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Sterling: the most stable of all the major currencies

Sterling's alleged "volatility" is often invoked as a reason for the UK to replace sterling by a currency which is assumed - wrongly - to be less volatile, the Euro.1

Stable Sterling, Volatile DM and Yen

The US dollar, as the dominant world currency,2 is the volatility benchmark against which movements of currencies can be measured.

Sterling has been the least volatile of the major currencies over the past six years when measured against the dollar. This can be seen clearly if the percentage divergencies of sterling, Deutschmark (DM) and Yen against the dollar are charted from the end of 1992, following sterling's departure from the ERM. Under both Conservative and Labour Governments, sterling has moved in a much narrower band than other currencies. This steadiness has continued during the first four months of 1999.

Since its launch it is the Euro which has progressively weakened and shown the greater divergency and it is sterling which has held its value within quite narrow limits.

The general trend of stability between sterling and the dollar is shown clearly in the two graphs overleaf, the first covering the six-and-a-third year period from 1st January 1993 to 30th April 1999 and the second covering the four-month period from 4th January 1999 to 30th April 1999.

In the period since 1st January 1993, both the DM (the Euro's core constituent) and the Yen have fluctuated widely against the dollar, with the Yen moving in total over 68 per cent in value and the DM moving in a band of over 33 per cent. During the same

The USA is by far the UK's biggest single export market, (absorbing 17 per cent of the UK's visible and invisible exports, as much as Germany and France combined).3

The USA is the biggest overseas investor in the UK (accounting for 63 per cent of all Foreign Direct Investment [FDI] earnings in the UK, compared with 17 per cent for the whole of the EU).4

The UK is the biggest overseas investor in the US, which provides 34 per cent of worldwide UK FDI earnings (compared with 18 per cent from the EU).5

The biggest single contributor to UK export earnings,6 which transacts the bulk of its business in dollars, is the City of London, the world's premier financial centre.

Most of the UK's high-tech exports, such as aerospace, wholesale pharmaceuticals and microchips, are denominated in dollars, as are UK exports of commodities such as oil and gas. This is important not just for UK exports of these items to the US, but also to the rest of the world, including, of course, the EU.7

All of the above involve sterling/dollar transactions through the foreign exchange markets and contribute to the relative stability of the sterling/dollar relationship.

Conclusion

As the interdependence of the British and US economies deepens,8 the involvement of the British economy with Continental EU weakens.9 This suggests that the period, the value of sterling has remained relatively stable and has fluctuated within a 19 per cent band.

The graph covering the period since the introduction of the Euro shows that while the Euro has fallen by over 10 per cent in value, and the value of the Yen has fluctuated by a total of 11 per cent, sterling has remained remarkably constant and has moved by at most 4.3 per cent against the dollar.

Why Sterling is Stable

It is the sterling/dollar rate which matters most to the British economy. And it is the close and myriad linkage between the US and UK economies that helps explain the relative steadiness of the sterling/dollar exchange rate: -

sterling/dollar relationship will continue to be stable and important, and that the sterling/Euro relationship will continue to be more volatile.

Calls for stability of the British currency ignore the fact that it already exists: in the core sterling/dollar relationship.

Sources:

1. The widespread assumption that exchange rate stability favours growth in trade and investment has, in fact, never been proven. Outside the EU, in the last decade, world trade, and, especially, foreign direct investment, have increased rapidly in a world regime of predominantly floating exchange rates.
2. The dollar is used in some 56 per cent of commercial transactions and 80 per cent of currency exchange transactions worldwide, as stated by European Commissioner de Silguy in the European Commission's newsletter *Infeuro* in December 1998.
3. Table VIII, page 5 of the Global Britain paper: *UK Trade in 1997*, March 1999.
4. Table I, page 14 of the *eurofacts* Occasional Paper no 5, *The Facts about Foreign Direct Investment*, November 1998.
5. Table II, Idem.
6. Table III, page 1 of the Global Britain paper *UK Trade in 1997*, March 1999.
7. BMDF Paper, 3rd February 1999.
8. Page 1 of *eurofacts*, 22nd January 1999, based on *Economic Trends*, ONS, December 1998.
9. Page 1 of *eurofacts*, 8th January 1999, based on Economic Trends, ONS, December 1998.

This Briefing Note was prepared for Global Britain by British Management Data Foundation (BMDF). Anthony Cowgill, MBE