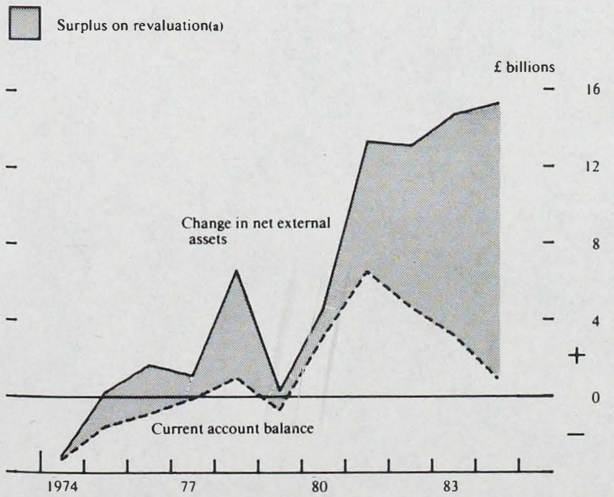
The external balance sheet of the United Kingdom: developments to end-1984

This article, which continues an annual series, describes the main changes in external assets and liabilities recorded in 1984. It also examines changes in the pattern of capital flows in the periods before and after the abolition of exchange controls and their impact on the structure of the United Kingdom's external balance sheet. Some broad estimates of the full returns on overseas investment are made, and compared with recorded flows of interest, profits and dividends in the current account.

The United Kingdom's net external assets have risen sharply in recent years and there was a further large increase of £15 billion (to a total of £74 billion) in 1984 (Table A and Chart 1.) The rise was, however, largely attributable to net capital gains, which mainly reflected sterling's depreciation (Chart 1). The flow of net investment abroad—the financial counterpart of the surplus on current account—fell sharply to only £900 million compared with £3.2 billion in 1983. The current account was, however, adversely affected by the coal dispute, which probably depressed the surplus by about £3 billion last year.

Currency movements now have a significant impact on the sterling value of the United Kingdom's external balance sheet because the United Kingdom has large net external assets denominated in foreign currency.[1] However, given the present volatility of exchange rates, a

Chart 1
Contributions to the change in UK net external assets 1974–84



(a) Residual measure: includes changes in coverage and reflects impact of capital transfers (in 1974 only) and allocations of SDR (1979–81).

Table A
UK external assets and liabilities
£ billions

	End-1983	Identified trans-actions in 1984(a)	Reval-uations etc	Total change over year	End-1984
Private portfolio investment:					
Assets	**59.9**	8.8	13.8	22.6	**82.5**
Liabilities	**9.6**	0.8	2.9	3.7	**13.3**
Net assets	**50.3**	8.0	10.9	18.9	**69.2**
Private direct investment:					
Assets	**61.0**	5.7	7.1	12.8	**73.8**
Liabilities	**36.3**	2.4	− 1.9	0.5	**36.8**
Net assets	**24.7**	3.3	9.0	12.3	**37.0**
Net private investment assets	**75.0**	11.3	19.9	31.2	**106.2**
Net banking and other commercial assets	**−17.5**	− 8.3	− 6.0	−14.3	**−31.8**
Net public sector assets	**0.7**	− 1.0	− 0.6	− 1.6	**− 0.9**
Total net assets	**58.2**	2.0	13.3	15.3	**73.5**
Gross assets	**486.4**	30.9	98.0	128.9	**615.3**
Gross liabilities	**428.2**	29.0	84.6	113.6	**541.8**

(a) The sign convention is *not* the same as in the balance of payments statistics: thus an increase in assets or liabilities is +, decrease −.

proportion of recent net gains arising from sterling's depreciation may well prove to be transitory. While sterling fell by 20% between end-1983 and end-1984 against the US dollar—in which the largest shares of UK external foreign currency assets and liabilities are thought to be denominated—it had recovered much of the loss by end-August 1985. Against non-dollar currencies, sterling fell 9% during 1984 but has subsequently appreciated.

Following the pattern of recent articles in this series, a detailed description of recent movements in the various components of external assets and liabilities is reserved for the final section. Prior to that, some longer-term trends in the pattern of capital flows, external assets and claims, and earnings thereon are described.

Pattern of capital flows since the abolition of exchange controls

The abolition of exchange controls in October 1979[2] has been associated with significant structural shifts in the

(1) However, comprehensive information on the currency composition of the United Kingdom's external assets and liabilities is not available. Moreover, the valuation of a large part of the United Kingdom's external claims and liabilities—namely direct investment—is to a large extent notional. For example, most UK direct investment overseas is in the United States, and much represents direct claims on physical capital there. In the external inventory such assets are recorded as the sterling equivalent of dollar-denominated book values, unadjusted (or only partially adjusted) for inflation.

(2) Some relaxations of the rules regarding the financing of overseas investment were introduced in the summer of 1979.

pattern of capital flows at a time when the UK current account has moved into surplus. These structural shifts have in turn influenced the distribution of assets and liabilities in the United Kingdom's external balance sheet. Analysis of such developments, and of the returns on overseas investment, has been facilitated by the publication in the Pink Book,[1] for the first time, of tables which link stocks of external assets and liabilities and their associated investment and ipd flows.

The main features of the UK balance of payments in the five-year periods before and after the abolition of exchange controls are summarised in Table B. From 1980, the current account has been consistently in surplus with a rising surplus on trade in oil and invisibles offsetting a sharp deterioration in the balance of non-oil trade. However, before the financing of these surpluses is examined it should be noted that, on average, the balancing item—representing the difference between the current balance and identified capital flows—has shifted from a net 'inflow' to a net 'outflow' between the two periods, the swing 'financing' £1.6 billion of the £4.2 billion average improvement in the current account.

After allowance for the balancing item and allocations of SDR, the average annual flow of identified net investment abroad rose from £0.8 billion in 1975–79 to £3.4 billion in 1980–84. Net investment overseas by the non-bank private sector[2] rose sharply between the two periods, the increase exceeding the improvement in the current balance. At the same time, UK banks increased the flow of their net borrowing from abroad while general government, having been, on average, a net lender overseas in the earlier period, became a net borrower.

Table B
Changes in the structure of the UK balance of payments

£ billions: annual averages: *1980 prices in italics*
Increase in assets −/Increase in liabilities +

	1975–79		1980–84	
Current account balance	−0.5	*−0.9*	3.7	*3.2*
Balancing item	1.2	*1.8*	−0.3	*−0.3*
Allocation of SDR	—	—	0.1	*0.1*
Balance of above	0.8	*0.9*	3.4	*3.0*
Financed by identified capital account transactions (net)	−0.8	*−0.9*	−3.4	*−3.4*
of which:(a)				
Non-bank private sector	−0.8	*−0.8*	−5.3	*−4.6*
UK banks	0.6	*0.6*	0.9	*0.7*
General government	−0.6	*−0.8*	1.0	*0.8*

(a) Totals may not match components because of rounding. 1980 price data have been derived by deflating current price data by the implicit price deflator for the expenditure estimate of GDP at factor cost. For definitions of sectors and classification of capital flows, etc see notes to Table C.

Further detail of the change in the pattern of capital flows is given in Table C. A large increase in the outflow of portfolio investment following the abolition of exchange controls accounts for much of the rise in net investment overseas by the non-bank private sector. While the average net outflow of direct investment also rose by £1 billion between the two periods, the figures for the latter period are heavily influenced by the Royal Dutch/Shell Group's acquisition in 1984 of most of the minority shareholding in its main US subsidiary, Shell Oil. Excluding this transaction, which was financed in foreign currency, the average net outflow of direct investment was unchanged in real terms between the two periods.

Table C
Transactions in UK external assets and liabilities

£ billions; annual averages; *1980 prices in italics*
Increase in assets −/Increase in liabilities +

Outward investment	1975–79		1980–84	
Non-bank private sector(a)				
Direct investment(b)	−3.1	*−4.3*	−5.2	*−4.5*
Portfolio investment	−0.3	*−0.3*	−3.1	*−2.7*
Other(d)	−0.8	*−1.1*	−1.2	*−1.1*
Total	**−4.2**	***−5.8***	**−9.5**	***−8.2***
UK banks				
Export credit	−0.4	*−0.6*	−1.1	*−1.0*
Other sterling lending	−0.1	*−0.2*	−3.0	*−2.6*
Total	**−0.5**	***−0.8***	**−4.1**	***−3.5***
General government(f)				
Official reserves	−1.4	*−2.0*	1.0	*0.9*
Other claims	−0.4	*−0.7*	−0.2	*−0.1*
Total	**−1.8**	***−2.6***	**0.8**	***0.7***
Memorandum item: net transactions				
Non-bank private sector	−0.8	*−0.8*	−5.3	*−4.6*
UK banks	0.6	*0.6*	0.9	*0.7*
General government	−0.6	*−0.8*	1.0	*0.8*

Inward investment	1975–79		1980–84	
Non-bank private sector(a)				
Direct investment(b)	2.1	*3.1*	3.2	*2.8*
Portfolio investment(c)	0.2	*0.3*	0.5	*0.4*
Other(d)	1.1	*1.6*	0.5	*0.4*
Total	**3.4**	***5.0***	**4.2**	***3.7***
UK banks				
Net foreign currency liabilities(e)	0.2	*0.3*	0.9	*0.8*
Sterling deposit liabilities	0.9	*1.2*	4.0	*3.4*
Total	**1.1**	***1.4***	**5.0**	***4.3***
General government(f)				
Official financing liabilities	0.8	*1.4*	−0.5	*−0.5*
Gilt-edged securities	0.4	*0.6*	0.8	*0.7*
Other liabilities	−0.1	*−0.2*	−0.2	*−0.2*
Total	**1.1**	***1.8***	**0.2**	***0.1***

(a) Includes public corporations, excludes certain miscellaneous financial institutions which are included in UK banks.
(b) Includes direct investment by/in UK banks.
(c) Includes overseas investment in local authority securities and issues abroad.
(d) Mainly unrelated trade credit and lending to/borrowing from banks, etc abroad. Includes some UK bank export credit 1975–82. No trade credit data are available after 1982.
(e) Net of UK banks' portfolio investment and other lending in foreign currency abroad.
(f) Includes all official financing transactions.

(1) Central Statistical Office: *United Kingdom Balance of Payments 1985*.
(2) Including public corporations but excluding certain miscellaneous financial institutions whose transactions are included in the total for UK banks. General government includes all transactions classified as official financing. Certain minor exceptions to this classification are described in the notes to Table C.

Table D
Distribution of UK external assets and liabilities;[a] 1979–84

£ billions: *percentages in italics*

Assets	End-1979		End-1984	
Non-bank private sector				
Direct investment	31.4	*41.2*	74.3	*37.4*
Portfolio investment	11.4	*14.9*	59.3	*29.8*
Other	9.7	*12.8*	16.6	*8.4*
Total	**52.5**	*68.9*	**150.3**	*75.5*
UK banks				
Export credit	3.9	*5.2*	12.2	*6.2*
Other sterling claims	1.6	*2.1*	17.3	*8.7*
Total	**5.5**	*7.2*	**29.6**	*14.9*
General government				
Official reserves	13.2	*17.3*	13.2	*6.6*
Other claims	5.0	6.6	5.9	*3.0*
Total	**18.2**	*23.9*	**19.1**	*9.6*
Total assets	**76.2**	*100.0*	**198.9**	*100.0*
Memorandum item: net assets				
Non-bank private sector	14.6		85.6	
UK banks	− 6.6		−11.2	
General government	4.3		− 1.0	
Total	**12.4**		**73.5**	

Liabilities	End-1979		End-1984	
Non-bank private sector				
Direct investment	21.9	*34.3*	36.8	*29.4*
Portfolio investment	4.9	*7.7*	13.6	*10.8*
Other	11.1	*17.4*	14.2	*11.3*
Total	**37.9**	*59.4*	**64.6**	*51.5*
UK banks				
Net foreign currency liabilities	3.4	*5.4*	10.7	*8.6*
Sterling deposit liabilities	8.6	*13.5*	30.0	*23.9*
Total	**12.1**	*18.9*	**40.7**	*32.5*
General government				
Official financing liabilities	6.5	*10.2*	7.2	*5.7*
Gilt-edged securities	*3.7*	*5.8*	8.9	*7.1*
Other liabilities	3.6	*5.7*	4.0	*3.2*
Total	**13.9**	*21.7*	**20.1**	*16.0*
Total liabilities	**63.8**	*100.0*	**125.4**	*100.0*

(a) The classification of assets and liabilities in this table corresponds to that of Table C.

The flow of UK banks' net borrowing from abroad has on average risen somewhat since 1979: an increase in export credit lending has been more than matched by a rise in 'other' net borrowing in sterling and foreign currencies. Since the abolition of exchange controls, the banks' gross lending and borrowing abroad in sterling have risen sharply. More recently, the banks' lending overseas has increasingly taken the form of purchases of floating-rate notes and other securities. While classified as part of portfolio investment in the balance of payments accounts, in Table C the banks' transactions in such securities have been netted off from their other net external foreign currency borrowing.

Since 1979, general government transactions have also led to a rise in net external borrowing. Overseas purchases of gilts rose sharply in 1977 and have been significant in most years since 1979. Export credit claims held by the ECGD (included in 'other' general government assets), arising from the refinancing of lending by UK banks, began to be run off from 1978, although since 1982 there has been a build up of overseas assets acquired from UK lenders on the payment of insurance claims on the ECGD. Since the decision in late 1977 to 'uncap' the exchange rate, net official financing transactions have been fairly small. While there were substantial net repayments of official financing borrowing between 1978 and 1982, these were largely matched by net drawings on the reserves.

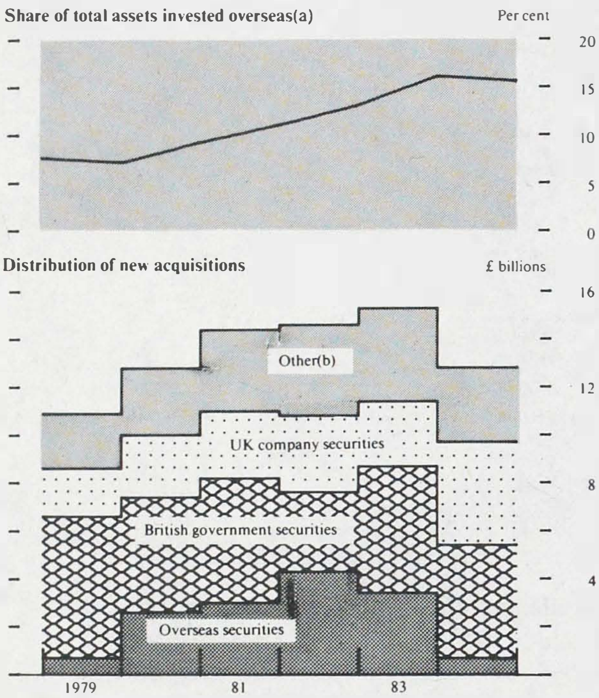
Changing structure of the external balance sheet

The changed pattern of capital flows since the abolition of exchange controls, allied with valuation effects attributable to movements in exchange rates and security prices, has led to a marked shift in the sectoral distribution of external assets and liabilities (Table D). Assets of the private sector (including banks) rose from 76% to 90% of total external assets between 1979 and 1984, while public sector external claims have remained essentially unchanged in nominal terms. Non-bank private sector portfolio investment accounted for 30% of external assets at end-1984 compared with only 15% shortly after the abolition of exchange controls. UK banks' sterling claims (other than those associated with the financing of UK exports) have also risen sharply. On the liabilities side, the main trend to emerge has been a rapid growth in UK banks' (largely short-term) external liabilities in both sterling and (net) in foreign currencies. The share of official financing liabilities in the total has fallen from 10% to 6%. Net external assets of the non-bank private sector have risen sharply over the period. UK banks have increased their net indebtedness, while the general government position has switched from that of a net creditor to a small net debtor.

Non-bank portfolio investment

The rise in the non-bank private sector's holdings of portfolio investment abroad has been a major element both in UK capital flows and in the private sector's growing share of UK external claims. Since 1979, non-bank portfolio outflows have totalled £15.4 billion, while unrealised net capital gains on the outstanding stock of these assets have amounted to £32.6 billion. Much of the investment has been undertaken by non-bank financial institutions (OFIs). Chart 2 shows the pattern of their investments in both domestic and overseas assets and the growing share of overseas securities in their total portfolios. The share of new net investment by OFIs allocated to overseas securities rose sharply following the abolition of exchange controls. However, in 1983 the share fell somewhat and investment abroad declined sharply in the first half of 1984. Although OFI investment abroad picked up again in the second half of 1984 and was at a high rate in the first quarter of 1985, for 1984 as a whole the outflow was as low as that recorded in 1979. The increase in the share of net investment allocated overseas in 1980–82 was largely mirrored by a fall in the proportion allocated to gilt-edged securities. The share of

Chart 2
Investment by other financial institutions (OFIs)



(a) 1984 estimated.
(b) Mainly land and property.

total investment placed in UK company securities remained fairly stable over this period; it then declined in 1983 but rose sharply last year.

In terms of the stock of investment outstanding, between end-1979 and end-1983 the share of OFIs' portfolios held in overseas assets doubled to around 16%, but may have fallen back a little by end-1984, despite significant valuation gains, because of the low net investment outflow during the year.

Returns on external assets and liabilities

The structural changes in the United Kingdom's external balance sheet have also had a pronounced impact on returns on overseas claims and liabilities as measured by flows of interest, profits and dividends (ipd) in the current account. In real terms (ie at 1980 prices), net ipd receipts fell between 1973 and end-1980. Since then they have risen but have not yet matched their 1973 peak, despite the large increase in net external assets (Chart 3). Growing net payments on foreign borrowing and inward direct investment, associated with the development of North Sea oil and gas, have largely offset a rising net ipd surplus on other external assets and liabilities.

Developments in ipd can also be expressed in terms of implicit yields on external assets and liabilities.[1] The first section of Table E compares nominal (ie current price) ipd yields on external assets and liabilities in, broadly, periods before and after the abolition of exchange controls. During the 1970s, ipd yields on assets and

Table E
Average rates of return on external assets and liabilities
Per cent per annum

	1970–80	1981–84	1970–84
Ipd yields			
Assets	8½	8½	8½
Liabilities	7¾	12¼	9
Full returns			
Assets	11¼	20¼	13¾
Liabilities	8¾	17½	11¼
'Real' full returns			
Assets	– 2	15	2½
Liabilities	– 4½	12	—
'Real' short-term interest rates			
Major industrial economies(a)	– 1¾	4¼	—

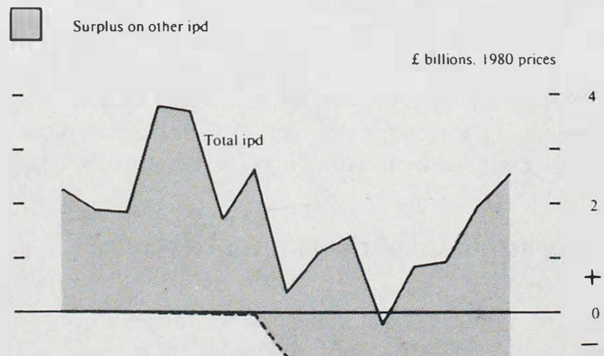
(a) The group of ten countries plus Switzerland. Data derived from P Atkinson and J C Chouraqui 'Real interest rates and the prospects for durable growth' OECD *Working Paper No 21* May 1985. Figures are for period 1971–84.

liabilities were, on average, similar. More recently, the average yield on liabilities has exceeded that on assets by a considerable margin, so dampening the otherwise favourable impact on the ipd balance of a much faster growth in the stock of assets than in the stock of liabilities.

However, as emphasised in earlier articles in this series, returns on overseas investment shown in the current account exclude those in the form of capital gains or losses. When realised, such returns will be recorded, indistinguishably, as a part of disinvestment on capital account. In the case of non-bank private sector portfolio investment—an increasingly important component of the United Kingdom's external assets—returns in the form of capital gains will form a large part of the UK income from overseas investment, yet will be unrecorded in the current account.

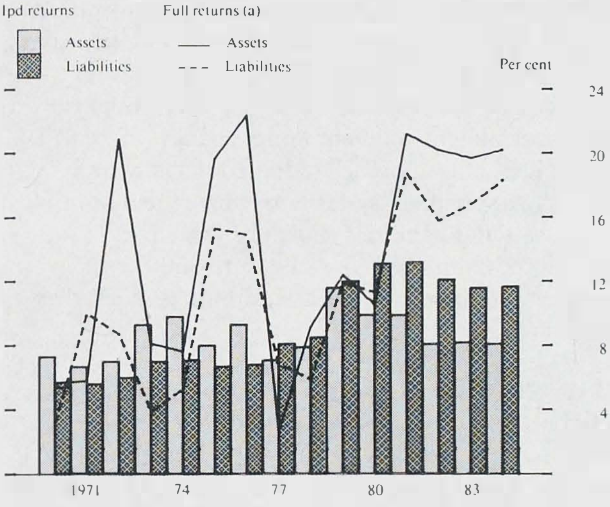
A rough estimate of returns on overseas investment inclusive of unrealised capital gains can be made, although given the limitations of the statistics and the inevitable crudeness of the calculation, the results should be treated with caution. Chart 4 compares movements in nominal ipd yields with fuller measures including unrealised net capital gains. As might be expected, the latter show a

Chart 3
Trends in interest, profits and dividends (ipd)



(1) Details of method of calculating these yields and of broader measures of rates of return used in this article are given in the appendix.

Chart 4
Estimated nominal rates of return on total identified external assets and liabilities



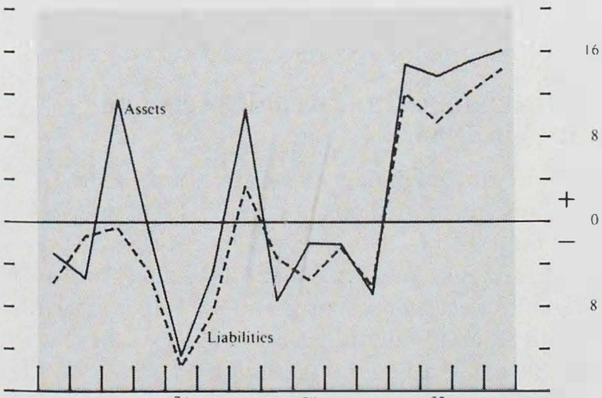
(a) Including unrealised capital gains.

much greater degree of volatility, with a marked tendency to be high in years when the exchange rate has fallen, and low when sterling has appreciated. However, on average, full returns on assets and liabililties have been broadly similar, with assets perhaps showing a somewhat higher rate of return in both of the two sub-periods shown in Table E.

The 'real' current account

The balance of payments on current account measures the excess of the nation's income over its expenditure (including net transfers paid abroad). Equivalently, it represents that part of the nation's saving used to acquire net financial assets overseas rather than investment goods (new buildings, plant and machinery, inventories, etc) at home. The exclusion from the current account of returns on external assets and liabilities in the form of capital gains may lead to a significant understatement of net income from overseas, particularly at a time when a growing share of overseas assets takes the form of

Chart 5
Estimated 'real' rates of return on external assets and liabilities[a]



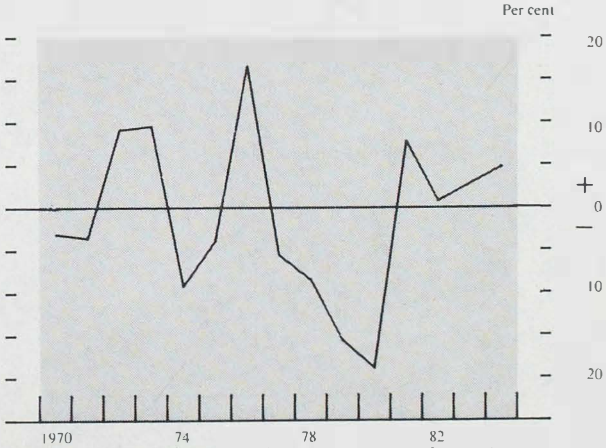
(a) Including unrealised capital gains.

portfolio investment. However, full returns on overseas investment (ie ipd and capital gains) will include an element which merely compensates asset holders for inflation and so will overstate real income (and hence real saving).

An alternative approach to measuring income from overseas investment would take into account 'permanent' capital gains measured in domestic currency terms (ie transitory fluctuations in asset values would be ignored) but would also deduct an amount representing the fall in the real value of stocks of assets and liabilities attributable to inflation. With returns on overseas assets and liabilities measured this way, the 'real' (inflation adjusted) current account balance (ie 'real' saving placed abroad) would then measure the change in the permanent real value of the United Kingdom's net external assets.

Measures of rates of return which allow for inflation, but make no attempt to smooth away temporary fluctuations in capital values, are shown in Chart 5. These full, inflation-adjusted returns were typically negative during the 1970s but have been strongly positive in the early 1980s (see Table E). The volatility of the series, partly reflecting large swings in the United Kingdom's real exchange rate (Chart 6), makes it difficult to assess underlying rates of return.

Chart 6
Change in sterling's real exchange rate[a]



(a) As measured by relative normalised unit labour costs (rest of world: UK). A positive change indicates a depreciation of sterling's real exchange rate.

However, over the whole fifteen-year period covered, the influence of real exchange rate changes will have been relatively small. The table suggests that over such a long period the real full return on UK liabilities has been close to average real interest rates in industrial countries (approximately zero), while the return on UK assets has been somewhat higher.

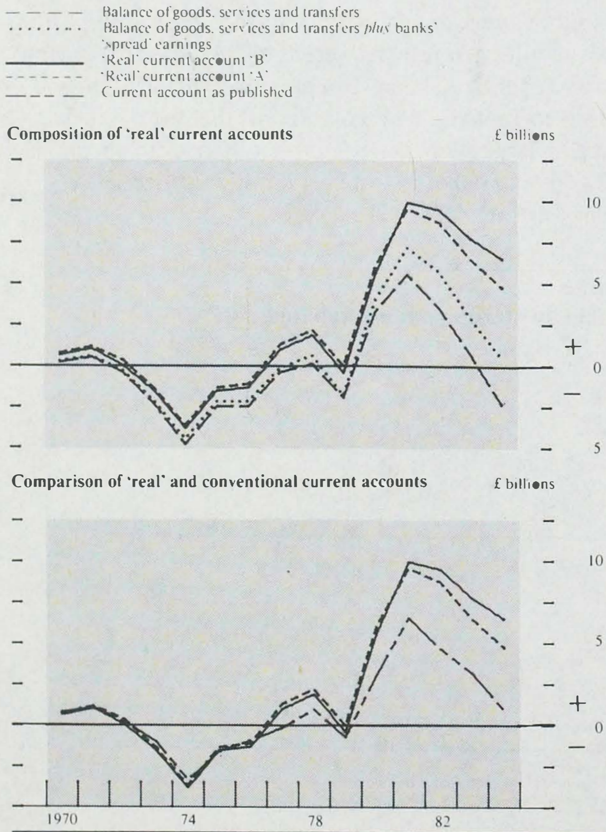
Such evidence on real rates of return may be used in estimating a 'real' current account balance for the United Kingdom. Chart 7 compares two such estimates with the conventionally measured current account.

The first step in the calculation of a 'real' current account balance is to deduct net ipd receipts leaving the balance of goods, services and transfers. To this is added back an estimate of net 'real' earnings from overseas investment. Such earnings consist of two components:

- an amount, within recorded net ipd earnings from UK banks' external borrowing and lending, representing earnings attributable to the spread between the banks' lending and borrowing rates. While treated as part of the banks' overseas investment income, such earnings can be regarded as receipts for intermediation services provided by the banks and so as exports of services in the balance of payments;

- a 'real' net investment income component derived by applying estimates of 'real' permanent rates of return to the stock of external assets and liabilities.

Chart 7
'Real' and conventional current accounts compared



By far the largest part of the banks' 'spread' earnings is derived from their external borrowing and lending in foreign currencies (the latter defined to include holdings of overseas securities).At end-1984, external foreign currency borrowing by the banks amounted to £427 billion, out of total UK external liabilities of £542 billion. Foreign currency lending abroad by the banks was £416 billion, out of total UK external assets of £615 billion. Although the banks had net external foreign currency liabilities of £11 billion at end-1984, the spread between their borrowing and lending rates was sufficient to provide net ipd receipts of £2 billion. Of this, 'spread' earnings are estimated to have been £2.8 billion, the balance representing net interest paid on net liabilities.

In estimating a 'real' net investment component (where the banks' foreign currency borrowing and lending have been treated on a net basis and included in external liabilities), a major practical problem is to distinguish between 'permanent' and temporary changes in 'real' capital values. One approach (adopted in last year's article) is to apply the long-term average of real returns on UK assets and liabilities shown in Table E ($2\frac{1}{2}$% on assets and 0% on liabilities). A measure of the 'real' current account based on this assumption is marked as 'A' in Chart 7.

However, there is perhaps a case for treating the 1970s and early 1980s as two distinct periods, the first being characterised by generally negative real interest rates world-wide and, perhaps, with a tendency for UK interest rates to be somewhat depressed by the existence of exchange controls, and the second by a return to positive real interest rates and freedom from exchange restrictions in the United Kingdom. In the 'B' measure shown in the chart it has been assumed that world 'real' interest rates have undergone a step change between the 1970s and the 1980s. The 'permanent' return on UK liabilities is taken to be roughly equal to the average world 'real' interest rate in each of the periods 1970–80 and 1981–84 ($-1\frac{3}{4}$% in the first period, $4\frac{1}{4}$% in the second—see Table E) while the 'permanent' return on UK assets is assumed to be two percentage points higher (ie slightly less than the average differential over the whole period).

In the earlier part of the period covered in Chart 7 (when real rates of return were zero or negative), the difference between the recorded current account and the two measures of the 'real' current account tends to be small. However, the more recent rapid expansion of the United Kingdom's net external assets, at a time when real rates of return have become positive, has led to a sharp rise in 'real' earnings inclusive of 'permanent' capital gains. Given the uncertainties involved in the calculation of the 'real' current account, the figures presented should be regarded as no more than illustrative. Nevertheless, both measures imply that since 1979 'real' earnings from overseas investment have been substantially higher than is indicated by the balance of ipd recorded in the current account.

The main changes in external assets and liabilities in 1984[1]

The sterling value of both external assets and external liabilities rose by more than a quarter in 1984, to levels of £615 billion and £540 billion respectively (Table G). As in the previous two years, valuation changes had a considerable effect on both gross and net levels, and only £2 billion of the £15 billion rise in net assets in 1984 was attributable to identified transactions. Net private sector

(1) In this section references to UK banks apply to monetary sector institutions only.

portfolio investment abroad continued to be the single most important source of increase, with net assets rising by £19 billion to £69 billion. Net private sector direct investment abroad added £12 billion, compared with £3 billion in 1983.

Private sector

The stock of *UK portfolio investment* overseas continued to grow rapidly. Some £13.8 billion of the increase of £22.6 billion was attributable to valuation changes. Rather more than half the valuation change reflected rising security prices, particularly in the United States where a high proportion of such investment is held; the balance reflected a fall in the sterling exchange rate over the year, particularly against the US dollar.

Net new purchases (£8.8 billion) were substantial. Banks bought £7.2 billion on their own account and almost all of this was in floating-rate notes and fixed-rate bonds, rather than ordinary shares. Other financial institutions outside the monetary sector took up a modest £0.6 billion compared with net investment of £3.5 billion in 1983.

The stock of overseas investment in UK company securities rose by £3.7 billion compared with £2.8 billion in 1983.

The book value of *UK direct investment* overseas rose by £12.8 billion to £73.8 billion (Table F). Net transactions by non-oil industrial and commercial companies generated an outflow of £1.9 billion. A large rise in UK oil companies' investment stake overseas, and a modest decrease of overseas oil companies' investment in the

Table F
Private direct investment
£ millions

End-years	1980	1981	1982	1983	1984
Outward					
All industries other than oil, banking and insurance	20,290	28,030	32,740	37,210	45,720
Banks	2,510	3,390	3,330	3,040	1,470
of which:					
Offshore bond issues	—	*- 590*	*- 1,150*	*- 2,010*	*- 4,590*
Oil companies	7,550	10,100	12,550	14,550	19,650
Insurance companies	2,420	3,030	3,430	3,630	4,240
Property	1,080	1,690	2,080	2,610	2,750
Total	**33,850**	**46,240**	**54,130**	**61,040**	**73,830**
Inward					
UK companies other than oil, banking and insurance	15,880	16,960	17,530	19,150	21,120
Banks	1,260	1,480	1,875	2,270	2,930
Oil companies	8,150	10,300	10,800	12,950	10,950
Insurance	260	310	430	610	435
Property	870	990	1,130	1,350	1,405
Total	**26,420**	**30,040**	**31,765**	**36,330**	**36,840**

United Kingdom, largely reflected the Shell Group's purchase of most of the minority shareholdings in its main US subsidiary, Shell Oil, (part of which is recorded as an inward disinvestment because of the ultimate Dutch shareholders' 60% interest in the funds transferred to the United States).

The level of banks' outward direct investment fell by £1.6 billion as the banks continued to raise foreign currency capital in the form of subordinated loans from overseas subsidiaries in the Netherlands and the United States, the subsidiaries having raised the funds by bond issues in their own name.[1] UK industrial companies also raised foreign currency capital abroad in this way, reducing their net outward direct investment levels.

Net *banking and other commercial liabilities* rose by a very substantial £14.3 billion to stand at £31.8 billion. Sterling lending overseas rose strongly, by £5.0 billion, twice the rate recorded in 1983. The increase was fairly evenly spread throughout the year, with developed countries being the principal borrowers.

The banks' external sterling deposits also showed a strong rise, £6.3 billion (+ 27%) in 1984. Just over 80% of this increase was attributable to private rather than official holdings. Banks overseas accounted for the greater part (60%) of the rise in private holdings, reversing the experience of 1983 when non-banks had been responsible for a similar portion of the increase.

The eurosterling business of UK banks rose sharply in 1984. After remaining practically unchanged for two years, UK banks' claims rose by 67%. However, with their liabilities also rising substantially (58%), UK banks increased their net borrowing from the eurosterling market over the year, from £1.5 billion to £2.1 billion.

Transactions contributed £8.9 billion to the growth of UK banks' net external foreign currency liabilities in 1984, after a net inflow of £1.4 billion in 1983. The main counterparts to the increase were again continuing investment in external foreign currency securities and higher net foreign currency lending to UK non-banks.

After showing little change in 1983, UK non-banks' sterling transactions with banks overseas showed moderate increases (£0.3 billion) in both deposits and borrowing in 1984. Foreign currency deposits abroad continued to grow very strongly (£1.5 billion, an increase of one sixth); and there was a large (£0.9 billion) rise in foreign currency borrowing from banks overseas.

Public sector

Official financing liabilities rose by £1.6 billion during the year. Three quarters of this increase reflected sterling's depreciation.

Official reserves, translated into sterling terms at end-year market rates, increased by £0.4 billion. Net drawings of £0.9 billion were more than offset by the valuation effect of a fall in sterling's exchange rate: this, together with a small rise in the sterling value of gold, added £1.3 billion to the sterling value of the reserves.

(1) These loans are recorded in the balance of payments as outward disinvestment in accordance with international guidelines.

Table G
UK external assets and liabilities[a]

£ millions

End-years	1980	1981	1982	1983	1984
External assets					
Private sector					
Private investment abroad:					
Direct	33.849	46.238	54.130	61.039	73.829
Portfolio	18.100	24.400	40.000	59.900	82.500
Total identified private investment abroad	51.949	70.638	94.130	120.939	156.329
UK banks' assets					
Sterling	7.849	11.555	15.577	18.060	23.077
Foreign currencies	139.484	208.103	264.216	307.536	387.353
Deposits held abroad (other than by UK banks) plus advance and progress payments on imports by UK businesses	6.202	13.639	15.916	20.692	28.308
Suppliers' trade credit on exports	4.088	4.838	4.650	..	..
Foreign notes and coin held by UK residents	44	51	54	64	74
Total identified banking and other commercial claims	157.667	238.186	300.413	346.352	438.812
Total identified external assets of the private sector	**209.616**	**308.824**	**394.543**	**467.291**	**595.141**
Public sector					
Inter-government loans by the United Kingdom	1.265	1.256	1.226	1.223	1.191
Subscriptions to international financial organisations (excluding the IMF)	1.528	1.748	2.001	2.266	2.473
Other official assets	419	469	506	545	628
Direct investment, trade credit and overseas stocks	2.212	2.086	2.131	2.241	2.634
Total public sector lending, etc	5.424	5.559	5.864	6.275	6.926
Official reserves	13.275	11.960	12.939	12.805	13.219
Total external assets of the public sector	**18.699**	**17.519**	**18.803**	**19.080**	**20.145**
Total identified external assets	**228.315**	**326.343**	**413.346**	**486.371**	**615.286**
External liabilities					
Private sector					
Overseas investment in the UK private sector:					
Direct	26.422	30.040	31.766	36.330	36.841
Portfolio	5.100	5.800	6.800	9.600	13.300
Total identified overseas investment in the private sector	31.522	35.840	38.566	45.930	50.141
UK banks' deposit liabilities in:					
Sterling	11.564	14.438	18.859	23.358	29.635
Foreign currencies	143.911	217.026	278.505	326.075	421.978
Advance and progress payments on exports:	2.004	2.780	2.800	..	..
Direct borrowing abroad by UK non-banks, plus suppliers' trade credit on imports	7.430	11.496	13.876	14.395	18.965
Overseas deposits with building societies	25	25	32	37	68
Total identified banking and other commercial liabilities	164.934	245.765	314.072	363.865	470.646
Total identified external liabilities of the private sector	**196.456**	**281.605**	**352.638**	**409.795**	**520.787**
Public sector					
Inter-government loans to the United Kingdom (net)	1.375	1.649	1.846	1.957	2.323
Short-term liabilities	207	406	853	372	250
British government stocks held by:					
Central monetary institutions	2.248	2.461	2.872	3.157	3.375
Other overseas holders	2.986	2.807	4.162	4.748	5.559
British government foreign currency bonds	335	402	327	343	16
Overseas holdings of local authority securities and mortgages	200	230	220	210	200
Foreign currency securities issued by public corporations	158	164	161	171	80
Local authorities' non-exchange cover scheme borrowing abroad	37	43	41	39	36
Public corporations' non-exchange cover scheme borrowing abroad and advance and progress payments on imports	1.274	909	707	645	661
Overseas holdings of:					
UK Treasury bills and non-interest-bearing notes	1.044	1.018	1.186	1.207	1.330
Overseas temporary deposits with local authorities	22	42	25	12	5
Total public sector borrowing (non-exchange cover scheme)	9.886	10.131	12.400	12.861	13.835
Official financing liabilities:					
Net drawings on the IMF	301	191	35	—	—
Foreign currency borrowing by the Government	1.045	—	—	—	311
New York bond issue by the Government	146	183	216	241	302
Foreign currency borrowing by public bodies under the exchange cover scheme	3.460	3.889	4.621	5.281	6.551
Total official financing liabilities	4.952	4.263	4.872	5.522	7.164
Total external liabilities of the public sector	**14.838**	**14.394**	**17.272**	**18.383**	**20.999**
Total identified external liabilities	**211.294**	**295.999**	**369.910**	**428.178**	**541.786**

(a) Notes and definitions on the series which comprise UK external assets and liabilities can be found in *United Kingdom Balance of Payments 1985* (the Pink Book) published by the Central Statistical Office.

Appendix

Calculation of rates of return

For purposes of calculating rates of return, the stock of external foreign currency lending (including portfolio investment in overseas securities) by UK monetary sector and certain other miscellaneous financial institutions (here referred to as 'UK banks') has been deducted from total gross assets and instead applied as an offset to total liabilities. This procedure reflects the treatment of the banks' earnings discussed in the text.

In the calculation of rates of return the denominator or 'base stock' in a given year is taken as the stock of assets or liabilities at the end of the previous year *plus* one half of the corresponding investment flow. In certain years account has also been taken of significant coverage changes.

Ipd yields on assets exclude UK banks' earnings on external foreign currency lending and portfolio investment. In calculating the yields on liabilities, ipd debits attributable to UK banks' gross external foreign currency borrowing have also been deducted from total ipd debits. Included instead are estimated amounts payable on the banks' net foreign currency liabilities; in principle these will equal the difference between net ipd earnings of the banks from their foreign currency business as a whole *less* the service element attributable to the spread between their borrowing and lending rates.

For 1970–78, estimated payments on the banks' net foreign currency liabilities have been calculated by applying the average three-month eurodollar rate to the base stock of net liabilities. For 1979–84, the availability of figures for gross borrowing and lending transactions enables a more direct estimate to be made. Implied yields on gross liabilities can be calculated as the ratio of the banks' gross ipd debits to the base stock of gross liabilities and these can then be applied to the base stock of net liabilities to derive the amounts payable.

Unrealised capital gains have been defined as the change in the stock during the year *less* the investment flow, with an adjustment for changes in coverage where known. (Such adjustments are, however, crude and are likely to be incomplete: an element of differences in coverage may well be included in estimated capital gains). Full returns are defined as the sum of ipd *plus* capital gains. The inflation adjustment has been estimated by multiplying the stock of assets and liabilities at the end of the previous year by the percentage change (Q4 on Q4) in the deflator for GDP (expenditure measure at factor cost). 'Real' returns are defined as the full return less the inflation adjustment.

For assets, gold held in the official reserves has been valued throughout at end-year market prices. In Table 13.2 of the Pink Book, gold is valued on that basis from end-1978, but at SDR 35 = 1 oz for years prior to that date. The procedure adopted here has the effect that the capital gain arising from the increase in the SDR gold price accrues gradually over the period 1971–78 rather than in a lump sum at end-1978, which would distort the measured rates of return over the preceding years.

For liabilities, cumulative SDR allocations have been added to the liability stock and SDR allocations have been included in the investment flow. Charges paid by the United Kingdom on cumulative SDR allocations (and interest received on SDR holdings) are included in ipd flows.