Regional view - United Kingdom

Keeping it sticky

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We are set for a parliamentary showdown in the week ahead, and given the speed at which developments are proceeding, political predictions are folly. Outside the UK, the predictability of the unpredictability in the Sino-US trade dispute is starting to become tiresome. Businesses and investors are reducing exposure to such risks and moving on. If we are to look for positives, identifying macro or micro trends which are stable is a good place to start. What will come as a relief is that despite the headlines, when it comes to the UK's external trade and financial assets, demand is still quite stable. In market lingo, the sticky money is still here.

Take trade for example. The drop in the global goods trade has been well documented. If supply chain shifts are further disrupted due to current disputes, current trends are unlikely to improve. However, economies whose exports are more services than goods, such as the UK, should fare relatively better. The data certainly bear this out. UK service exports to the EU have held at around GBP 30bn per quarter since the end of 2017, while services exports to markets outside the EU and the US (which would cover most developing countries) have also been sticky at between GBP 25bn and GBP 30bn per quarter since early 2016. Services exports to the US are performing the best, having grown by a third in the last three years. While all regions have benefited from sterling weakness since 2016, the US stands out because its own growth has outperformed. Even if the US joins emerging markets and the EU in undershooting more recent growth numbers, a weak sterling is still there to help keep services demand for the UK relatively sticky.

As for financial flows, the picture is more nuanced, but again we would be push back against any notion that the UK will face balance of payments difficulties. Sterling's share as a share of global reserves – the bulk of which are held by developing nations – has remained stable at around 4.5% since 2015 (until 1Q19), according to the International Monetary Fund. What's actually quite telling about this figure is that as global reserve shares are calculated according to their dollar values, just holding this share despite the decline in sterling since 2015 means that reserve managers have been taking advantage of sterling weakness to aggressively purchase sterling. Just on a simple valuation basis, more sterling has entered global reserves in the last four years (net increase of GBP 220bn) than the total accumulated since IMF records began calculating this figure. The IMF numbers are also backed up by Bank of England figures tracking foreign purchases of gilts, the bulk of which can also be attributed to reserve managers. The data here is more noisy from month-to-month, but on a 12-month rolling basis net gilt holdings only turned negative (and very marginally so) briefly from late 2014 to early 2015.

What about corporate flows? Foreign direct investment (FDI) is often the first place to look and we acknowledge that Brexit uncertainty has had an impact, especially for inbound investment flows. There is another segment to foreign direct investment, which is less watched but equally important – retained (or reinvested) earnings of foreign companies operating in the UK. Again, there has not been a negative quarter (meaning non-UK companies repatriated their UK earnings) since the end of 2016. At GBP 24.6bn, the reinvestments accounted for 17.8% of the total increase in inbound FDI in 2018. Admittedly, the weak sterling may have deterred the repatriation of earnings. On the other hand, once sterling strengthens again as the uncertainty clears, growth prospects for the UK may encourage companies to actually increase their retention and reinvestment levels.

Be it through services exports, reserve buying or the retention of UK corporate earnings, it's always good to have stable sources of flow. Nevertheless, achieving growth in these times, rather than hoping for stability, should be the long-term objective. Adverse internal conditions are beyond our control, so let's start at home. Over to you, Westminster.

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