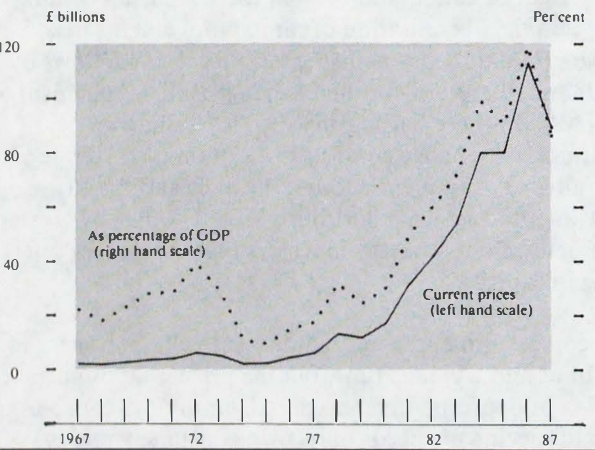
External balance sheet of the United Kingdom: recent developments

This article, which continues an annual series, examines changes in external assets and liabilities recorded in 1987, and indications for 1988. In particular, the article considers the impact of changes in asset prices on the external balance sheet, showing that exchange rate movements accounted for most of the reduction in recorded net identified external assets during 1987. The implications of the balancing item for the net asset level and the current account are also addressed. Some international comparisons of recent trends in external wealth are drawn and recent capital flows and flows of interest, profit and dividends are also discussed.

Developments to end-1987 and indications for 1988

The United Kingdom's net identified external assets fell markedly from their end-1986 level to stand at £89.5 billion at the end of 1987.[1] This decline followed seven years of near continuous growth from a level of £12.1 billion at end-1979 to a revised level of £113.2 billion at end-1986 (Chart 1), a growth which can

Chart 1
Level of net external assets, in current prices and as a percentage of GDP



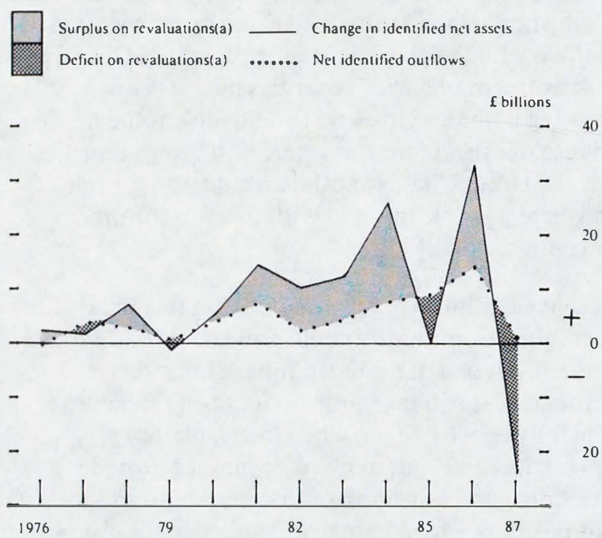
be attributed roughly equally to identified capital account outflows and to revaluation effects caused by rising equity prices, higher bond prices and a lower UK exchange rate. As Table A shows, almost half of this cumulative revaluation effect was wiped out in 1987 and can be

Table A
Cumulative changes in net external assets

£ billions, cumulative changes

	End-1979–end-1986	End-1979–end-1987
Cumulative change in net external assets	101.2	77.4
of which: capital flows	48.8	49.9
revaluations	52.3	27.5

Chart 2
Contributions to the change in UK net external assets



(a) Residual component—difference between change in recorded net stock and net identified outflows.

considered the principal statistical factor behind the fall in identified external assets. Chart 2 illustrates the year-by-year contributions to the change in net assets attributable to capital flows and revaluation effects respectively.

Tables B and C provide further details of the make-up of the United Kingdom's external assets and liabilities and the movements in 1987, while Table K (at the end of this article) shows more detailed figures of the composition of the balance sheet for the last six years. The total reduction in net assets of £23.8 billion in 1987 is more than accounted for by the reduction of £28.2 billion in net non-bank portfolio assets, reflecting both the heavy repatriation of funds by the non-bank financial institutions, the bulk of which occurred in the fourth quarter, and the substantial revaluation effects noted above. Offsetting this, there were major positive contributions to net external assets from both an

(1) This article is based on estimates published in *United Kingdom Balance of Payments, 1988 Edition* (the Pink Book): Central Statistical Office, August 1988, where the basis of valuation is also described.

Table B
UK external assets and liabilities[a]
£ billions

	Stock end-1986	Identified capital flows	Net valuation effect(b)	Total change in stock	Stock end-1987
Non-bank portfolio investment:					
Assets	**111.1**	− 6.2	−15.9	−22.1	**89.0**
Liabilities(c)	**24.9**	7.2	− 1.2	6.1	**30.9**
Direct investment:(d)					
Assets	**92.2**	15.1	−12.2	2.9	**95.0**
Liabilities	**48.2**	6.0	− 0.7	5.3	**53.4**
UK banks'(e) net liabilities in:					
Foreign currency	**12.9**	− 1.8	− 2.5	− 4.3	**8.6**
Sterling	**10.9**	4.0	− 1.1	2.9	**13.9**
Public sector:					
Reserves (assets) *less* official foreign currency borrowing	**8.5**	12.8	− 0.9	11.9	**20.4**
British government stocks (liabilities)	**13.6**	4.1	− 0.3	3.7	**17.4**
Other net public sector assets	**7.7**	− 0.7	− 1.2	− 1.9	**5.8**
Other net assets	**4.3**	− 0.4	− 0.3	− 0.7	**3.6**
Total net assets	**113.2**	1.0	−24.8	−23.8	**89.5**

(a) The sign convention is *not* the same as in the balance of payments: thus a transaction that increases an itemised stock is + and one that decreases it is −.
(b) Residual component.
(c) Excluding estimated take-up of UK banks' floating-rate note issues, which appears indistinguishably from foreign investment in other UK company securities in the published data but is treated here as part of banks' net foreign currency liabilities.
(d) Excluding UK banks' external borrowing from overseas affiliates, which is treated as an offset to outward direct investment in the published data but is treated here as part of banks' net foreign currency liabilities.
(e) UK monetary sector plus certain other UK financial institutions. Banks' holdings of foreign bonds are treated as foreign currency lending.

unprecedentedly large build-up of the official reserves, associated with upward pressure on sterling, and very strong outward direct investment flows, boosted by acquisition activity in the United States.

It can be argued that the published estimate of net identified external assets is misleadingly low since sterling's recorded exchange rate against the dollar on 31 December 1987 was unrepresentative of the period. At 1.89 the sterling/dollar rate at the close on 31 December was some 4% higher than the average daily closing rate for December 1987 and January 1988 combined. If this latter average rate were to be used in the net asset calculation, then the United Kingdom's estimated net identified external assets would have been somewhat higher, reflecting the fact that a large proportion of the United Kingdom's assets are dollar denominated. The dollar has generally strengthened in 1988, so that at the end of the third quarter the sterling/dollar rate was some 11% lower than the end-December figure. This, combined with the modest recovery in world stock market prices, suggests that at the end of the third quarter the United Kingdom's net identified external assets were likely to have been around £100 billion again. Total net identified transactions were, on present estimates, broadly flat over the first half of 1988 and therefore will not affect this conclusion materially, but there was a large positive balancing item reflecting either unrecorded current account credits or capital inflows. Within the identified capital account there were strongly divergent trends: heavy net portfolio and direct investment outflows were offset by strong inflows into the UK monetary sector, particularly in sterling.

Table C
UK capital flows, 1976–87[a]
£ billions

	Annual averages 1976–80	Annual averages 1981–85	1986	1987	1988 H1
Non-bank portfolio investment:					
Net transactions in assets	−1.0	−4.9	−17.7	6.2	−5.1
Net transactions in liabilities(b)	0.3	0.9	4.8	7.2	0.2
Direct investment:(c)					
Net transactions in assets	−3.7	−5.3	−12.0	−15.1	−6.9
Net transactions in liabilities(b)	2.7	2.7	4.2	6.0	2.9
UK banks' net liabilities in:(d)					
Foreign currency	0.3	−1.3	4.5	− 1.8	2.4
Sterling	0.5	1.1	− 0.3	4.0	5.7
Public sector:					
Reserves *less* official foreign currency borrowing	−1.0	0.5	− 1.5	−12.8	−1.3
British government stocks	0.7	1.1	2.1	4.1	0.6
Other public sector flows (net)	−0.2	−0.5	− 0.5	0.7	−0.6
Other net flows	−0.7	−0.4	2.2	0.4	1.5
Total net identified capital flows	**−2.2**	**−6.2**	**−14.2**	**− 1.0**	**−0.6**

(a) Increase in assets − /liabilities +.
(b) See footnote (c) to Table B.
(c) See footnote (d) to Table B.
(d) See footnote (e) to Table B.

Effects of revaluations

An attempt can be made to disentangle the various revaluation forces acting upon the external stocks through 1987 by means of crude revaluation techniques and the known quarterly capital flows, so that the relative importance of exchange rates, bond prices and share prices can be ascertained. Table D sets out Bank estimates of the driving forces behind stock revaluations in 1987, splitting the year into two convenient periods: approximately before and after the stock market crash.

Table D
Sample of revaluation variables
Percentage changes

	End-1986–end-Q3 1987	End-Q3 1987–end-Q4 1987	End-1986–end-1987	End-1987–end-Q3 1988
£/$ exchange rate	+10	+16	+27	−11
£ effective exchange rate	+ 6	+ 4	+10	—
UK 20-year gilt price	+ 3	+ 5	+ 8	+ 1
US 30-year Treasury	−23	+ 9	−16	− 1
UK share price	+45	−28	+ 5	+ 8
World(a) share price	+29	−24	− 1	+19

(a) Excluding the United Kingdom.

Table E gives estimates of the *ex-post* contribution from each of these main forces to the total revaluation component calculated in Table B. However, the calculation of revaluation effects is an inexact science, because of the paucity of information regarding the geographical/currency/instrument breakdown of assets and liabilities and the lack of knowledge on the timing of flows within quarters. Therefore these estimates should be treated as indicative of broad movements only.

During the first three quarters there were powerful, but opposing, forces acting on the net external asset position: the strong sterling exchange rate, reinforced by the weakness of foreign bond prices (especially in the United States), acted to depress UK net assets, but this was approximately counterbalanced by strong positive

Table E
Contributions[a] to revaluations of net external assets
£ billions

	1987			1988
	Q1–Q3	Q4	Year	Q1–Q3
Equity prices	15	−14	1	8
Bond prices	− 6	3	− 4	−1
Exchange rates	−11	−12	−23	4
Other	2	—	2	—
	− 1	−24	−25	11

(a) Bank estimates.

revaluation effects from world equity price movements. Even though the UK stock market rose faster than overseas markets, the very large net asset position enjoyed by the United Kingdom in terms of equity ensured that the absolute revaluation of foreign assets was greater than that on domestic liabilities. However, the strong net equity position worked to reduce UK net assets in the fourth quarter, although the fall was probably mitigated somewhat because the London stock market declined by more than the average of the rest of the world, so that UK equity liabilities were devalued by more than foreign equity assets. Because of the many uncertainties surrounding these calculations, it is impossible to be precise as to the net effect of stock market revaluations over the year as a whole, but they were probably quite small. The most powerful dampener in the fourth quarter (as in the early part of the year) was the strong exchange rate, primarily against the dollar, and over the full year the effects of the rising exchange rate probably accounted for most of the total negative revaluations. The exchange rate performed such a powerful role both because most of the United Kingdom's (non-bank) liabilities are denominated in sterling, so that net foreign currency assets are much greater than net total assets, and because the rise in sterling against the dollar amounted to some 27%.

Balancing items

The calculation of net external assets can only measure the stock of identified external wealth. Since by definition the balance of payments must balance, the unidentified item represents the failure to capture all transactions moving across the exchanges. Over the past few years the balancing item has been persistently positive and has thus represented either unrecorded current account credits or unrecorded capital inflows, or some combination of both. Given the volatility and size of the balancing item (+£14.4 billion in 1986 and +£3.5 billion in 1987), it is unlikely to represent mainly errors in the visible trade data, which are comprehensively recorded. While significant underrecording of service, transfer or IPD credits is rather more probable, it is likely that a substantial proportion of the balancing item is due to errors and omissions in the capital account where, in some areas, coverage is at best partial and where identified flows can be large and highly volatile. That part of the balancing item belonging to the capital account may in particular represent: unrecorded portfolio inflows (net); omitted trade credits (which would tend to produce a more positive balancing item if the trade deficit increases); errors in estimating flows from reported changes in stocks; and, more recently, failure to capture the financing arm of securities dealers' operations adequately.[1]

Proper attribution of the balancing item is of some importance because, as far as is possible, the external inventory, capital account and IPD data are made to be consistent with one another, so that for each item in one category there are likely to be corresponding items in the other two. Consequently, if there are unrecorded capital account inflows (net) then there will also be unrecorded liability stocks (net) and, probably, unrecorded IPD debits (net). As an extreme indication of the size of this potential effect, if end-1975 were taken as a starting point and the unidentified stock assumed then to be zero, and if the subsequent accumulated unidentified inflows were all to be attributed to the capital account, then UK net external assets would have still been £54 billion by end-1987. The additional IPD debits—assuming these liabilities earned the same average rate of return as identified portfolio liabilities—would have worsened the current account by around £2 billion by 1987 (in levels terms). However, this calculation assumes that all the balancing items are capital inflows and would be offset to the extent that the balancing item represents unrecorded current account credits, so that while net IPD could be less in surplus than presently recorded, the current account overall could remain as recorded, or better than recorded. It must be noted that this example is only one of many theoretical possibilities; by definition it is not known which gross transactions make up the net unidentified flows nor when (if ever) the stocks of unidentified assets and liabilities netted out to zero.

International comparisons

When expressed in dollars, the level of the United Kingdom's net external assets (excluding gold) remained flat in 1987 compared with 1986 and represented some 20% of annual gross national product and some 80% of annual exports. Table F presents these data in historical context and compares the UK position with those of the three major overseas economies. While it should be noted that statistics in this area are subject to numerous qualifications and uncertainties, and are not strictly comparable between countries, the divergent trends among the three major overseas countries are almost certainly correct.

The familiar trade imbalances between these economies are mirrored in the net indebtedness data, with the current account deficit of the United States being reflected in a shift from a large net creditor position in 1980 to a large net debtor position at the end of 1987. Both Japan and Germany, over the same period, have accumulated large net overseas asset stocks, reflecting their continuing

(1) There is a statistical correlation between securities dealers' transactions and the balancing item.

Table F
International comparisons of external net asset positions(a)(b)

End-years	1980	1981	1982	1983	1984	1985	1986	1987
United States								
$ billions	95	130	126	78	− 8	−122	−280	−379
Per cent of GNP	3	4	4	2	—	− 3	− 7	− 8
Per cent of exports(c)	35	44	47	30	− 3	− 43	− 97	−114
Japan								
$ billions	10	10	24	36	74	129	179	240
Per cent of GNP	1	1	2	3	6	8	9	8
Per cent of exports(c)	6	5	13	19	37	50	65	66
West Germany								
$ billions	26	24	26	27	36	46	87	160
Per cent of GNP	3	3	4	4	6	6	9	12
Per cent of exports(c)	12	11	12	14	19	17	26	39
United Kingdom								
$ billions	30	53	59	72	87	110	161	160
Per cent of GNP	6	11	13	16	23	21	28	20
Per cent of exports(c)	20	41	50	61	81	74	110	79

(a) Excluding gold holdings.
(b) The data underlying this table are taken from national sources which may use disparate methodology.
(c) Gross exports of goods and services.

current account surpluses. The growth of these debit/credit stocks results, in part, from the trade imbalances but is also compounded by the financing of interest, profit and dividend flows which derive from these net creditor/debtor stock positions. The UK position is rather different in that its net asset position is so large that a substantial surplus is earned on IPD (some £5.5 billion in 1987), although the overall current account is in deficit.

Capital flows

It is useful to consider capital account flows in terms of broadly autonomous, 'structural' flows (eg direct and non-bank portfolio—excluding securities dealers) based upon longer-term investment decisions, and 'short-term' flows. Flows of the former category are, by and large, independent of the current account, at least in the short run, and may therefore either exacerbate or alleviate the requirement for net financing flows. These distinctions are by no means clear cut and can only be approximated using available data. For example, 'short-term' flows include such items as syndicated credits and time deposits, which do not accord with the general perception of short-term flows.

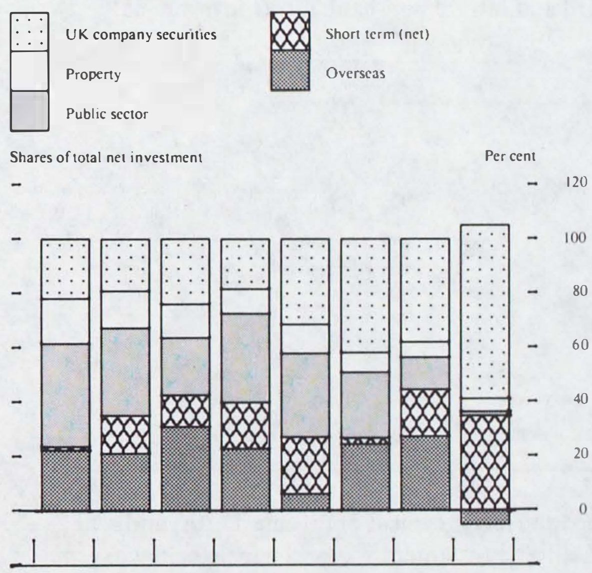
For the United Kingdom, over most of the 1980s autonomous structural capital account outflows coincided with current account surpluses, thus producing comparatively small net structural imbalances to be met through short-term flows. Meanwhile, the structural net asset position grew strongly, so that at the end of 1987 it was worth the equivalent of virtually all of the total identified net external asset position.

However, in 1987 there was a shift in the composition of capital flows compared with earlier years. The small current account deficit was met by heavy capital inflows into both 'structural' and 'short-term' sterling instruments. *Ex post* this surplus was financed, at a rising exchange rate and with downward pressure on interest rates, largely by the unprecedented rise in the reserves.

The stock of reserves doubled in dollar terms to stand at $51 billion at the end of the year, which represented 25% of gross exports of goods and services, or 6¼% of annual gross national product.

Although the underlying level of capital inflows was undoubtedly strong in 1987, much of the recorded net structural inflows reflected the unusual circumstances of the fourth quarter. Throughout the 1980s, the main investing institutions had steadily increased the proportion of their stock portfolios devoted to overseas investments (principally equities) with flows reaching a peak of almost £7 billion in 1986. During the fourth quarter of 1987, when equity prices fell worldwide, the institutions sold large volumes of their overseas equity portfolios (£5.6 billion, some 7% of the stock), building up their holdings of UK equities, as well as their net liquid balances, with the proceeds (Chart 3). It is not entirely clear why the institutions repatriated so much of their overseas equity holdings (in the event, prices in most overseas markets did not fall by as much as those in the United Kingdom), but they may have been motivated by a belief that, with P/E ratios so high, the Japanese market would fall furthest, and that the US market was also risky because of both the falling dollar and fears about a possible recession in the United States.

Chart 3
Composition of main OFI(a) flows



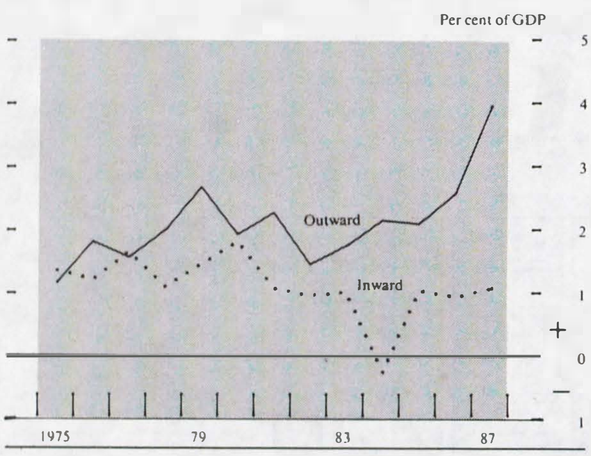
(a) Pension funds, insurance companies, investment and unit trusts.

Early indications for 1988 are that the institutions have been slow to return to overseas equity markets, despite a general worldwide consensus that the falls in share prices have not led to a significant slowdown in world growth. There may be a number of reasons for this reluctance to reinvest abroad, such as a desire to rebalance equity portfolios after the domestic market fell further than the foreign markets. Also the assumed benefits of risk-spreading by investing in a range of stock markets may seem less compelling after the worldwide falls in prices last October, and the unit trusts, who traditionally invest most heavily abroad (in proportionate terms), appear to have suffered the sharpest reduction in net inflows since the crash, and thus far show only limited signs of recovery.

In the aftermath of the falls in equity prices, good quality bonds were in strong demand and the securities dealers, taking advantage of the falling interest rates, sold over £3 billion of their own-account stock to overseas residents. The activities of the securities dealers made the greatest single contribution to the turnaround in net portfolio flows in 1987 compared with 1986. In 1986, influenced perhaps by Big Bang but also by the effects of the crisis in the floating-rate note market at the end of the year, these dealers acquired (net) some £7.7 billion of foreign bonds; this net increase was almost fully unwound in 1987, half in the fourth quarter alone. In the first half of 1988, however, these institutions were once again heavy net purchasers of foreign bonds.

Nominal direct investment flows reached record levels in both directions during the past two years, with outward direct investment in 1987 being more than double the 1985 flow and inward direct investment 40% up over the same period. However, when expressed as a percentage of GDP this growth does not appear quite so striking (Chart 4); real outward direct investment only recently

Chart 4
Outward and inward non-bank direct investment



exceeded the levels typical of the late 1970s, and real inward direct investment was still a little below its level of ten years ago in 1987. Undoubtedly, one factor behind the lull in direct investment flows in the early 1980s was the global recession and the associated financial squeeze on companies. However, since then the major economies have recovered strongly and it is perhaps only to be expected that outward direct investment, especially into the United States, has been so buoyant, given the level of UK company profitability in recent years combined with the strength of sterling against the dollar from the end of 1985 onwards relative to the previous two years or so. A higher sterling exchange rate against, say, the dollar would tend to encourage the volume of direct investment overseas in the first instance, at least, by reducing the sterling cost of acquiring dollar capital assets.

Outward direct investment continued to be strong during the first half of 1988, reflecting, in part, unremitted profits earned from the large stock and also acquisition of firms overseas, which, after a weak first quarter, once again recovered in the second quarter to levels typical of the period just before the equity shock. The most recent activities, in both directions, may be beginning to show some early reactions to the European Community's 1992 proposals for a single internal market, with several large takeover and merger transactions taking place.

Earnings related to the external position

Despite the sharp rise in the exchange rate, the United Kingdom's identified net investment income continued to grow in sterling terms in 1987—amounting to some £5.5 billion, compared with £5.1 billion in the previous year and £2.8 billion in 1985. The surplus on interest, profits and dividends (IPD) can be analysed in terms of two stylised components: banks' earnings from the spread they charge on loans to non-residents funded by borrowing from non-residents, which can be regarded as receipts from banking intermediation between non-residents; and the balance of IPD earned or paid on the remainder of assets or liabilities respectively.

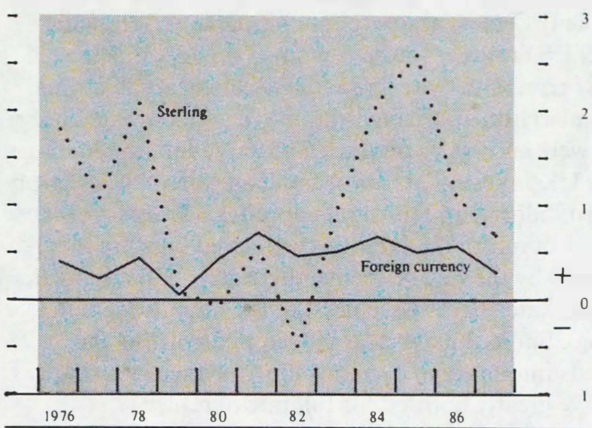
The banks' net interest income fell sharply in 1987, turning negative for the first time since the early 1980s (Table G). Since the banks have net foreign currency liabilities to the overseas sector, the appreciation of sterling will have tended to increase net foreign currency interest income through a reduction in their interest payments, in sterling terms, on those net foreign currency liabilities. However, this effect was outweighed by further sharp reductions in estimated margins between lending and borrowing rates, causing a reduction in spread earnings on foreign currency business of £1 billion to £1.3 billion (see Chart 5). While a steady narrowing of foreign currency margins has been apparent through most of the 1980s, the fall was particularly sharp in 1987, and may have been affected by moratoria on interest payments by certain developing country debtors, and by rescheduling at revised interest rates. There are some indications of a partial recovery of margins in the early part of 1988. Margins on sterling business (which comprises 10% of total business with the overseas sector) also fell sharply in 1987, but rapid volume growth limited

Table G
UK banks'(a) estimated spread earnings in 1987
£ billions, *percentages in italics*

	Foreign currency	Sterling	Total
Net interest income(b)	0.6	−0.9	−0.3
less			
Estimated cost of net liabilities	−0.7	−1.2	−1.8
Cost of funds(c)	*6.2*	*9.3*	*6.5*
equals			
Implicit spread earnings	**1.3**	**0.2**	**1.5**
Implied margin	*0.3*	*0.7*	*0.3*

(a) UK monetary sector plus certain other financial institutions.
(b) Including income from holdings of foreign bonds and export credit.
(c) Equals calculated average cost of all liabilities.

Chart 5
Calculated margins on UK banks' international lending



the reduction in spread earnings. However, the payments on net sterling liabilities also rose, despite a fall in UK interest rates, as the overseas sector continued to build up net sterling deposits rapidly.

Table H brings together the full picture of the banks' external earnings by including also their net earnings from, and payments to, overseas parents and affiliates, and their fee income, which enters the services account and has become increasingly important in recent years as securitisation has replaced some more traditional forms of

Table H
UK banks'(a) income from external transactions
£ billions

	Annual averages			
	1976–80	1981–85	1986	1987
Net IPD earnings: (b)				
Foreign currency	−0.1	0.9	1.6	0.6
Sterling	−0.1	−0.4	−0.8	−0.9
Sub-total	−0.2	0.4	0.9	−0.3
Direct investment earnings	—	−0.3	−0.1	0.2
Fee income	0.4	0.8	1.2	1.3
Total net income	**0.1**	**0.9**	**1.9**	**1.2**

(a) UK monetary sector plus certain other financial institutions.
(b) Including income from holdings of foreign bonds and export credit; excluding direct investment earnings.

bank intermediation. Both these latter items registered a surplus in 1987, so that the banks' overall contribution to the current account was some £1.2 billion, well down on 1986 but appreciably above the levels of the early 1980s.

Despite the rise in the exchange rate, the IPD balance, excluding spread earnings, registered a considerably greater surplus in 1987 than in 1986. Both receipts and payments rose fairly strongly, the former more than the latter (Table J). Within the aggregate figures the most notable changes were the rise in outward direct investment earnings (40% up on the previous year) and the rise in portfolio debits (35% up on 1986). Both of these increases were far in excess of the (rapid) volume growth in stocks during 1987, and probably reflect growth in stocks during previous years. On longer-term investments

Table J
Interest, profits and dividends
£ billions

	1986	1987
UK banks' spread earnings on external lending	2.7	1.5
Earnings on assets(a)	13.3	16.4
Payments (−) on liabilities(a)	−10.9	−12.4
IPD balance	5.1	5.5
Balance excluding spread earnings	2.4	4.0

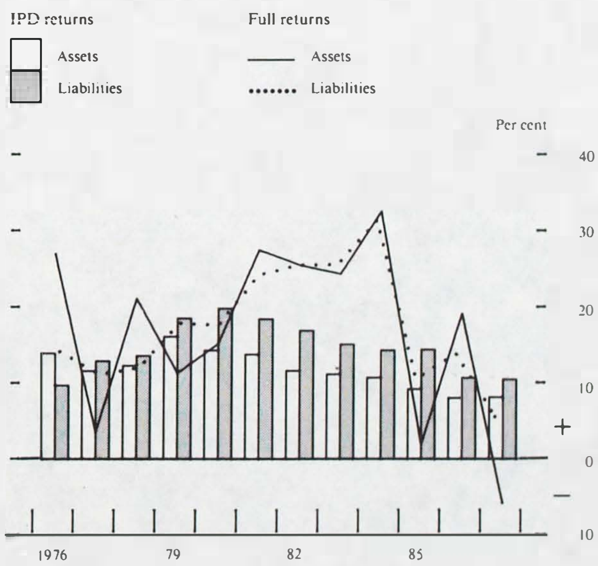
(a) Figures for UK banks, other than their spread earnings, are entered on a net basis only, as payments on their net liabilities.

such as direct and some portfolio investments the IPD returns may be payable with a considerable time lag. In contrast to returns on banking flows, which, because of the very short-term maturity of most international banking business, are payable on a near contemporaneous basis, the IPD returns associated with direct and portfolio investments, eg dividend/coupon payments, or future profits, are payable, or accrue, over a longer time horizon.

There was a step increase in the outward direct investment quarterly flows in the third quarter of 1986: the quarterly average flow between the third quarter of 1986 and the second quarter of 1987 was some £4 billion compared with some £1.5 billion in the previous four quarters. A time-lag between investments and income flows of around half a year would produce a pattern consistent with that shown in the recent recorded statistics.

The growth of overseas investment in UK portfolio instruments has been even more marked, beginning with a striking acceleration in 1985 of flows into both British government securities and UK company bonds, including those of banks and building societies: the recorded increase in overseas portfolio investment flows into the United Kingdom in 1985 compared with 1984 was over 400%. This higher rate has been more than maintained

Chart 6
Estimated IPD and full rates of return on identified assets and liabilities



since, with 1987 flows more than 50% up on 1985 with a compositional shift within UK company securities towards equities. The earlier surges in investment flows have fed through to income flows so that by the end of 1987 both IPD portfolio debits and the portfolio liability stock were a little over double the 1984 figures. Dividends payable to overseas residents will also reflect dividend payments generally, which have been boosted by the strength of UK corporate profitability and also, indirectly, by the reduction, resulting from the 1984 changes in corporate tax legislation, in the number of tax-exhausted companies that are inhibited from paying dividends because of advanced corporation tax liabilities.

Measured IPD earnings reflect only part of the returns related to the external position because they exclude changes in capital value. Capital gains or losses are, to the investor, equally a part of his total return (indeed, for the speculator, expected capital gains are the prime source of expected return). Full rates of return attempt to allow for these asset price changes and are shown in Chart 6 along with the IPD rates of return for comparison. While the overall IPD rates of return remained broadly unchanged in 1987 compared with 1986, the effects of revaluations (particularly those arising from movements in exchange rates) were such as to produce a negative full rate of return on the UK investments abroad and a positive, but sharply reduced, full rate of return on liabilities. However, because the rates of return on liabilities estimated here are the rates paid by the UK residents, there is a relatively weak exchange rate effect (since most of the liabilities are in sterling), but to the overseas investor converting the proceeds into his own currency the exchange rate changes will have greatly boosted his full rate of return.

Table K
UK external assets and liabilities[a]

£ millions

End-years	1982	1983	1984	1985	1986	1987
External assets						
Private sector						
UK banks' assets						
Overseas investment:						
Direct	1,676	1,277	751	2,331	5,050	5,016
Portfolio	6,701	10,572	22,265	28,124	34,422	28,867
External claims:						
Sterling	14,031	16,474	20,863	23,041	28,972	34,603
Foreign currencies	264,216	307,536	385,185	346,715	409,350	390,809
Non-bank assets						
Private investment abroad:						
Direct	50,132	56,372	78,147	71,902	82,800	86,350
Portfolio	33,591	49,047	61,214	73,259	111,071	88,967
Deposits held abroad plus advance progress payments on imports by UK business	20,158	16,989	24,947	22,887	26,570	27,000
Other lending and short-term assets	4,820	7,554	9,887	8,634	6,547	5,291
Foreign notes and coin held by UK residents	55	68	80	84	101	118
Total private sector	**395,380**	**465,889**	**603,339**	**576,977**	**704,883**	**667,021**
Public sector						
Public corporations' assets						
Overseas investments:						
Direct	231	174	184	151	158	60
Other long-term assets	435	474	563	615	660	666
Other short-term assets and credit on imports	201	299	487	61	108	2
Total identified external assets of public corporations	867	947	1,234	827	926	728
General government						
Inter-government loans by the United Kingdom	1,226	1,214	1,149	1,097	1,028	944
Subscriptions to international financial organisations (other than IMF)	2,002	2,266	2,473	2,682	2,909	3,119
Other long-term assets	71	70	70	70	70	70
Export credit and bills	2,977	3,199	4,356	4,580	4,935	4,528
Total general government lending	6,276	6,749	8,048	8,429	8,942	8,661
Official reserves	12,939	12,805	13,219	13,201	17,424	27,008
Total external assets of general government	19,215	19,554	21,267	21,630	26,366	35,669
Total public sector	**20,082**	**20,501**	**22,501**	**22,457**	**27,292**	**36,397**
Total identified assets	**415,462**	**486,390**	**625,840**	**599,434**	**732,175**	**703,418**
External liabilities						
Private sector						
Overseas investment in the UK private sector:						
Direct	32,301	37,232	40,092	43,521	48,177	53,444
Portfolio	7,246	9,728	13,359	18,973	27,707	33,368
Total identified overseas investment in the private sector	39,547	46,960	53,451	62,494	75,884	86,812
UK banks' deposit liabilities in:						
Sterling	18,859	23,357	29,647	33,909	39,491	47,906
Foreign currencies	279,510	327,338	423,956	382,088	453,924	426,290
Advance and progress payments on exports	2,867	81	82	71	101	135
Direct borrowing abroad by UK non-banks, plus suppliers' trade credits on imports	14,703	14,719	16,585	16,871	21,296	20,862
Other (mainly short-term) liabilities	1,564	2,451	3,450	3,489	4,404	5,145
Total identified banking and other commercial liabilities	317,503	367,946	473,720	436,428	519,216	500,338
Total identified external liabilities of the private sector	**357,050**	**414,906**	**527,171**	**498,922**	**595,100**	**587,150**
Public sector						
Public corporations' liabilities						
Overseas borrowing by public corporations:						
Under the exchange cover scheme	2,432	2,640	3,013	2,725	2,917	2,408
Other	802	815	812	553	492	273
Overseas holdings of public corporations' securities	963	1,077	942	712	706	411
Total liabilities of public corporations	4,197	4,532	4,767	3,990	4,115	3,092
Liabilities of general government						
Net drawings on the IMF	35	—	—	—	—	—
Inter-government loans to the United Kingdom	1,846	1,957	2,323	1,758	1,631	1,226
Overseas borrowing by local authorities:						
Under the exchange cover scheme	262	360	481	530	708	751
Other	88	67	67	55	52	39
Short-term liabilities	859	382	273	281	484	598
British government stocks held by:						
Central monetary institutions	3,028	3,138	3,173	4,690	5,199	6,447
Other overseas residents	4,162	4,748	5,531	6,786	8,433	10,927
British government foreign currency bonds	491	547	272	562	1,689	815
Overseas holdings of local authority securities	223	210	200	200	210	200
Overseas holdings of Treasury bills and non-interest-bearing notes	1,186	1,206	1,330	1,345	1,304	2,681
Total general government	12,180	12,615	13,650	16,207	19,710	23,684
Total external liabilities of the public sector	**16,377**	**17,147**	**18,417**	**20,197**	**23,825**	**26,776**
Total identified external liabilities	**373,427**	**432,053**	**545,588**	**519,119**	**618,925**	**613,926**

(a) Notes and definitions on the series which comprise UK external assets and liabilities can be found in *United Kingdom Balance of Payments, 1988 Edition* (the Pink Book) published by the Central Statistical Office.