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The balance of payments – speech by Martin Weale

In a speech delivered at the Warwick Economics Summit 2013, Martin Weale – External Member of the Monetary Policy Committee (MPC) – reviews two issues. First, what has happened to exports and imports in the aftermath of the 2007/08 depreciation? And secondly, what has happened to other components of the balance of payments, in particular investment income? He then provides some conclusions on how far the current account of the balance of payments is, in its present condition, sustainable.

Martin Weale begins by looking at a range of data on export and import flows, unit values and relative costs. Weale says that the data indicates that it is possible that the full benefits of the 2008 depreciation in sterling are yet to be realised. And that the growth in net exports following from the depreciation has been weaker than he would have expected. But that it would be wrong to put too much blame for this on the fact that our export prices in sterling have risen, and relative to other exporters have not fallen very much, in the aftermath of depreciation.

Martin Weale considers what might be limiting exports from manufacturing sectors. One explanation he considers is that exporters who want to increase their sales have to break into new markets. He suggests that the costs which need to be incurred in entering new markets are more of a deterrent than usual because businesses are particularly reluctant to take on new risks at a time of heightened uncertainty. And he draws on conversations from businesses he has visited to support this.

Turning to the current account of the balance of payments, Weale looks at data which indicate that while there was an improvement in the months after the start of the recession, the balance of trade measured in current prices is now not much better than it was in 2008. He notes that trade flows are not the whole story, and looks to the overall current balance which, in the last two quarters, has been, as a percentage of GDP, larger than at any time since late 2006. Weale notes that the data are imprecise, but concludes that the general impression is that, despite the depreciation, our balance of payments deficit is no smaller than it was before the depreciation. He concludes: "...seen from this perspective, the United Kingdom seems to have made no progress with rebalancing."

Martin Weale reviews whether the current position is sustainable. He lists what changes might reduce the deficit: the income account recovering; sustained capital gains on our overseas assets outrunning those on our overseas liabilities; or the trade balance narrowing. Alternatively, he suggests that productivity could improve or hourly wage costs in the UK could rise less than in our major trading partners. He makes it clear that a fall in wage rates is not a solution he would welcome, given it would probably be associated with stagnant or falling prices at home. Finally, he suggests that the most natural means of resolving the problem is for the nominal exchange rate to fall. He acknowledges that the first consequence of such a fall would be a further rise in inflation. And he also notes that the MPC remains oriented towards meeting its objective using domestic instruments, and does not target exchange rates. He refers to the MPC's statement of 6th February, that "as long as domestic cost and price pressures remained consistent with the inflation target in the medium term, it was appropriate to look through the temporary, albeit protracted, period of above target inflation." And he states that: "I certainly see that there would be a strong case for treating the effects of any further depreciation similar to that experienced in the last few weeks in the same way. To do any different would be to veer towards deflation as a means of restoring external equilibrium. But I should stress that this point is quite different from saying that I would be unconcerned about the effects of a sharp depreciation on prospects for inflation."

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