steeper declines
- Emerging market currencies show ~80% higher volatility than developed peers

Whether you're hedging corporate exposure, timing speculative positions, or simply planning an international money transfer, understanding *why* politics hammers exchange rates — not just *that* it does — lets you make an informed decision.

What makes political crises different from economic shocks?

Economic downturns follow recognizable patterns. Central banks cut rates, governments increase spending, and growth eventually rebounds. Political crises offer no such playbook. Markets hate ambiguity — and political turmoil delivers it in bulk.

Expectation disruption

Currency valuations embed assumptions about future policy, trade relationships, and institutional stability. A political shock rewrites those assumptions overnight. The Brexit referendum illustrates the principle perfectly.

On June 23, 2016, polls suggested Remain would win. Sterling appreciated in the days before the vote, reaching nearly \$1.50.

When results showed Leave had prevailed, the pound plunged to \$1.32 within hours — an 8% collapse that ranked among the largest single-day currency crashes in 30 years.

The economy hadn't changed between midnight and dawn. Expectations had.

Information vacuum

Economic data releases are scheduled, methodical, and accompanied by context. Political crises erupt chaotically.

No one knew in February 2022 whether Western sanctions would freeze Russian central bank reserves (they did) or cut Russian banks from SWIFT (some were).

The uncertainty itself — not just the eventual outcomes — drove the Deutsche Bank Currency Volatility Index to its highest level since April 2020.

Contagion pathways

Political crises rarely stay contained. The Russia-Ukraine conflict went one step further than just crashing the ruble.

Polish zloty, Czech koruna, and the Hungarian forint fell 8–12% as investors fled geographically proximate currencies.

Brexit negotiations created spillover volatility in the euro. Weakness in the Turkish lira is transmitted to European bank stocks with Turkish exposure.

How do capital flows respond to political instability?

Money moves predictably when governments become unpredictable. The pattern has repeated across dozens of crises, from the 1997 Asian financial crisis through 2024's geopolitical tensions.

Safe-haven demand

When political risk spikes, traders shift capital toward currencies perceived as stable stores of value:

- U.S. dollar (global reserve status, deep liquidity)
- Swiss franc (political neutrality, banking system reputation)
- Japanese yen (current account surplus, low inflation history)

The flows are self-reinforcing. Rising demand strengthens safe-haven currencies, which attracts more demand.

During the initial Russia-Ukraine shock, J.P. Morgan Research noted that the yen and dollar outperformed "high beta currencies" as investors reduced risk exposure across portfolios.

Emerging market exodus

Emerging market currencies face asymmetric pressure during political crises — even crises occurring elsewhere. The mechanism works through global risk appetite rather than direct exposure.

Crisis	Direct currency impact	EM spillover
Brexit referendum (2016)	GBP -8% vs USD	EM currencies weakened broadly as risk-off sentiment spread
Russia-Ukraine war (2022)	RUB -50% initially	PLN, HUF, CZK down 8–12%, broader EM sell-off
Turkey lira crisis (2021)	TRY -58% for the year	European bank stocks with Turkish exposure declined
Israel-Hamas conflict (2023)	Limited direct FX impact	Energy currencies fluctuated due to concerns about oil prices

Research from the Russia-Ukraine war found that geographic proximity, energy dependence on Russia, and elevated economic policy uncertainty all correlated with larger currency depreciation. The effect wasn't random — it tracked exposure channels.

Flight to liquidity

Beyond safety, traders seek liquidity during crises. They gravitate toward deep, easily traded currency pairs where large positions can be entered or exited without moving the market.

The 2025 BIS Triennial Survey confirms that the USD accounts for roughly 89% of all global FX trades — a dominance that intensifies during volatility spikes.

What role does central bank credibility play?

Currencies ultimately reflect confidence in the institutions that manage them. When political interference undermines central bank independence, exchange rates suffer — sometimes catastrophically.

The Turkey case study

Turkey provides perhaps the clearest modern example of political pressure destroying currency value. President Erdoğan's conviction that high interest rates *cause* inflation (contradicting mainstream economics) led him to:

- Fire three central bank governors between 2019 and 2021
- Force rate cuts from 19% to 14% while inflation was rising
- Replace monetary officials with appointees who shared his views

The lira responded accordingly. From less than 4 TRY per dollar in 2018, the exchange rate collapsed to 18 TRY by late 2021 — a depreciation exceeding 400%.

When Erdoğan declared an "economic war of independence" in November 2021, the lira crashed to 13.44 against the dollar within hours of his speech.

The underlying economy hadn't suddenly deteriorated. Investor confidence in Turkish monetary policy had evaporated.

Credibility versus reserves

Central banks typically defend currencies by selling foreign exchange reserves or raising interest rates. Political interference disrupts both mechanisms:

- Selling reserves depletes the war chest needed for future interventions

- Rate hikes become impossible if political leaders oppose them
- Market participants anticipate the constraints and front-run further weakness

Russia's 2022 experience showed what happens when sanctions freeze reserves.

The Central Bank of Russia held over \$600 billion in foreign exchange reserves, but with most of its assets frozen in Western banks, its intervention capacity vanished.

The ruble lost 50% before capital controls, rate hikes (to 20%), and mandated foreign-currency conversion stabilized it.

Institutional quality as a buffer

A 2025 CEPR study examining the 2024 U.S. election found that strong domestic institutions have historically buffered against exchange rate shocks.

Countries with credible rule of law, independent central banks, and consistent policy frameworks attract capital during uncertainty elsewhere.

The exception is that when geopolitical alignment shifts, even strong institutions may transmit rather than absorb volatility.

The researchers noted that countries closely aligned with outgoing U.S. policy priorities faced currency pressure regardless of their domestic institutional quality.

How does political crisis volatility differ by currency type?

Not all currencies respond equally to political shocks. The structure of a country's economy, its trade relationships, and the depth of its financial markets all shape its vulnerability.

Emerging versus developed

Research covering 2000–2024 found that emerging market currencies exhibit an average exchange rate volatility of 2.598, compared with 1.437 for developed economies (on a standardized scale). The gap reflects:

- Weaker institutional buffers (less credible policy responses)

- Greater commodity dependence (prices fluctuate with geopolitics)
- Shallower financial markets (less liquidity to absorb selling pressure)
- Higher foreign-currency-denominated debt (depreciation increases repayment burdens)

Commodity linkages

Countries exporting oil, gas, or other strategic commodities face amplified volatility when political crises affect those markets:

- The Russian ruble correlates heavily with oil prices
- The Canadian dollar and Norwegian krone track energy markets
- The Australian dollar follows iron ore and coal prices

The Russia-Ukraine war disrupted energy flows, causing European natural gas prices to spike 80% within three weeks.

Currencies of energy importers (including the euro) weakened against exporters — until sanctions, price caps, and demand destruction reversed the dynamic.

Trade exposure

The ScienceDirect study of 35 countries found that currencies depreciate more following geopolitical shocks when countries participate more heavily in global value chains. Deep trade integration creates more channels through which political disruption can be transmitted.

The finding helps explain why Brexit hit sterling so hard.

The UK's trade integration with the EU meant that any friction would ripple through supply chains, investment flows, and labor markets — all of which currency markets priced immediately.

What patterns emerge from recent political crises?

Three major events — Brexit, the Russia-Ukraine war, and Turkey's currency collapse — offer lessons for anticipating and managing political volatility.

Brexit: Expectation as a mechanism

The Brexit timeline demonstrates how shifting political probability moves exchange rates:

Date	Event	GBP/USD impact
December 2015	Referendum Act promulgated	Depreciation began; correlation with Leave odds increased
June 23, 2016	Polls suggest Remain wins	GBP rallied to nearly \$1.50
June 24, 2016 (overnight)	Leave wins	GBP crashed 8% to \$1.32
2017–2019	Hard Brexit fears intensify	Further declines to August 2019 lows
December 2019	Boris Johnson wins majority	GBP appreciated 2% (reduced uncertainty)

Research by Manasse and colleagues (Economica, 2024) found that both the *level* of Leave probability and a separate *political risk premium* independently affected exchange rates. Markets priced not just expected outcomes, but the uncertainty surrounding them.

Russia-Ukraine: Sanctions as transmission

The 2022 ruble crash and recovery illustrate how specific policy choices — not just the political crisis itself — determine currency outcomes:

- RUB fell from 81 to 150 per dollar within days
- Western freeze of reserves eliminated intervention capacity
- Russia raised rates to 20% and imposed capital controls
- The current account surplus exceeded \$58 billion in Q1 2022

The ruble eventually recovered to pre-invasion levels — not because sanctions failed, but because import sanctions exceeded export sanctions, generating a massive trade surplus that supported the currency.

Direction of exchange rate movement, researchers noted, reflects the *type* of sanctions imposed, not necessarily their effectiveness.

Turkey: Political pressure as an accelerant

Turkey's currency crisis shows how political interference compounds economic vulnerabilities:

- U.S. sanctions hit in 2018 amid a high current account deficit
- The central bank raised rates from 8% to 24% to stabilize
- Erdoğan reversed course in 2021, firing governors who hiked rates
- Lira lost 58% in 2021; inflation reached 78.6% by mid-2022

The Turkish case demonstrates that political risk isn't just about external events (such as sanctions and wars). Domestic policy choices that undermine institutional credibility can generate equivalent volatility.

How can traders and senders navigate political volatility?

Political crises aren't predictable in timing or magnitude — but their effects on currency markets follow recognizable patterns. Preparation matters more than prediction.

Hedging tools

Corporations and individuals with foreign currency exposure can reduce risk through:

- Forward contracts lock in rates for up to 12 months
- Options protect against unfavorable moves while keeping upside
- Natural hedges match foreign revenues with foreign expenses
- Rate alerts trigger execution when targets are hit

For individuals [sending money](#) internationally, the practical implication is simpler — timing is very important.

Services like RemitBee allow Canadians to lock in rates and track political developments in both source and destination countries — helping identify windows of favorable rates and periods to avoid.

Liquidity focus

During political crises, bid-ask spreads widen, and execution quality deteriorates in less-liquid pairs. The Russia-Ukraine war rendered ruble trading "highly illiquid" according to BMO, with screen prices potentially misrepresenting actual transaction costs.

Sticking to major currency pairs (USD, EUR, JPY, GBP, CHF) during volatility spikes ensures trades execute at reasonable prices. Exotic pairs may show dramatic moves, but entering or exiting positions can prove costly.

Scenario planning

Rather than predicting specific outcomes, sophisticated participants map potential scenarios and their implications for currency.

The questions to consider: which currencies benefit or suffer if political event X occurs, what transmission channels apply (trade, capital flows, policy response), and how quickly markets might reprice.

The 2024 U.S. election provided a live example. Traders anticipated tariff-related dollar strength, EM currency pressure, and euro weakness given European trade exposure — then positioned accordingly as results became clear.

What's the bottom line for FX markets?

Political crises amplify forex volatility through three primary mechanisms: expectation disruption (markets reprice future policy), capital flight (safe-haven flows dominate), and credibility erosion (institutional trust collapses).

The patterns are consistent across decades of data:

- Emerging markets face ~80% higher baseline volatility than developed markets
- Currencies depreciate faster when countries integrate deeply into global value chains
- Central bank independence matters — political interference destroys currency value
- Geographic proximity and energy dependence predict spillover effects

For traders, political risk demands reduced position sizes, tighter stop-losses, and a focus on liquid pairs. For businesses, hedging exposure *before* crises emerge protects margins.

For individuals transferring money abroad, awareness of political developments in relevant corridors helps optimize timing.

Politics moves exchange rates independently of — and often faster than — economic fundamentals. The traders who understand the mechanisms gain an edge over those who simply react.