

Global Britain Briefing Note

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Exposure of the UK Economy to the Dollar & Euro

“Japan’s trade with Europe is done principally in Dollars...the Euro is not an international currency...there is no significant direct foreign exchange market between the Euro and the Yen...”

Toyoo Gyhoten, Chairman of the (Japanese) Institute for International Monetary Affairs, former Chairman of the Tokyo-Mitsubishi Bank, interview in Le Figaro économie, 4th April 2002

By Ian Milne

- For British exporters, **the US Dollar is the most important foreign currency**
- In terms of its economic impact on the internationally-traded part of the UK economy, the Dollar may be more important than Sterling
- As a **currency of invoicing**, **Dollar usage by British exporters is at least 1.6 times Euro usage**
- Sterling usage by British exporters is not much higher than Dollar usage: about one-and-a-quarter times
- As a **currency of invoicing**, and in terms of its economic impact, **the Euro accounts for about a fifth of British exports worldwide**
- **Overall Dollar exposure is likely to be even HIGHER.** In addition to exports invoiced in Dollars, the main determinant of many exports invoiced in other currencies is the Dollar. Most commodities - oil for example - are quoted, priced and traded worldwide in Dollars, as are many high-value-added products such as aerospace equipment and IT services.
- **Overall Euro exposure is NOT likely to be higher**, since the Euro is overwhelmingly, for the UK & Japan, and probably for other non-Continental countries as well, a regional (EU) currency. It is rarely, if ever, used as the reference currency for pricing world-traded products and services.

UK Exporters' Usage of the Dollar & Euro as a Currency of Invoicing

Estimate based on an analysis of all UK Credits on Current Account (all exports) in 2000

Values expressed in £ bn

Export Category	Total Recorded Value(<i>Pink Book</i> ²)	Estimate in Dollars	Estimate in Euros	Estimate in Sterling/Other
A. Goods	188	56	41	91
B. Income	134	57	30	47
C. Services	78	26	12	40
D. Transfers	13	3	8	2
Totals	413	142	91	180*
Percentages	100	34	22	44

* The overwhelming bulk of this is denominated in Sterling

Note that the relative weightings of all exports by foreign currencies in the table above: Dollars 34%, Euros 22%: bears no relation whatsoever to their weightings in the “ERI” - the Effective Exchange Rate Index or “Trade-Weighted Sterling Index”. Please refer to Note 4 overleaf.

References to the Table on the Preceding Page

A. Goods

UK Exports of Goods: Currency of Invoicing: Percentages by Value

Currency	To Whole World	To EU "14"	To World excl. EU
Sterling	46	45	51
US Dollar	29	18	42
Euro	22	33	4
Others	<u>3</u>	<u>4</u>	<u>3</u>
	<u>100</u>	<u>100</u>	<u>100</u>

Source: HM Customs & Excise/ONS/20th Nov 2001

Total UK Goods Exports in 2000:		£188 bn
Invoiced in Dollars:	29% x 188 =	£56 bn
Invoiced in Euros:	22% x 188 =	£41 bn

B. Income (UK receipts of income or "exports")

Total income in 2000: (Pink Book)

From Banking:	£56 bn	
From Portfolio Inv.	£32 bn	
From UK FDI* Overseas	£44 bn	(* Foreign Direct Investment)
From other	£2 bn	

From Banking:

B1: Banks Operating in the UK: External Deposits and Loans

Deposits ("Liabilities") Outstanding @ 31st Dec 2001:

Total:	£2332 bn	(100%)
Of which US Dollar:	£1063 bn	(46%)
Euro:	£535 bn	(23%)

Loans ("Claims") Outstanding @ 31st Dec 2001:

Total:	£2168 bn	(100%)
Of which US Dollar:	£960 bn	(44%)
Euro:	£681 bn	(31%)

Deposits & Loans together:

Total:	£4500 bn	(100%)
Of which US Dollar:	£2023 bn	(45%)
Euro:	£1216 bn	(27%)

The Dollar/Euro percentages above may be taken as **Proxies** for the likely relative importance of Dollars and Euros in the earnings arising from the commercial banking activities covered by this data.

Source: Bank of England, Table D, External Business of Banks Operating in the UK, Quarterly Release, April 2002, available at www.bankofengland.co.uk

Estimated Banking Income in Dollars: 45% x 56 = £25 bn
Estimated Banking Income in Euros: 27% x 56 = £15 bn

Other activities, some of whose earnings the ONS includes in the Banking Income category (and others in Exports of Services):

B2: Foreign Exchange ("FX") Trading in the UK

Percentage share in which the currencies indicated formed one side of the currency pair of which each transaction consists, 2001:

US Dollar:	46%
Euro:	19%
Ratio Dollar/Euro:	2.4 : 1

The Dollar/Euro ratio above may be taken as a **Proxy** for the likely relative importance of Dollars and Euros in earnings arising from FX trading.

Source: IFS: International Financial Markets in the UK, May 2002/Charts and Tables, available at <http://www.bi.org.uk/>

From Portfolio Investment:

B3: Sources of Assets in 1999 of British-based Financial Institutions

\$ bn	Pensions	Insurance	Mutual Funds	Total	%
US	7765	3168	6843	17776	50
"Euro-zone"*	758	2018	1464	4240	12
Others	<u>4455</u>	<u>6314</u>	<u>2766</u>	<u>13535</u>	<u>38</u>
Totals	12978	11500	11073	35551	100

* France + Germany + Netherlands + Italy + Eire (78% of Euro-zone GDP)

The US and Euro-zone percentages above may be taken as **Proxies** for the likely relative importance of the Dollar and Euro in earnings arising from the activities concerned.

Source: IFS: *ibid*: OECD, CCF Charterhouse; ICI; FEFSI; InterSec

Estimated portfolio income in US Dollars: 50% x 32 = £16 bn
Estimated portfolio income in Euros: 12% x 32 = £4 bn

From UK Foreign Direct Investment Overseas:

B4: Outward FDI from the UK:

Earnings flowing inward into the UK

Based on ten-year aggregates 1991-2000 inclusive, adjusted for the Netherlands Distortion, the relative amounts of dollar and euro earnings generated from UK Outward and Inward Investment are as follows:

Outward Investment by UK Investors Overseas

Proportion of worldwide earnings arising from the USA: 33%
Proportion of worldwide earnings arising from EU "14": 22%

Source: Recorded data from Business Monitor MA4: Foreign Direct Investment 2000, February 2002, ONS; adjusted for the Netherlands Distortion in Global Britain Briefing Note No 20, Foreign Direct Investment: The Netherlands Distortion, 31st July 2002.

Estimated income from UK FDI overseas in US Dollars: 33% x 44 = £15 bn
Estimated income from UK FDI overseas in Euros: 22% x 44 = £10 bn

TOTAL INCOME IN 2000

£bn:	In Dollars	In Euros
From Banking	25	15
From Portfolio investment	16	4
From FDI Overseas	15	10
From Other	<u>1</u>	<u>1</u>
Totals	<u>57</u>	<u>30</u>

C: Services

UK Exports of Services in 2000 (Pink Book):

To EU "14":	£31 bn	40%
To Rest of World:	£47 bn	60%
To Whole World:	£ 78 bn	100%

For UK Trade in Goods, HM Customs & Excise/ONS carries out surveys on Currency of Invoicing (see above, Note A); but not (yet) for UK Trade in Services.

It is assumed in this paper that for UK Exports of Services the proportionate Currency of Invoicing split between Dollar and Euro is the same as for Exports of Goods. This is because:

- The distinction between "goods" and "services" is somewhat artificial. For example: should services such as software and IT support, that enable goods such as machine tools or jet engines to work, be classified as "goods" or "services"? Should earnings from providing after-sales service and maintenance for machine tools or jet engines be thought of economically as "goods" or "services"?
- Many support services: for example, shipping, air-freighting, insurance, telecommunications, royalties, licence fees, legal & accountancy services, management and engineering consultancy; are associated with British exports of goods (and capital investment).

Thus, assumed Currency of Invoicing for UK Exports of Services (see Note A) is:-

Percentages	To EU "14"	To World Excluding EU "14"
Sterling	45%	51%
Dollar	18%	42%
Euro	33%	4%

UK Services Exports to EU "14" in 2000: £ 31 bn

Invoiced in US Dollars: 18% x 31 = £ 6 bn
Invoiced in Euros: 33% x 31 = £ 10 bn

UK Services Exports to World Excluding EU "14" in 2000: £ 47 bn

Invoiced in US Dollars: 42% x 47 = £ 20 bn
Invoiced in Euros: 4% x 47 = £ 2 bn

Total UK Services Exports Worldwide in 2000:

Invoiced in US Dollars: £ 26 bn
Invoiced in Euros: £ 12 bn

D: Transfers

Total Receipts of Transfers in 2000 (Pink Book):

From EU "14": £ 8 bn
From World excl. EU £ 6 bn

Estimated receipts of Transfers in US Dollars: assume 50% x 6 = £ 3 bn
Estimated receipts of Transfers in Euros: assume 100% x 8 = £ 8 bn

Notes

- 1 Sterling Volatility and European Monetary Union by Christopher Taylor, Discussion Paper 197, May 2002, NIESR, addresses many of the issues and arguments of this Briefing Note.
- 2 There are many other sets of data, available on the websites of - amongst others - the Bank of England, the ONS, and the IFS (the former "British Invisibles") which overlap one or more of the Pink Book sub-categories used above, and which tend to support the overall conclusions of this paper.
- 3 References to "the Pink Book" mean "United Kingdom Balance of Payments 2001 Edition: The Pink Book" ISSN 0950-7558/Office for National Statistics ("ONS"); Autumn 2001
- 4 The ERI is incapable of serving as a guide to the real foreign currency exposure of the UK economy. In the ERI, the "weight" of the Euro is grossly overexaggerated, at 65%, and that of the Dollar grossly understated, at 17%. The ERI purports to cover only Trade in Goods (well under half all UK exports); it uses data over ten years old, from 1989 to 1991; it uses geographical breakdowns of trade and takes no account of actual currency usage; it excludes large areas of the world in which UK trade is significant; and it incorporates unreliable data on relative "competitiveness" of foreign countries' manufacturing sectors (which normally account for only a fifth of those countries' overall GDP). Further details at the Bank of England website below.

Websites- NIESR: www.niesr.ac.uk/pubs/dps/dp197.pdf Bank of England: www.bankofengland.co.uk; ONS: www.statistics.gov.uk; International Financial Services: www.bi.org.uk/ or www.ifsl.org.uk

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