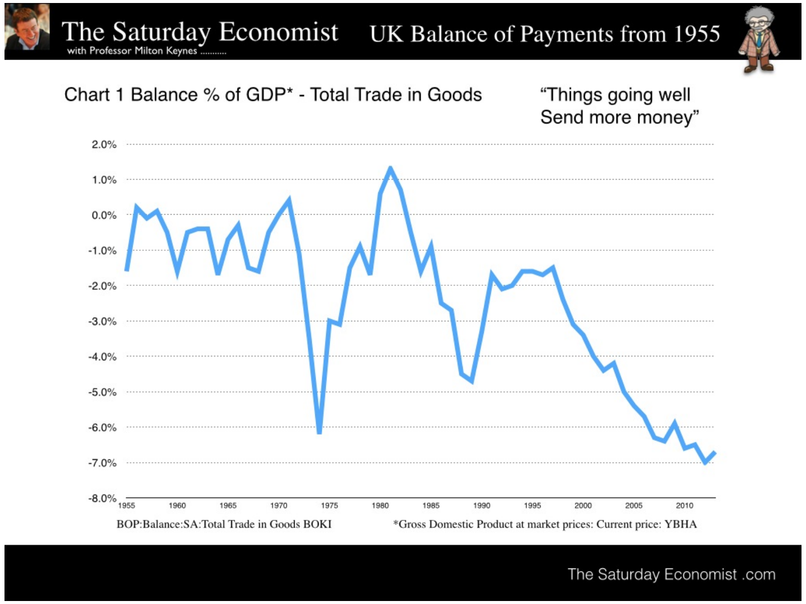
UK Balance of Payments from 1955 …

… things going well, send more money.

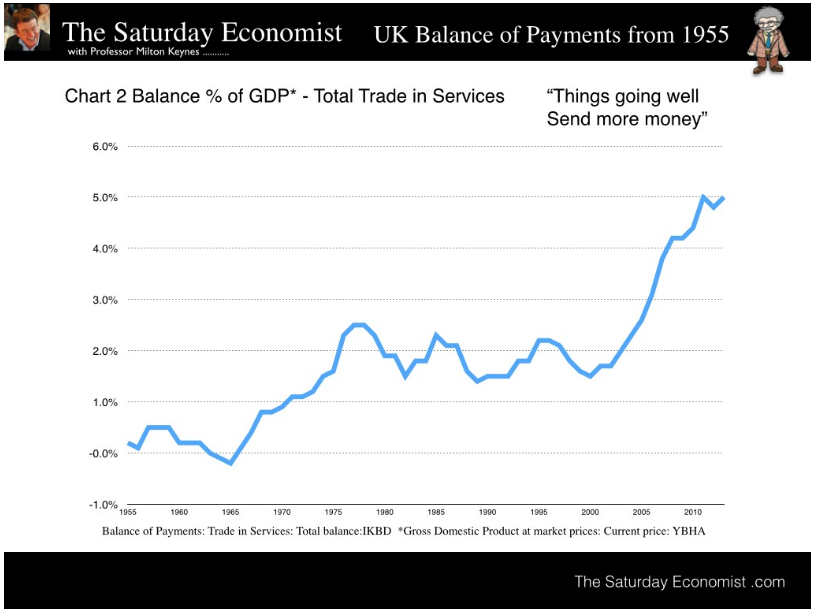
1 Trade in Goods and Services

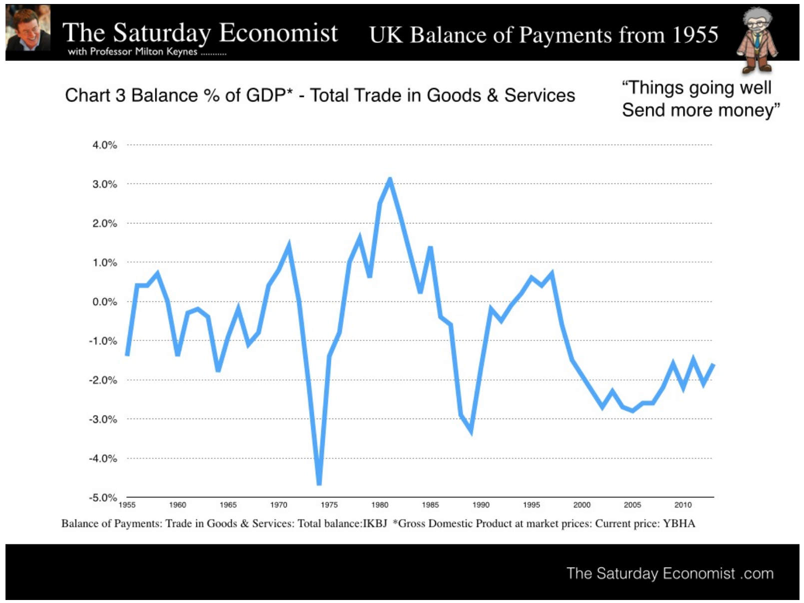
In 2013, the trade in goods deficit was £108 billion, equal to 6.7% of GDP. The trade in services surplus was £81 billion equal to 5% of GDP. The overall deficit trade in goods and services was £27 billion, equal to 1.6% of GDP.



The structural trade in goods deficit is progressively mitigated by the strength of service sector exports. A deficit trade in goods and services around 2% of GDP does not present a threat to the balance of payments or to sterling.

The progressive deficit trade in goods is illustrated in Chart 1. The deterioration from 2000 onwards is particularly marked. We model goods imports and exports as a function of demand and price. Our research confirms demand conditions are dominant. Imports are relatively inelastic with regard to price. Exports are demand dominant with price elasticity a subordinate factor. Depreciation does not improve the trade deficit.





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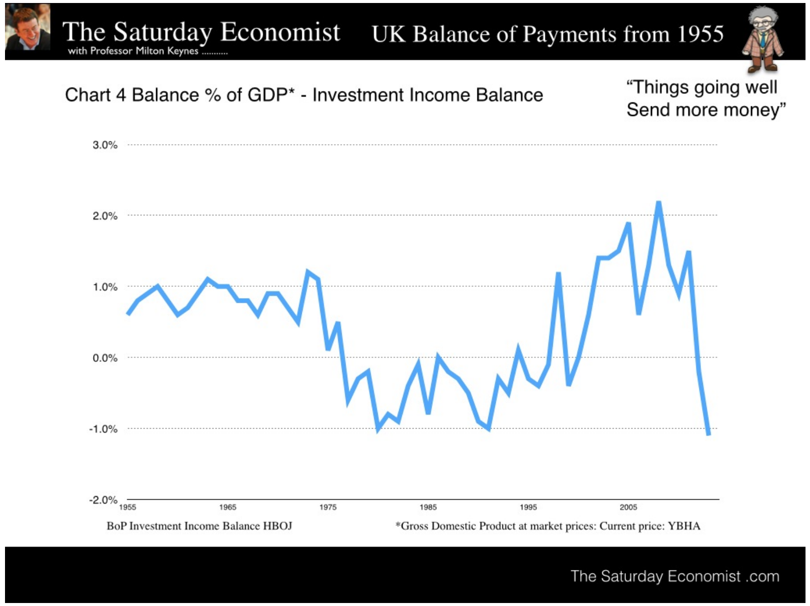
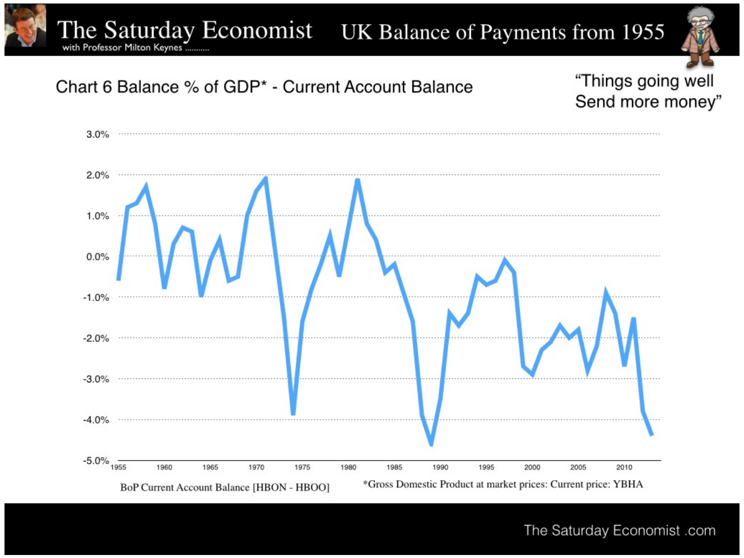
2 Current Account

The current account is measured by the trade in goods and services plus investment income from overseas, compensation of employees government and other transfers.

In 2014, the fall in investment income was particularly marked [Chart 4]. From 2001 to 2011, the average annual remittance from investment income was around £17.5 billion. In 2012, the return fell to minus £4 billion followed by a decline to minus £17.5 billion in 2013.

Largely as a result, the current account transfers were negative at just under 2% of GDP. [Chart 5]. The current account balance, i.e. transfers plus the trade deficit increased to 4.4% of GDP. [Chart 6].

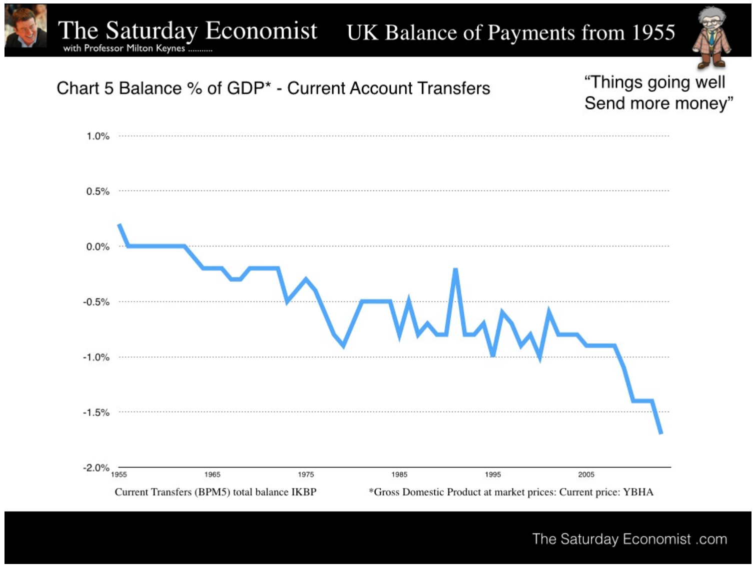




"We haven't experienced this level of deficit since 1974 and again in 1989.

Base rates were hiked to 12% and 14% in 1974 and 1989, to offset the potential capital flight

The IMF were in - 1976.



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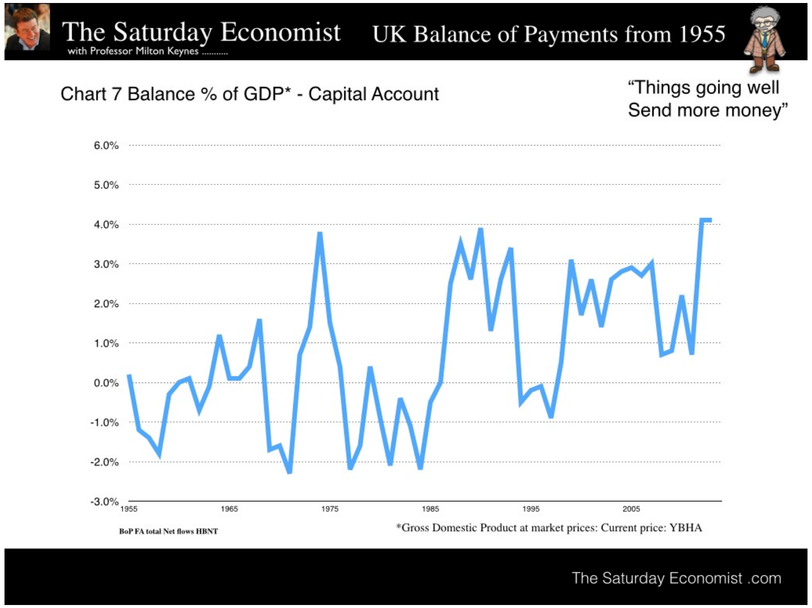
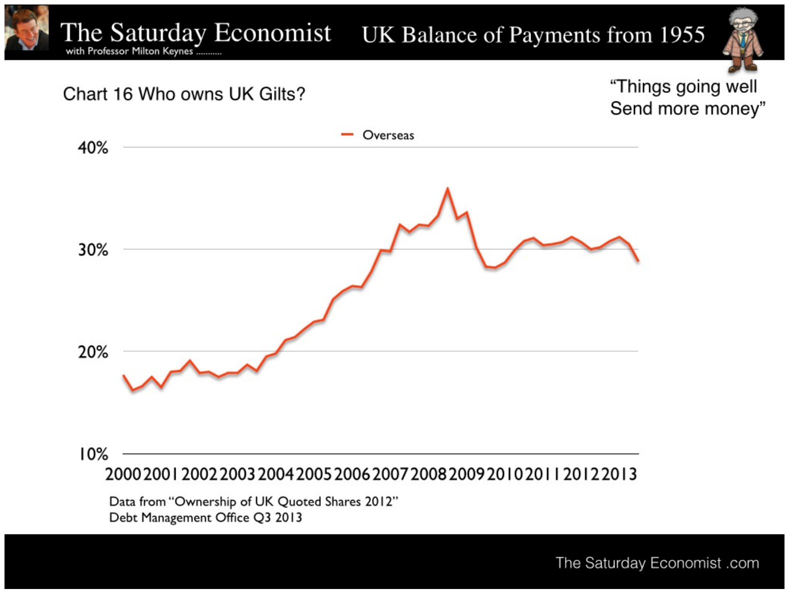
3 Capital Account

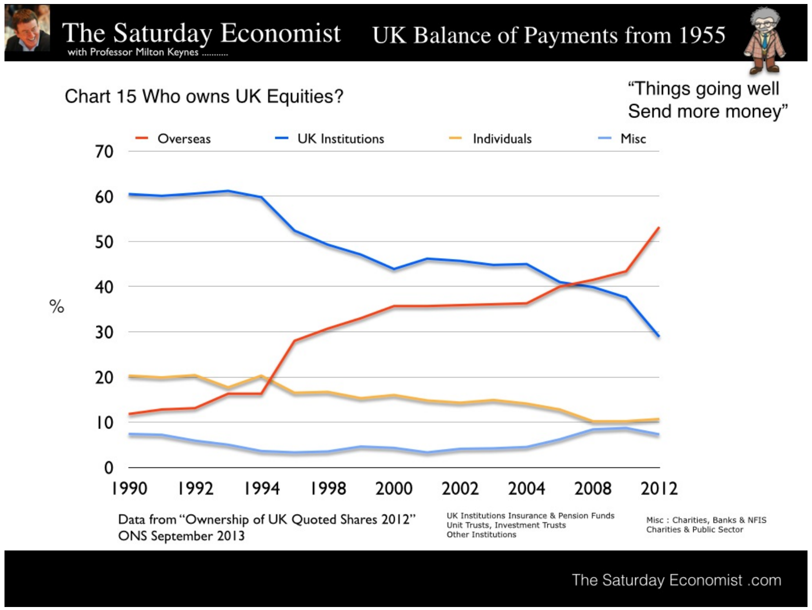
The great thing about the Balance of Payments is that by and large, they have to balance. The deficit on current account leads to sterling funding outflows which have to be matched by inflows within the capital account.



In 2013, capital inflows were £66 billion equal to 4% of GDP [Chart 7]. Foreign Direct Investment accounted for part of the mix, together with additional investment provision. Government gilts, equities and bonds also provide an attraction.

By 2013 overseas investors held 30% of UK gilts and over 50% of UK equities. The prospect of capital flight and a "run on sterling" would be of Tsunami proportions, if sentiment turned against the UK.





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4 Conclusions

The UK has a structural deficit trade in goods which is offset by the trade in services surplus. The residual deficit trade in goods and services averaged under 2% over the last three years.

We expect the trade in goods deficit to continue to deteriorate despite the fluctuations of sterling. Demand conditions are dominant with regard to exports and imports. Imports are particularly inelastic with regard to price; there is no substitution effect. Our research suggests, and empirical evidence confirms, a depreciation of sterling does not impact on the trade balance.

However this level of deficit does not provide a threat to the outlook for the UK. The surplus in service sector trade will continue. A strong professional and services sector including banking is particularly important. Recent developments with London as a centre for Renminbi are to be welcomed. The structural deficit trade in goods can be offset by the surplus, trade in services.

However, the fall in investment income in 2013 with an effective outflow of minus £17.5 billion is particularly concerning. The current account deficit of 4% of GDP can only be funded by overseas capital flows into investment, gilts, equities and other sectors. We are yet to see if the 2013 phenomenon was a “blip” or a “statistical error” which will be adjusted in due course.

The current account deficit at 4% of GDP has occurred thrice since 1955. The first time in 1974 and again in 1989. Interest rates were hiked to 12% and 14% in the respective years. The IMF paid a visit in 1976. If the trends in investment income continue, the UK will face a balance of payments crisis of Tsunami proportions. The Bank of England would have to act to prop up sterling. Forward guidance would be of little value in the enforced knee jerk reaction required.

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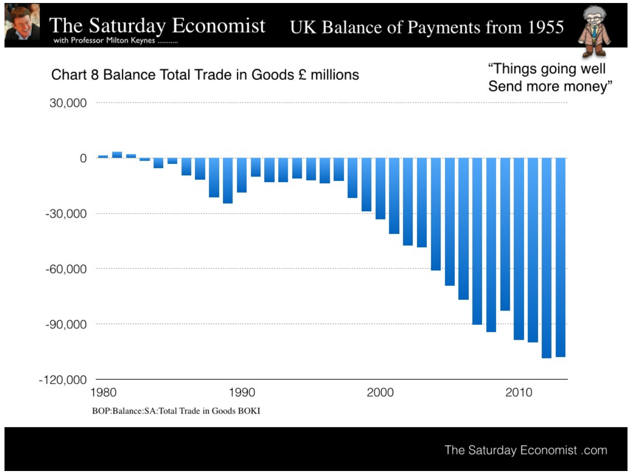

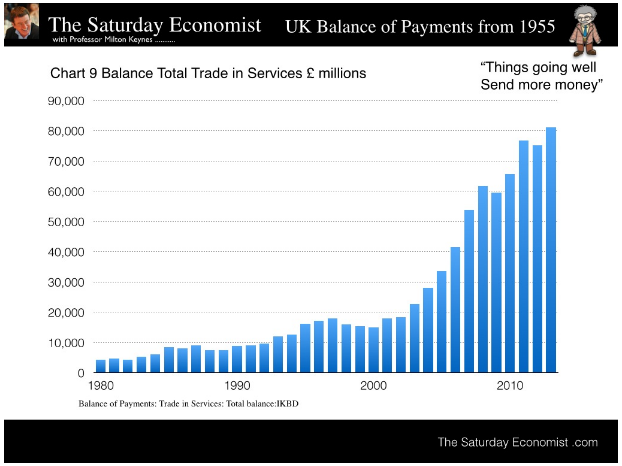

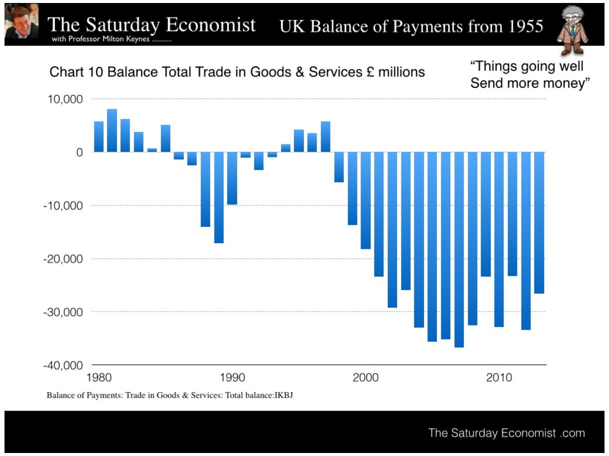

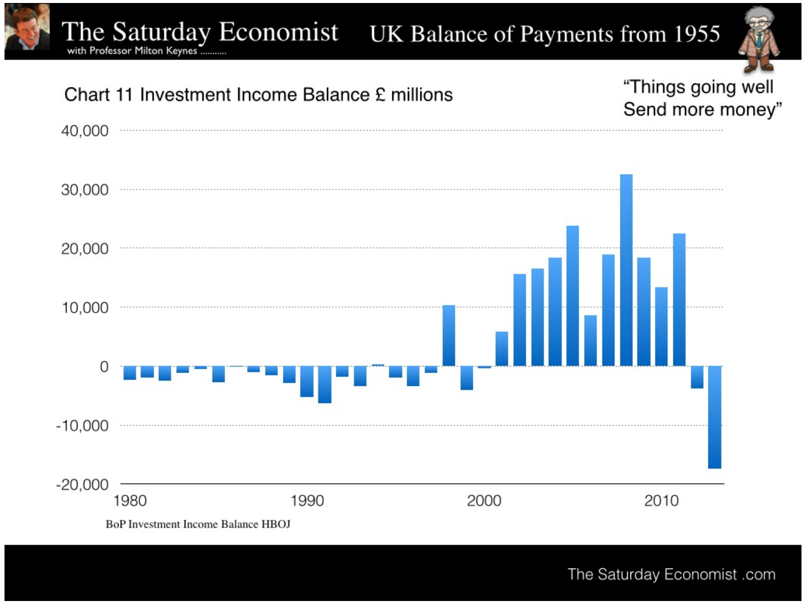

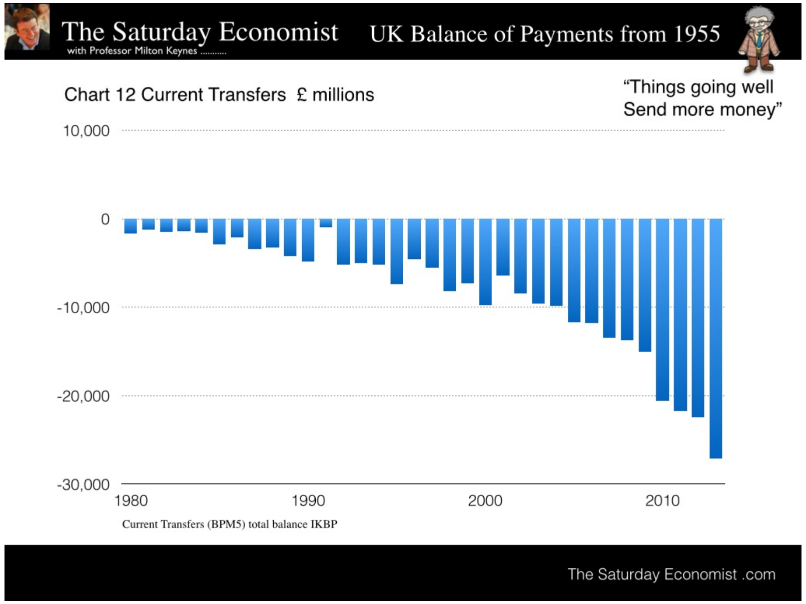

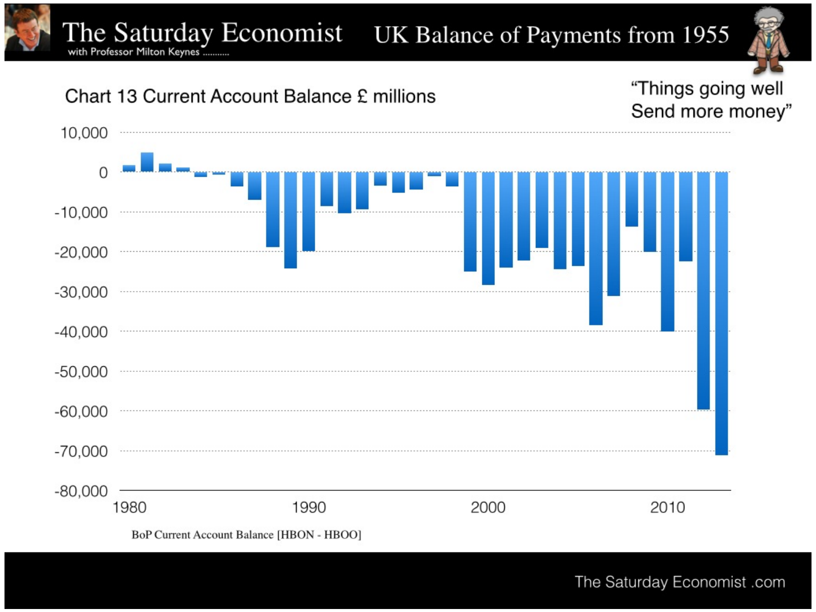

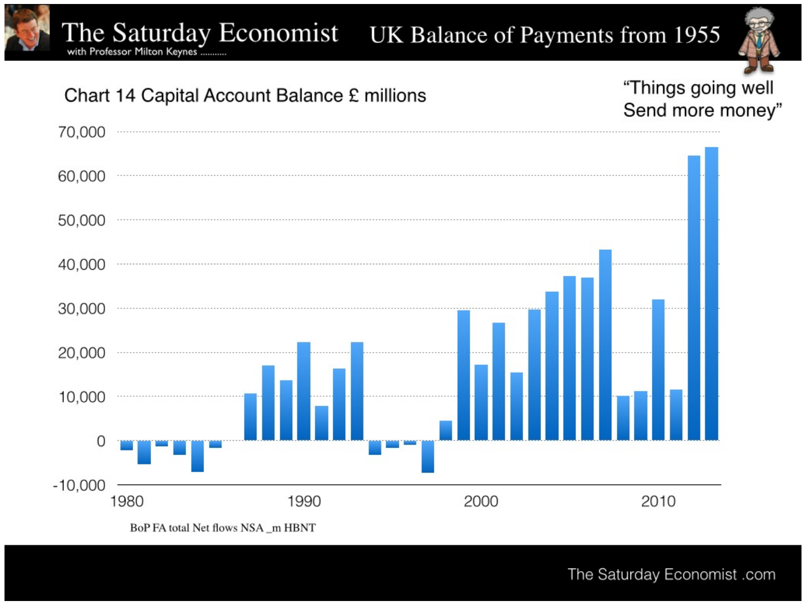

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