

# Explanation beyond exchange rates: trends in UK trade since 2007

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## Abstract

The UK's trade performance since the onset of the economic downturn has been one of the more curious developments in the UK economy. While the sterling effective exchange rate declined by more than 25% between Q3 2007 and Q1 2009, the balance of trade in goods and services remained broadly unchanged both during and following the depreciation. This article sets out several possible explanations for the UK's recent trade performance, including the roles of global supply chains, the importance of financial services exports, commodity and relative price movements and the extent of overseas demand. Although evaluating the relative importance and impact of these factors is beyond the scope of this article, it provides insights into the domestic and global conditions faced by the UK during and following the depreciation.

## Key Points

The UK's trade performance since the onset of the economic downturn has been one of the more curious developments in the UK economy. While the sterling effective exchange rate declined by more than 25% between Q3 2007 and Q1 2009, the balance of trade in goods and services remained broadly unchanged both during and following the depreciation.

This article sets out several possible explanations for the UK's recent trade performance. Although evaluating the relative importance and impact of these factors is beyond the scope of this article, it provides insights into the domestic and global conditions faced by the UK during and following the depreciation.

The findings of this article suggest that while the depreciation appears to have had little impact on the overall balance of trade, there is evidence of an increase in the balance of trade in goods during 2009. By contrast, exports of services show little evidence of the depreciation of sterling.

The relatively large fraction of UK exports accounted for by financial services meant that the UK's balance of trade was more exposed to the financial market shocks in 2007 than other economies in the G7.

The price of commodities and the UK's integrated position in global supply chains also may partially explain the UK's trade performance. The UK's increasing reliance on overseas supplies of oil limited the response of the trade balance to the change in the value of sterling.

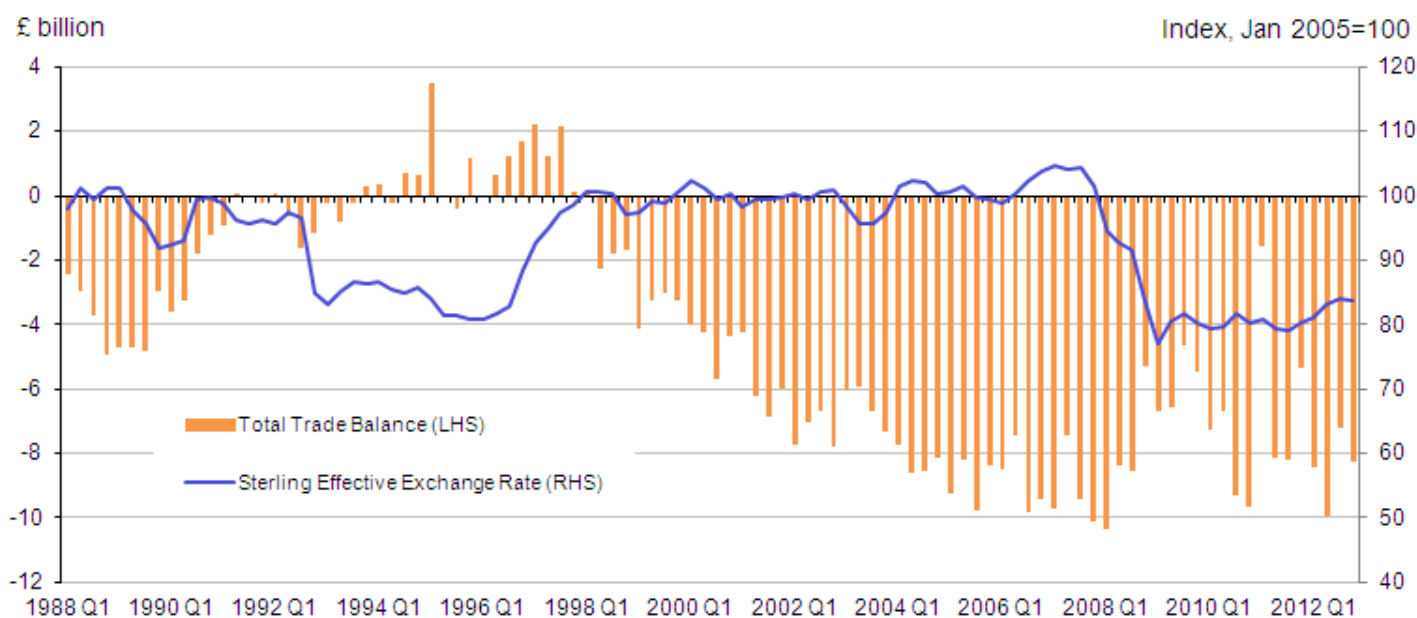
Overseas demand also appears to have played a role. Each of the UK's major trading partners suffered a contraction of output during 2008 and 2009, limiting demand for exports from the UK. Since 2011, UK exports have grown at a broadly comparable pace to demand amongst its key trading partners.

## Introduction

The UK's trade performance since the onset of the economic downturn in 2008 has been one of the more curious developments in the UK economy. Despite a substantial depreciation in the value of sterling, which in theory should have enhanced the UK's competitiveness, the performance of UK trade has been relatively modest.

Between Q3 2007 and Q1 2009, the sterling effective exchange rate – which captures the change in the value of sterling relative to the currencies of UK's trading partners – declined by more than 25%. However, the balance of trade on goods and services (see note 1) – the value of a country's exports less the value of its imports – was broadly unchanged both during and following the depreciation (Figure 1).

**Figure 1: Sterling effective exchange rate and balance of UK trade**



### Notes:

1. Source: ONS, Bank of England

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Economic theory suggests that a country's trade balance should increase following a depreciation of its currency. Goods produced abroad become more expensive compared with domestic alternatives, while the price of domestic goods falls relative to the price of goods produced abroad. Consequently, imports are expected to fall and exports are expected to rise, leading to an increase in the home country's balance of trade. This broad pattern is evident with a lag following sterling's exit from the European Exchange Rate Mechanism (ERM) in 1992, after which the UK's trade balance returned to surplus for much of the period between 1993 and 1998. However, the absence of a clear response of the UK's balance of trade to the depreciation of sterling during 2007 and 2008 suggests that something more complex has occurred.

This article presents several possible explanations for the UK's trade performance. Firstly, this article briefly considers the economic theory which links a currency depreciation with the balance of trade. Secondly, it sets out recent trends in the UK's trade data, highlighting developments since the depreciation of sterling. The remaining sections give alternative explanations for these developments, including the roles of:

- Import intensity and global supply chains;
- The financial sector and financial services exports;
- Commodity prices;
- The relative price movements of imports and exports; and
- Overseas demand.

## Notes

1. Throughout this article, we will refer to the 'trade balance' in preference to either the 'trade deficit' or the 'trade surplus'. An increase in the trade balance refers to a situation where the trade deficit is reduced or the trade surplus increases. Correspondingly, a reduction in the trade balance refers to situations where the trade deficit increases, or the trade surplus is reduced.

## Economic Theory

Economic theory suggests that a depreciation of a home country's currency increases the cost of foreign goods for domestic firms and consumers by reducing the purchasing power of the domestic currency. As it takes more domestic currency to purchase each good produced overseas, the volume of imports is expected to fall.

A currency depreciation has the opposite effect on exports. A domestic depreciation reduces the cost of domestic goods for overseas firms and consumers. As it takes fewer foreign currency units to purchase each domestically produced good, the volume of exports is expected to rise. Taking these two effects together, economic theory predicts that the domestic balance of trade should increase following a depreciation (see note 1).

However, there are a number of factors that may delay the impact of a depreciation. Firstly, while a depreciation leads to an instant change in the price of exported and imported goods, the reaction

of firms may be less rapid. Firms that have agreed to pay a fixed price for imports or exports will have to wait before they can renegotiate the terms of those contracts. Secondly, multinationals may choose to preserve their supply chains and pay a higher price for their imported goods in the short run, rather than undertake costly relocations of production. Equally, firms may choose to not pass through the full costs of the changed exchange rate in the short run to preserve market share.

These effects suggest that the full impact of a currency depreciation may be complex and subject to a lag. In the short run, the value of imports (including both the volume and the price effect) may rise, decreasing the trade balance. Over the medium to long run, firm behaviour changes, relative price effects work through and the trade balance increases. This is referred to as the J-curve effect.

## Notes

1. More formally, the impact of a depreciation on the trade balance is governed by the Marshall-Lerner condition. This states that following a currency depreciation an economy's balance of trade will increase when the sum of the absolute values of the price elasticities of demand for imports and exports are greater than one. Many of the factors which delay the impact of a depreciation on the trade balance – and so create a J-curve effect – concern the price elasticities of imports and exports.

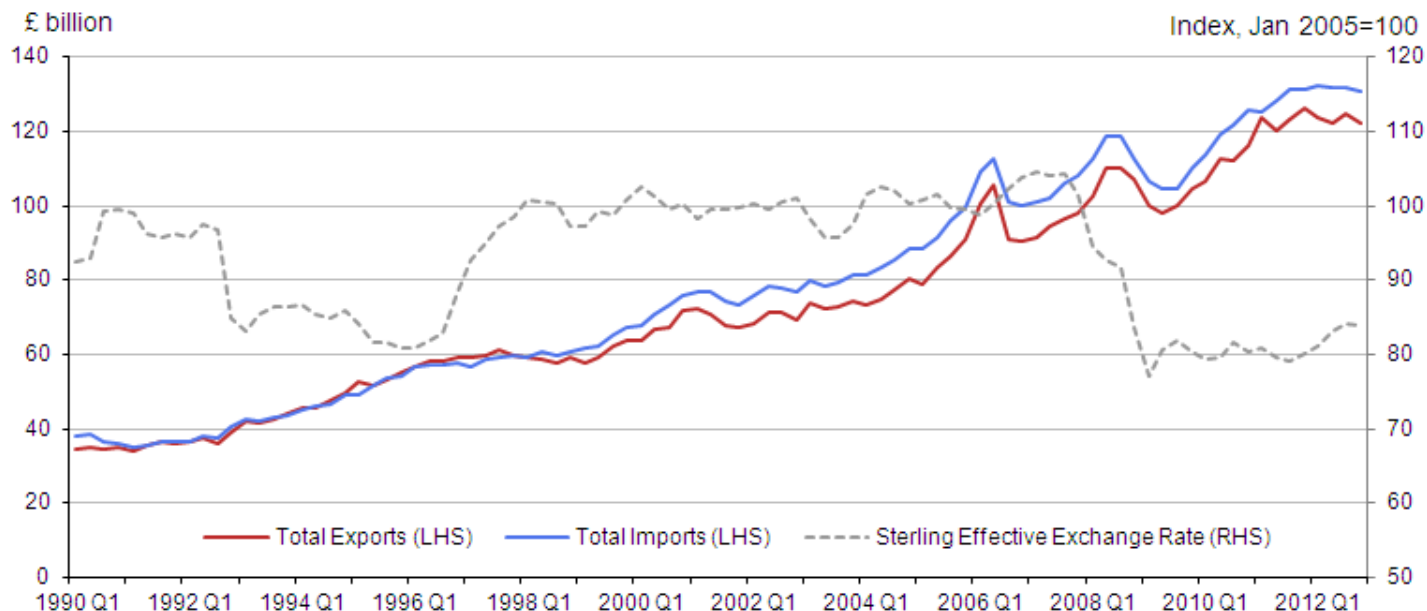
## UK Trade

The UK's trade performance has changed substantially during the past twenty years. Following the UK's exit from the European Exchange Rate Mechanism (ERM) in 1992 and the consequent depreciation of sterling, the balance of trade flows were fairly even throughout the 1990s. However, following an increase in the value of sterling between Q1 1996 and Q3 1998, the growth rates of imports and exports diverged. This led to a fall in the trade balance from a surplus of £35m in Q1 1998 to a deficit of £9.7bn in current price terms in Q1 2007.

However, between Q3 2007 and Q1 2009 the sterling effective exchange rate depreciated by 25%, at an average quarterly rate of 4.0%. This was the largest depreciation of sterling in recent history, more than reversing the appreciation of the late 1990s. Despite a brief increase between Q2 2007 and Q4 2008, the trade balance has remained around its pre-depreciation level and shows little clear evidence of the depreciation.

To examine the trade balance in more detail, Figure 2 shows the values of UK exports and imports, as well as the sterling effective exchange rate between Q1 1990 and Q4 2012. Throughout the majority of this period, the value of imports to the UK has exceeded that of UK exports and consequently the UK has consistently had a trade deficit.

**Figure 2: Sterling effective exchange rate and UK import and export values, current prices, seasonally adjusted**



**Notes:**

1. Source: ONS and Bank of England

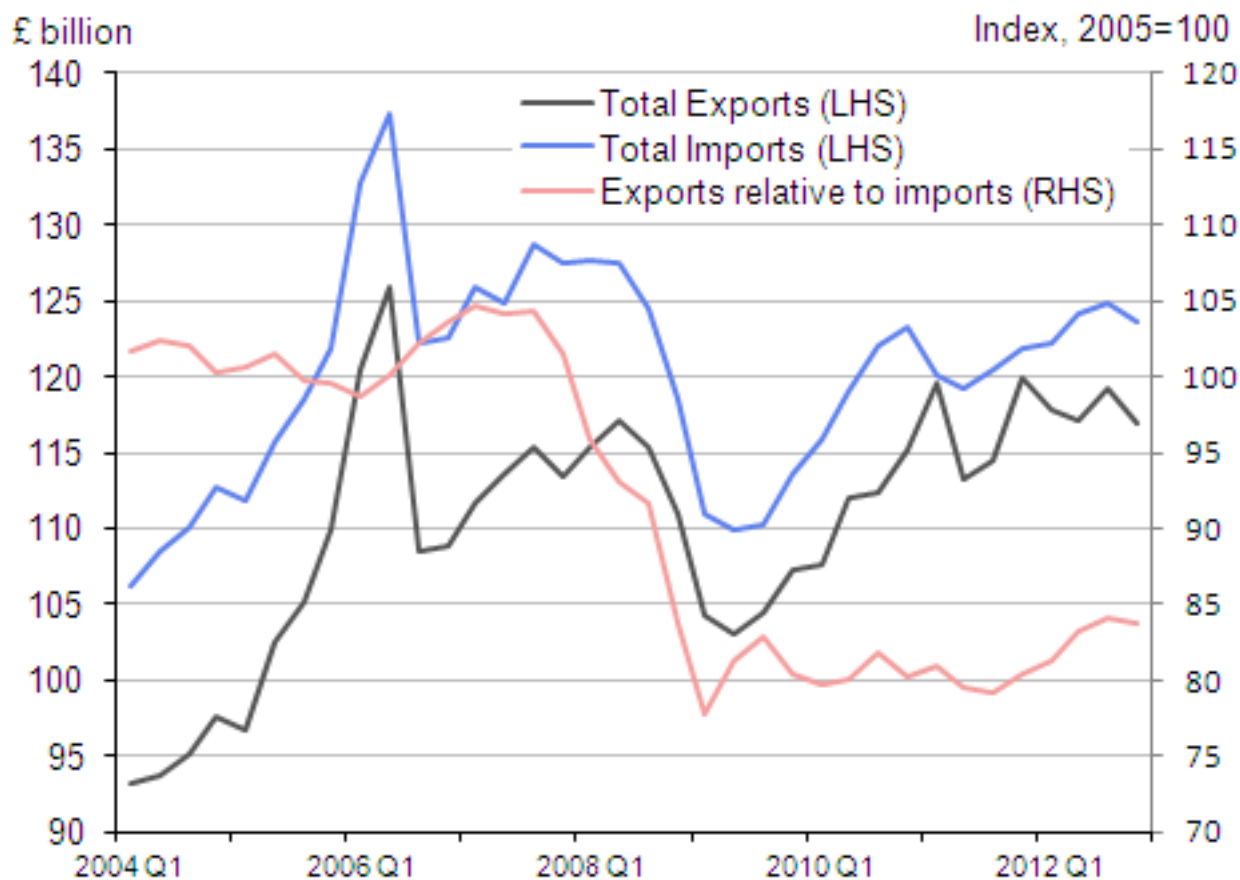
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The trade balance has remained broadly stable since 2008 as the values of exports and imports have grown at similar rates (at average rates of 1.2% and 1.0% per quarter respectively between Q1 2008 and Q4 2012). This reversed the long-term pattern established in the late 1990s, when import growth exceeded that of exports. However, this reversal was not large enough to have a noticeable effect on the trade balance.

As Figure 2 shows the value of exports and imports (which include both price and volume effects), it is difficult to establish whether it is the quantities or prices of traded goods that have changed. Figure 3 shows the path of the volumes of imports and exports (removing the effects of price changes) between Q4 2004 and Q4 2012. It shows that import and export volumes grew by 12.5% and 13.5% respectively between Q2 2009 and Q4 2012, but that exports have performed more strongly since 2010, growing by 8.7%, compared with 6.7% for imports. As with Figure 2, while the performance of exports relative to imports has improved since the depreciation, the change has not been large enough to have had a noticeable impact on the trade balance. Given the magnitude of the recent depreciation in sterling, a stronger response might have been expected from exports in particular.

**Figure 3: UK exports and imports, constant prices, seasonally adjusted****Notes:**

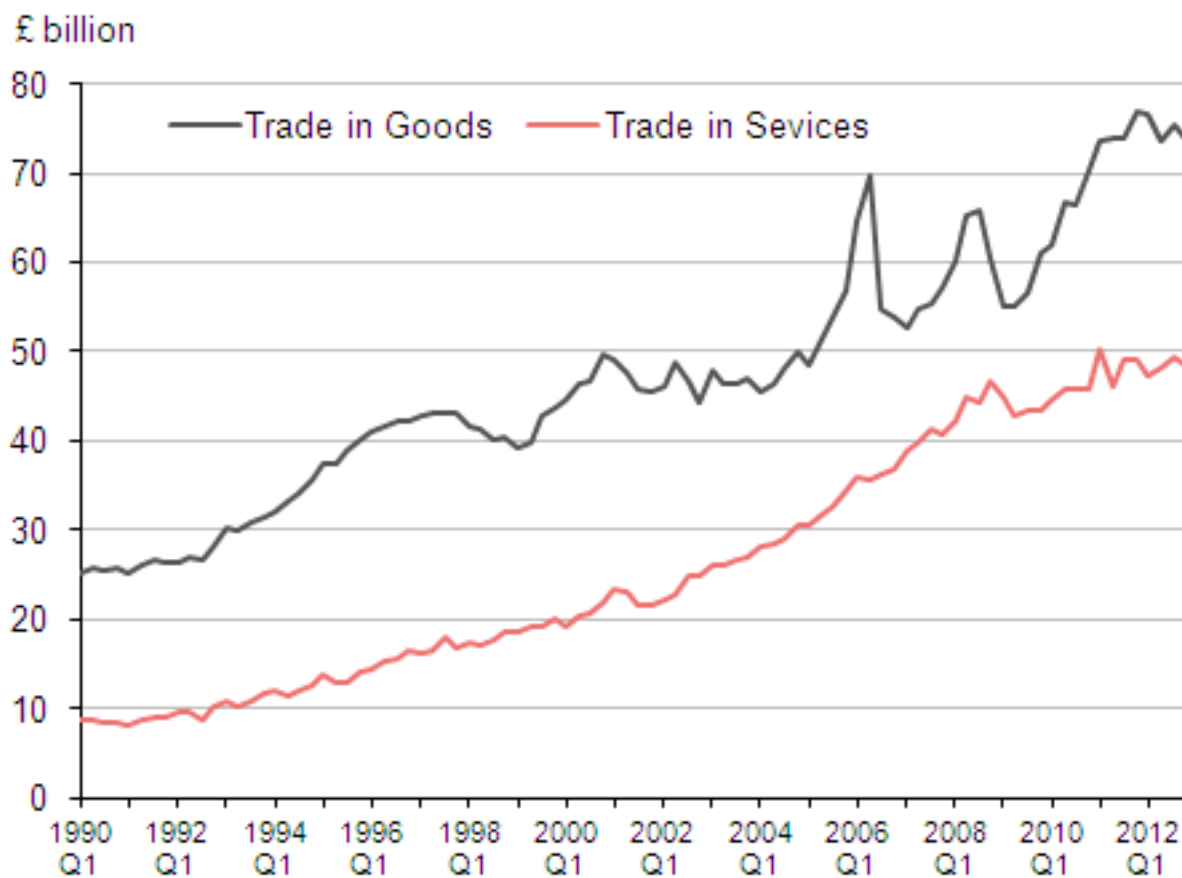
1. Source: ONS and Bank of England

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Exports can be broken down into goods exports and services exports. Figure 4 shows the evolution of the value of goods and services exports between Q1 2007 and Q4 2012. It suggests that the value of UK services exports has grown much more slowly than the value of goods exports in the period since the depreciation of sterling. While the value of services exports increased by 13.1% between Q2 2009 and Q4 2012, the value of goods exports increased by 34.3% over the same period. The relatively small response of services exports to the fall in sterling suggests that the composition of exports may play an important role in explaining the recent relative poor performance of UK trade.

**Figure 4: UK exports of goods and services, current prices, seasonally adjusted****Notes:**

1. Source: ONS

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**Explanations for the UK's trade performance**

This article explores some of the potential reasons why recent trends in UK trade may not have developed as might have been expected given the sizeable and sustained depreciation of sterling. These explanations reflect both the changing characteristics of production and trade in the UK economy and broader economic conditions in the global economy, including:

- Import intensity and global supply chains;
- The financial sector and financial services exports;
- Commodity prices;
- The relative price movements of imports and exports; and
- Overseas demand.

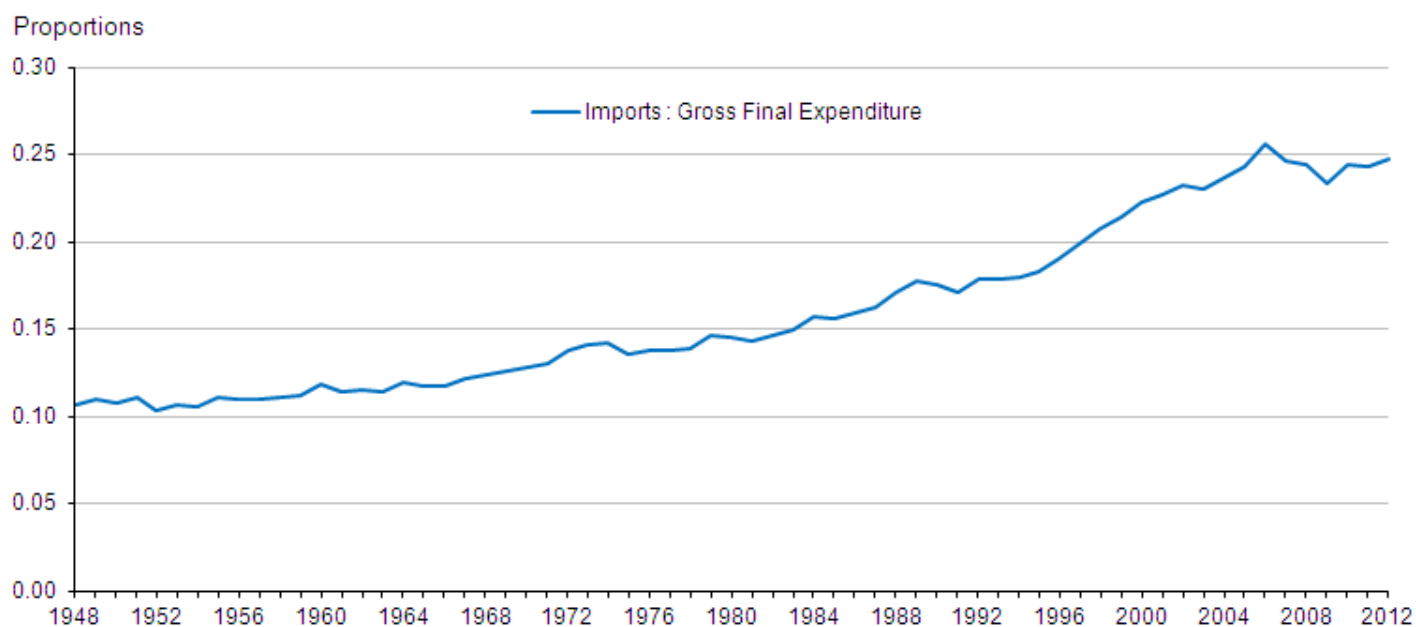
The remainder of this article sets out and examines these different possible explanations in light of the recent data.

### Import intensity and global supply chains

The UK economy has become increasingly integrated in the world economy. The total value of UK trade – taking the value of imports to and exports from the UK – as a proportion of GDP has risen from an average of 39% during the 1960s to an average of 59% in the ten years prior to 2013.

Consumers and firms in the UK increasingly rely on imports for both final and intermediate consumption, reflecting the broader globalisation trend. Figure 5 shows the degree of import penetration in the UK, which measures the extent to which the UK's demand for imports compares with wider economic activity, and suggests that import penetration increased most noticeably during the 1990s and 2000s, from approximately 18% in 1990 to 25% in 2010.

**Figure 5: Imports as a proportion of total gross final expenditure, current price, seasonally adjusted**



#### Notes:

1. Source: ONS
2. Note: The import series is not adjusted for the effects of Missing Trader Intra-Community (MTIC) fraud. See the Pink Book 2013 for more detail.

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Deeper integration in the global economy and the increasingly global nature of supply chains may partly explain why there has been limited reaction to the recent depreciation of sterling.





**Notes:**

1. Source: ONS
2. Note: The relative import price is the import price divided by the GDP deflator, indexed with 1998 as the reference year.

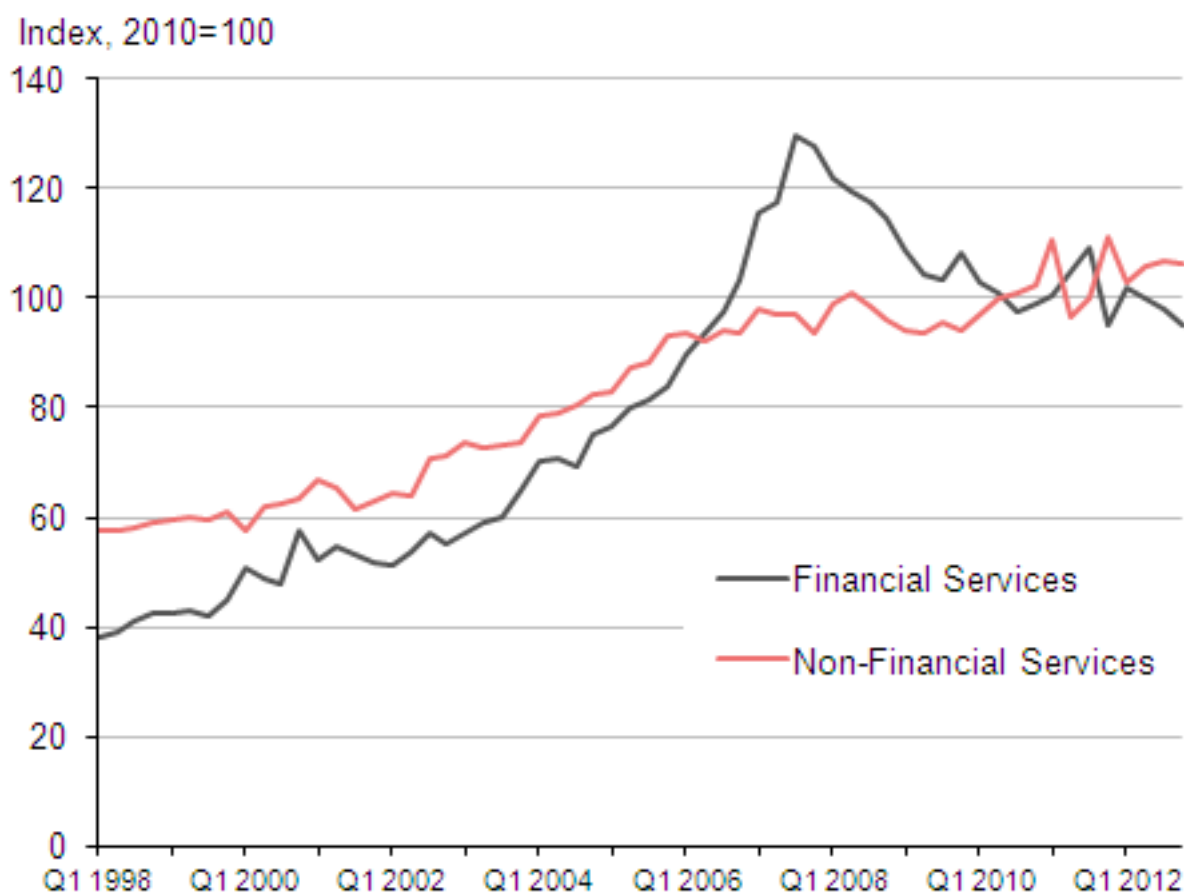
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**The financial market shock and the composition of trade**

The increasingly integrated nature of global supply chains during the 1990s and early 2000s was accompanied by a shift in the nature of the UK's exports. Between 1998 and 2007, the proportion of exports accounted for by services grew from around 30.2% to around 42.2%, while the proportion accounted for by goods fell by a corresponding amount. Among these services exports, an increasing proportion was accounted for by specialised financial services. This specialisation meant that the UK's trade position was particularly vulnerable to the global financial market shock in 2007.

In 2006, prior to the financial market shocks, financial services accounted for around 26% of the UK's services exports. Figure 7 shows the growth of financial services and non-financial services exports between 1997 and 2012. Over the five years preceding the financial shock in Q3 2007, financial services export volumes grew at an average rate of 4.4% per quarter, while non-financial services grew more slowly, at around 1.9% per quarter.

**Figure 7: The volume of UK services exports, seasonally adjusted****Notes:**

1. Source: ONS

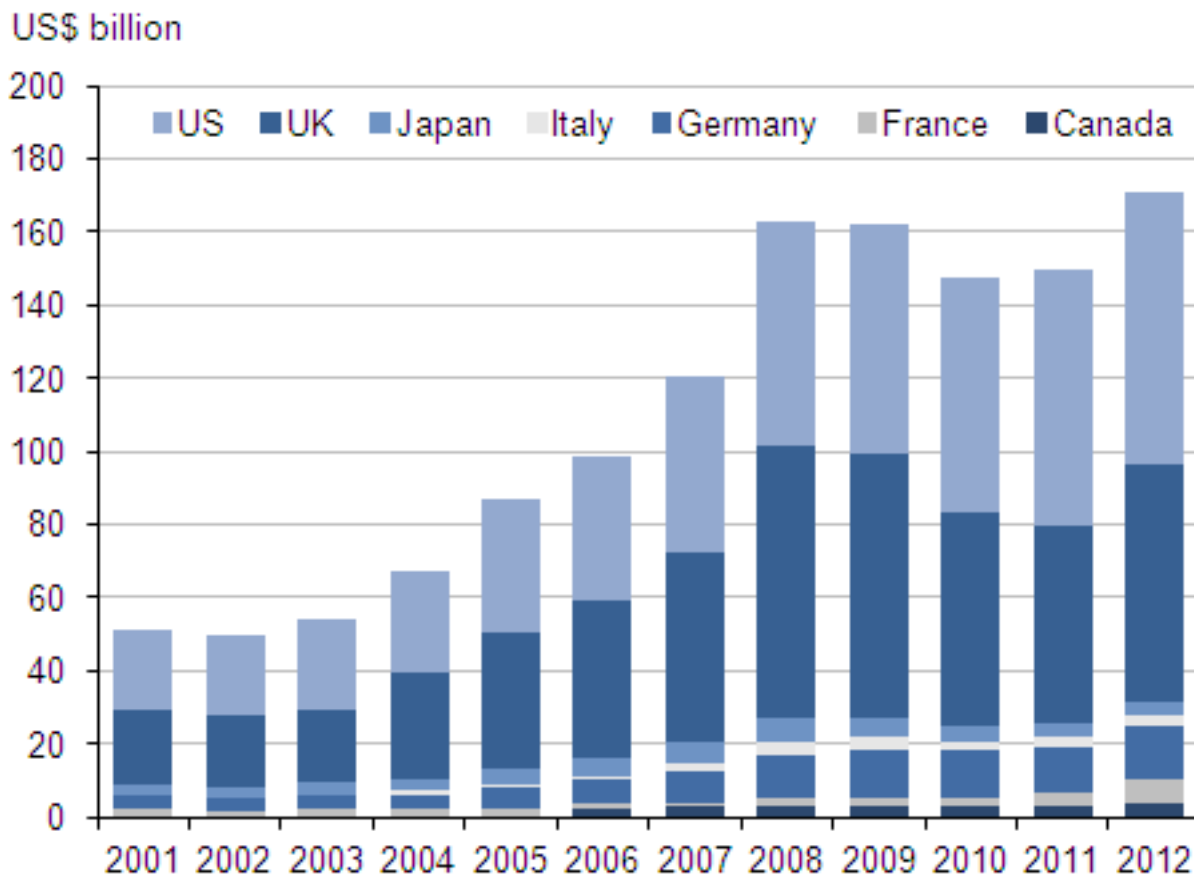
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However, following the financial market shock, the volume of financial services exports fell steeply, contracting by around 20% between Q3 2007 and Q3 2009 before stabilising. This fall is consistent with a global tightening of credit conditions in the period following the initial shock, a weakness of inter-bank lending and the substantial re-pricing of risk. Between Q4 2009 and Q4 2012, these exports have continued to contract by 0.1% per quarter on average, reducing the average growth rate of services exports as a whole.

The impact of the financial market shock on the UK's trade position is also likely to be pronounced in comparison with other economies as the UK was relatively more dependent on financial services. Figure 8 shows the level of financial services exports in current price terms in the G7 economies. This shows firstly that the value of financial services exports grew rapidly across the G7 between 2002 and 2007 and secondly that the UK accounted for the second largest proportion of G7 financial services exports during this period. The dollar value of UK financial services exports grew more rapidly than that of the G7 as a whole between 2002 and 2008, despite the depreciation in sterling, and contracted more rapidly following the financial market shock.

**Figure 8: G7 financial services exports, current prices, current exchange rates, US\$ billion****Notes:**

1. Source: UNCTAD

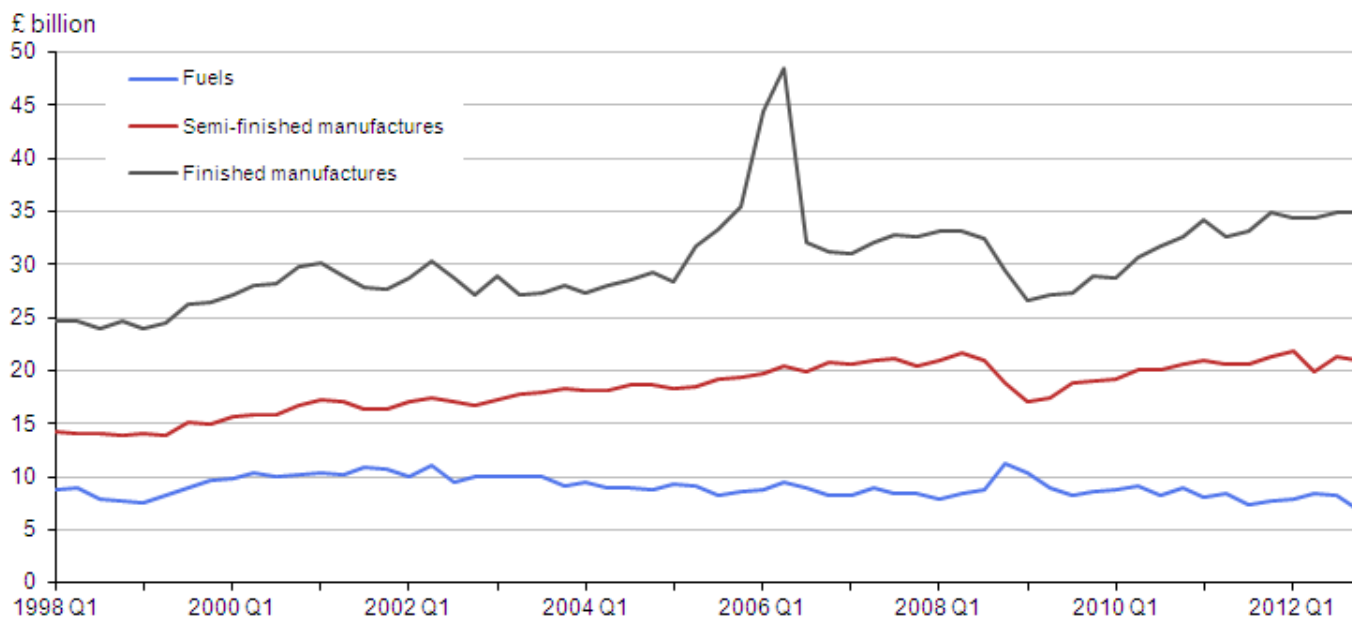
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While financial services exports and services exports as a whole show a relatively small response to the fall in the value of sterling, there is more evidence of a response in the UK's trade in goods. Figure 9 shows the volume of UK goods exports between Q1 2007 and Q4 2012, and indicates that following a sharp contraction during 2008 and 2009, exports of finished manufactures recovered strongly. Accounting for half of all UK exports by volume during 2012, finished manufactures exports were 4.7% above their pre downturn peak in Q4 2011. However, the expansion of both goods and services exports by volume slowed substantially during 2012.

**Figure 9: Volume of UK exports of goods by commodity, chain volume measure, seasonally adjusted, reference year=2010**



**Notes:**

1. Source: ONS

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Taken together, these data suggest that the UK's trade position was relatively more exposed to the global financial market shock than other major economies. While exports of goods and of finished manufactured products in particular, grew strongly during 2010 and 2011, the response of services and financial services exports was weaker, undermined by the impact of the financial shock. During 2012, exports of goods and services both grew, albeit at a slower rate.

**Price effects**

The balance of trade reflects both changes in the volume of goods and services traded – that is, the quantity of traded items – and changes in the value of those items – which includes the impact of changes in price. As discussed, the substantial depreciation of sterling during 2007 should have led to an increase in the price of goods imported to the UK, and a corresponding fall in the price of exported goods. However, there is a range of reasons why prices may not respond in this manner which may partially explain changes in the balance of trade since the depreciation of sterling. This section explores some of these effects.

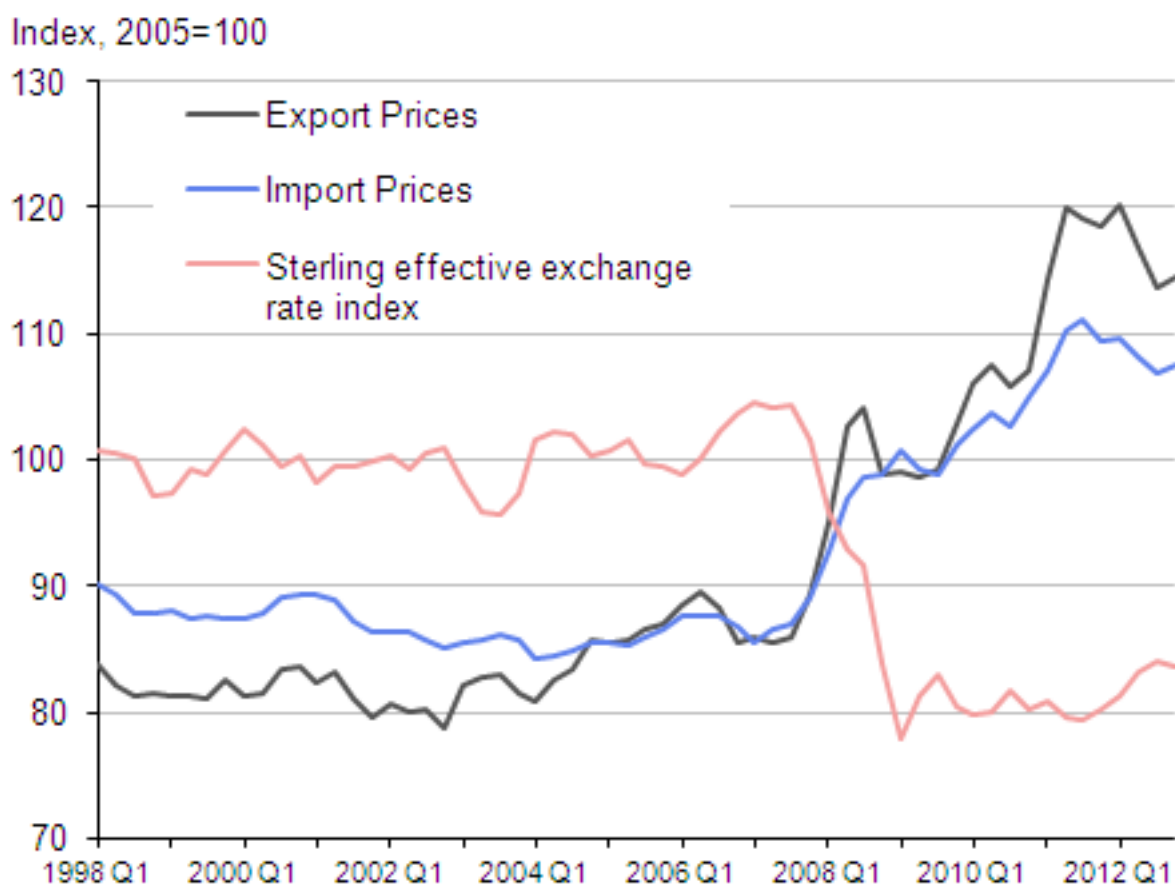
*Pass-through: Changes in import and export prices*

Firms may not pass on the full cost or benefit of an exchange rate change to their customers. For example, domestic importers – whose imported goods have become relatively more expensive

following the depreciation – may choose not to pass on the full additional cost to their customers, accepting lower profit margins to preserve market share. Equally, domestic exporters – whose goods are relatively less expensive as a result of the depreciation – may choose to increase profit margins on sales to overseas customers, rather than passing on the full benefits of the exchange rate change.

Figure 10 shows the path of UK import and export prices and the sterling effective exchange rate between Q1 1998 and Q4 2012. Following the sharp depreciation of sterling during 2007 and 2008, the import prices paid by UK firms and consumers increased markedly, reflecting the combined effect of price changes and the impact of the lower exchange rate. Import prices increased by 14% between Q2 2007 and Q3 2008 – slightly more than the fall in the value of sterling over this period of 12%.

**Figure 10: Sterling effective exchange rate index and UK import and export price indices**



**Notes:**

1. Source: ONS and Bank of England

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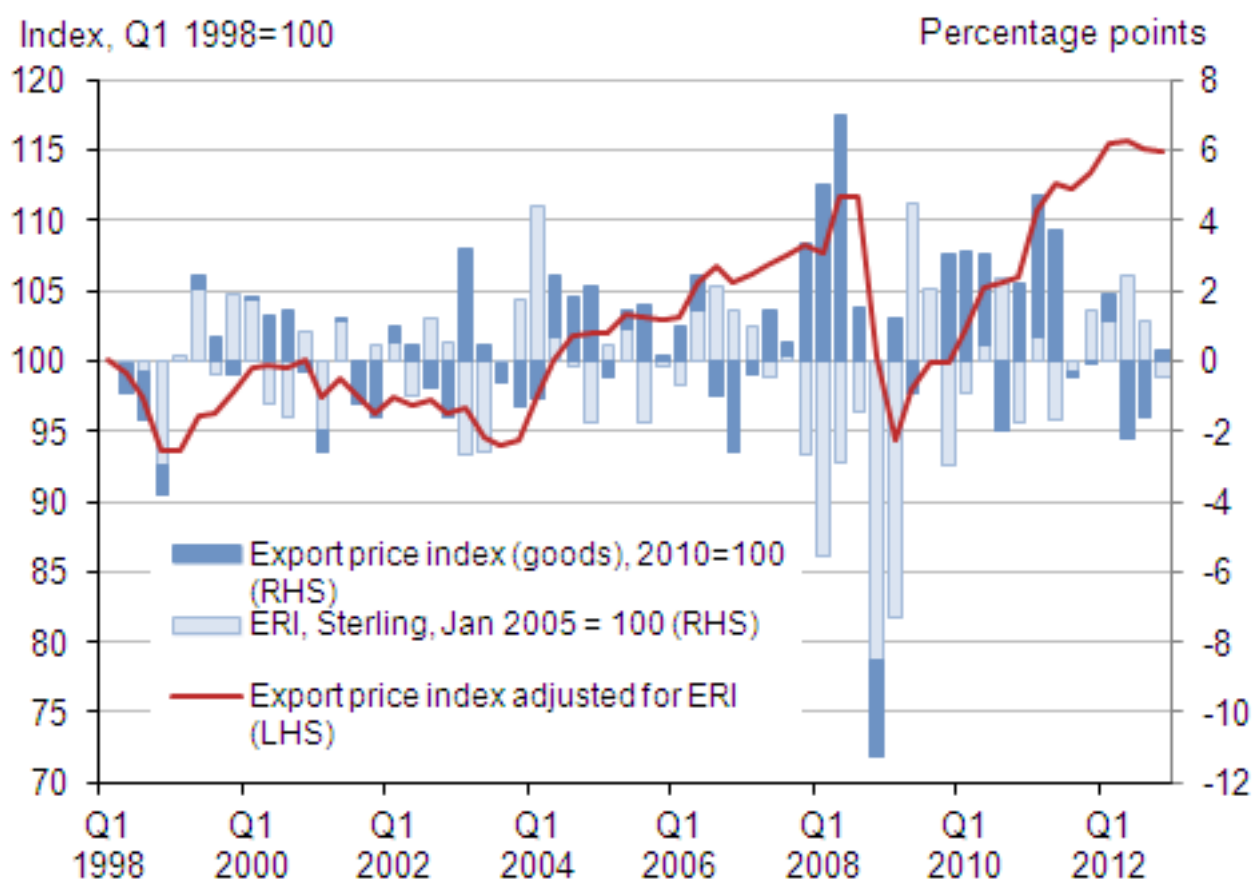
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Export prices in sterling terms also increased following the depreciation, possibly reflecting pass-through of higher imported input costs and firms attempting to capitalise on the falling exchange

rate. Figure 11 analyses these possibilities in more detail, showing an index of UK export prices adjusted for the change in the exchange rate. This is estimated by calculating the growth of sterling export prices each period, adding to this the percentage appreciation of the effective sterling exchange rate and converting the resulting series into an index. It shows that the effective overseas price of UK exports was relatively static between Q2 1998 and Q1 2006. During this period, changes in the sterling price of exports and changes in the exchange rate effectively cancelled each other out.

**Figure 11: Contributions to the price of UK exports paid by overseas firms and consumers, non seasonally adjusted**



**Notes:**

1. Source: ONS
2. Note: The effective export price index is estimated by calculating the percentage change in the average sterling export price, adding the percentage appreciation in the sterling exchange rate and converting the resulting series into an index form.

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The impact of the depreciation on the effective price of UK exports is evident from Q4 2007 onwards. During the six quarters between Q4 2007 and Q1 2009, the exchange rate acted to reduce the effective price of UK exports each period, offset to some extent by increases in sterling export

prices during 2008. The effective price of UK exports fell sharply during Q4 2008 and Q1 2009, likely contributing to the recovery of trade volumes during 2009 and 2010. However, Figure 11 also suggests that the effective export price increased strongly until the beginning of 2012, and has re-attained the level observed immediately prior to the depreciation.

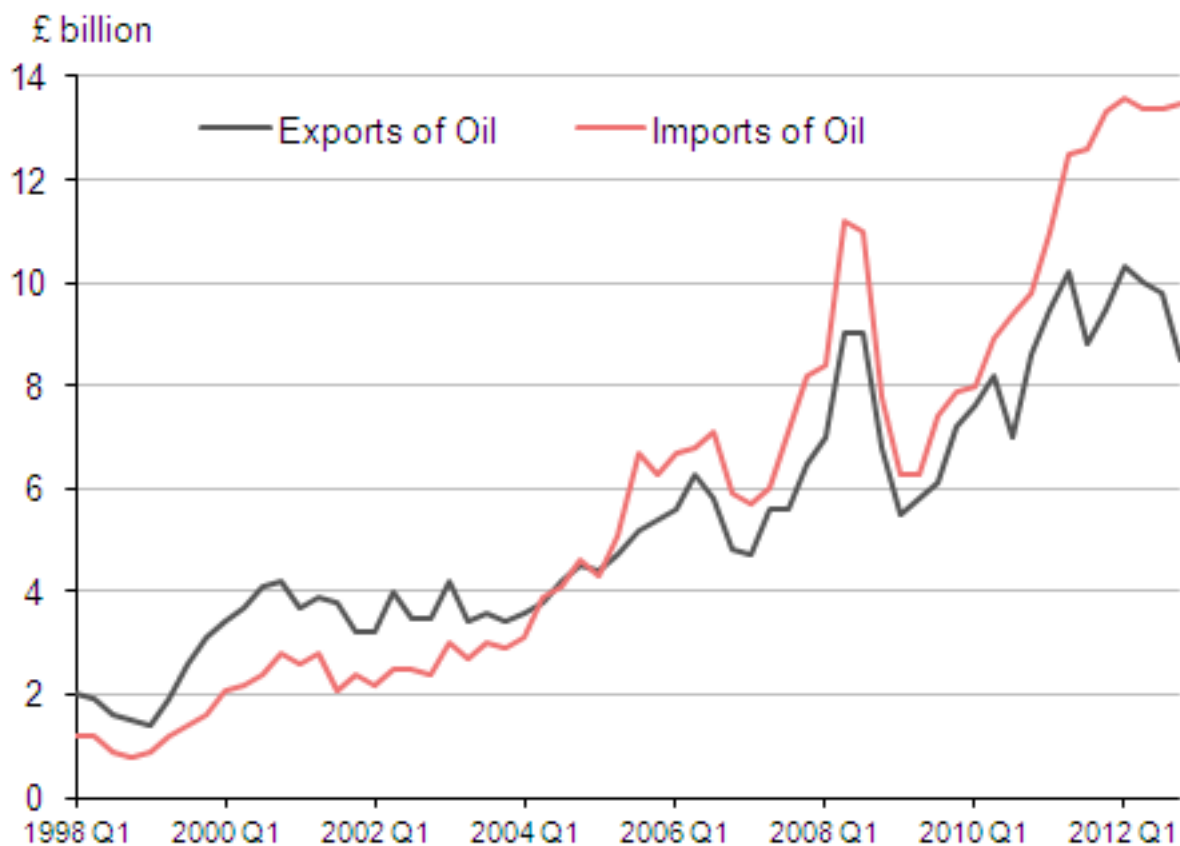
Taking these movements together, the depreciation appears to have had the predicted effect on sterling import prices, which increased by 21% between Q4 2007 and Q4 2012. The depreciation also had the predicted impact on the effective price of UK exports, which fell sharply during Q4 2008 and Q1 2009, supporting the recovery in trade during 2009 and 2010. However, effective export prices have since risen above their pre-depreciation level, which may offer a partial explanation for the recent weakness of trade.

#### *Commodity prices: Trade in oil*

Commodities, including oil, are essential for the operation of modern economies. Oil in particular assists in power generation, supports the manufacturing process and is the driving force behind most means of transport. As a result, modern economies tend to have relatively price inelastic demand for oil: when prices rise, they have little choice in the short run than to simply pay a higher price. If a nation is dependent on oil imports, a currency depreciation will raise the price it pays for these goods, but have little impact on the quantity demanded. As a result, the reaction of its balance of trade to a currency depreciation may be limited.

Figure 12 shows the value of the UK's exports, imports and balance of trade (the difference between the exports and imports) in oil since 1998. The UK has been a net importer of oil since 2004, largely as a result of the long term decline of North Sea oil production and the growing cost of extracting the remaining reserves. The balance of trade in oil remained relatively stable between 2005 and 2011, since when a substantial trade deficit has emerged.



**Figure 12: UK trade in oil, current prices, seasonally adjusted****Notes:**

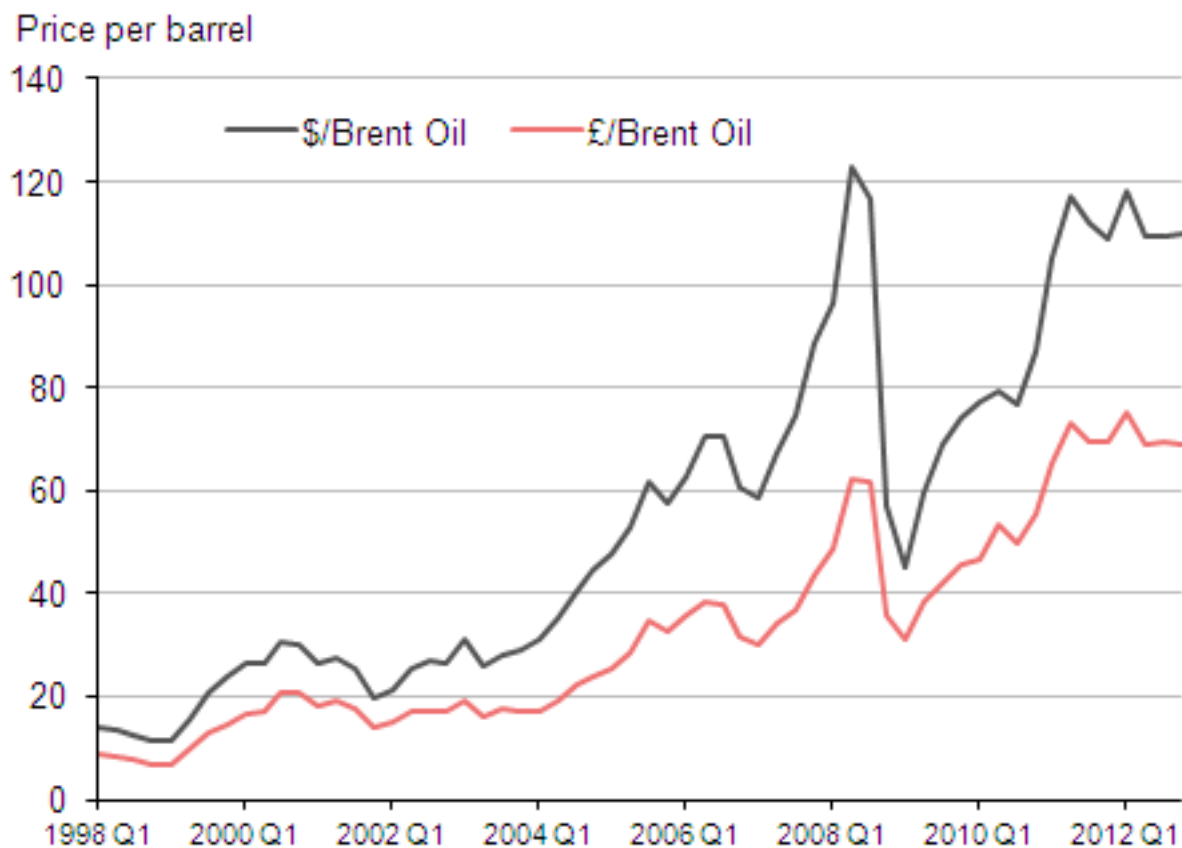
1. Source: ONS

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Although demand for oil has risen over time, much of the recent fall in the UK's balance of trade in oil has arisen as a result of recent changes in price. Figure 13 shows the price of Brent crude in both the currency in which it is traded – the US dollar – and the sterling equivalent. It shows that the dollar price of oil increased rapidly in the period leading up to the economic slowdown in 2008, and that the fall in price which followed was largely recovered by the beginning of 2011. While prices since 2011 have been more stable, they remain high by recent standards.

**Figure 13: Price of Brent crude oil, price per barrel****Notes:**

1. Source: ONS and Financial Times

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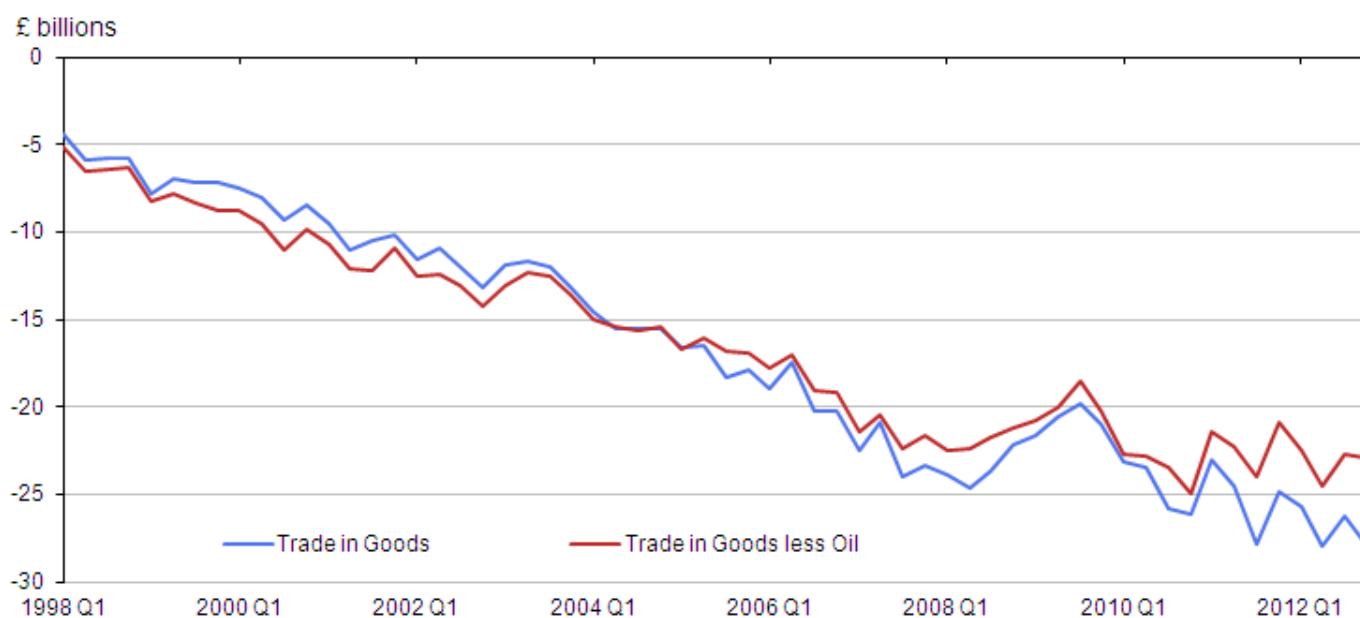
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The impact of this increase in the oil price on the trade balance has been accentuated by the recent depreciation of sterling against the dollar. Between Q1 2008 and Q4 2012, the dollar price of oil increased by around 14.1%, while the sterling price of oil (which includes the currency depreciation) has risen by around 41.9%.

Taken together, the rise in the dollar price of oil, the depreciation of sterling and the relatively inelastic demand for oil have had a substantial impact on the UK's trade position. Figure 14 shows the balance of trade in goods since 2005, including and excluding the impact of oil. It suggests that the contribution of oil to the balance of trade fell during 2008, before rising back towards balance in 2009. Following the recent rise in oil prices, the contribution of oil fell sharply from 2011 onwards.

**Figure 14: Balance of trade in goods and balance of trade in goods less oil, current prices, seasonally adjusted**



**Notes:**

1. Source: ONS

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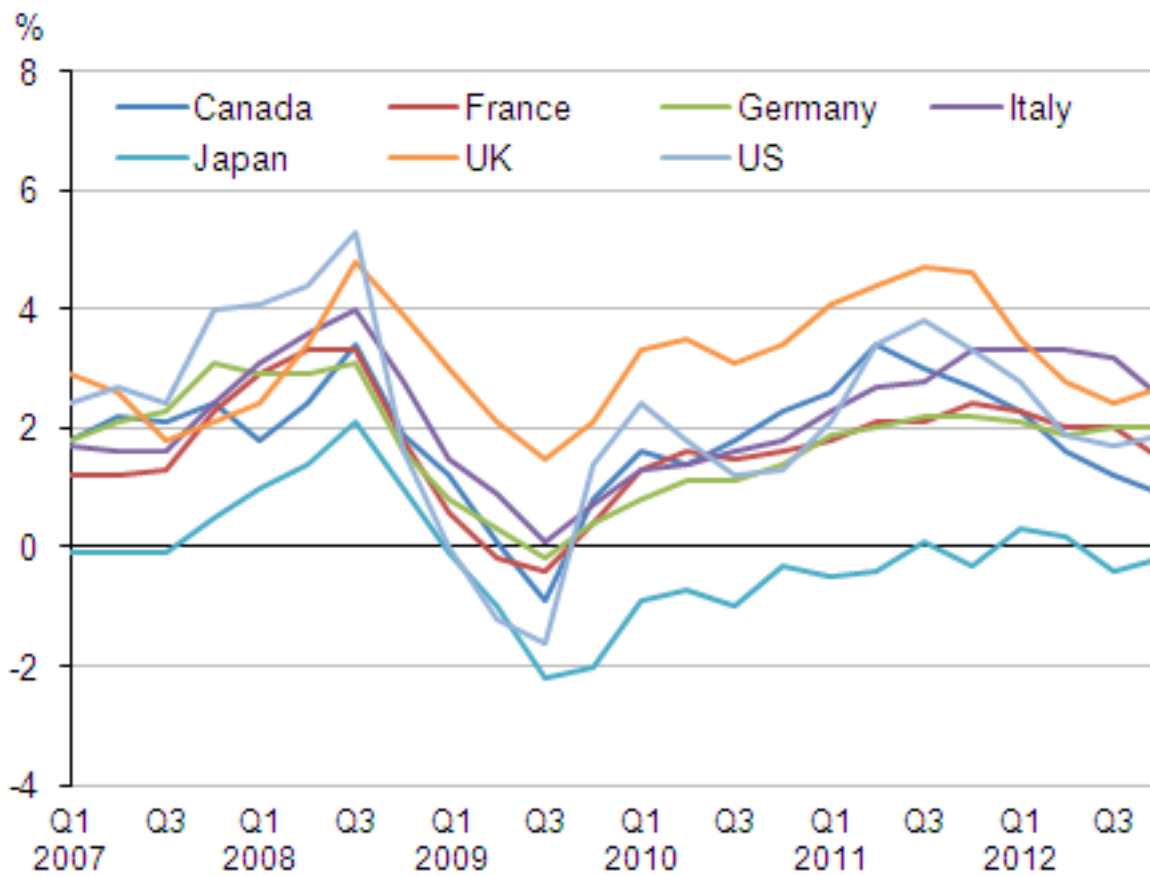
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*Relative price movements:*

A further explanation for developments in the UK's trade balance is the evolution of prices in the UK relative to major trading partners. If prices in one economy rise more rapidly than those in other economies with no change in the exchange rate, the balance of trade is likely to change. Higher domestic prices make domestic goods relatively more expensive in overseas markets. This reduces demand for domestic exports. Higher domestic prices also make imported goods relatively more attractive for domestic firms and consumers. As a result, consistent, relatively high rates of inflation tend to reduce the trade balance through lower exports and higher imports.

Annual Consumer Price Index (CPI) inflation in the UK is shown in Figure 15, alongside the equivalent series for the G7. Between the end of 2008 and the beginning of 2012, the UK had the highest annual rate of CPI inflation of this group, averaging 3.4% between Q4 2008 and Q1 2012. Between Q1 2009 and Q4 2012 the annual inflation rate in the UK averaged 3.2% per quarter, compared with an average of 1.6% per quarter in the US and 1.4% in France and Germany over the same period.

**Figure 15: Annual Consumer Price Index inflation rate for the G7 economies****Notes:**

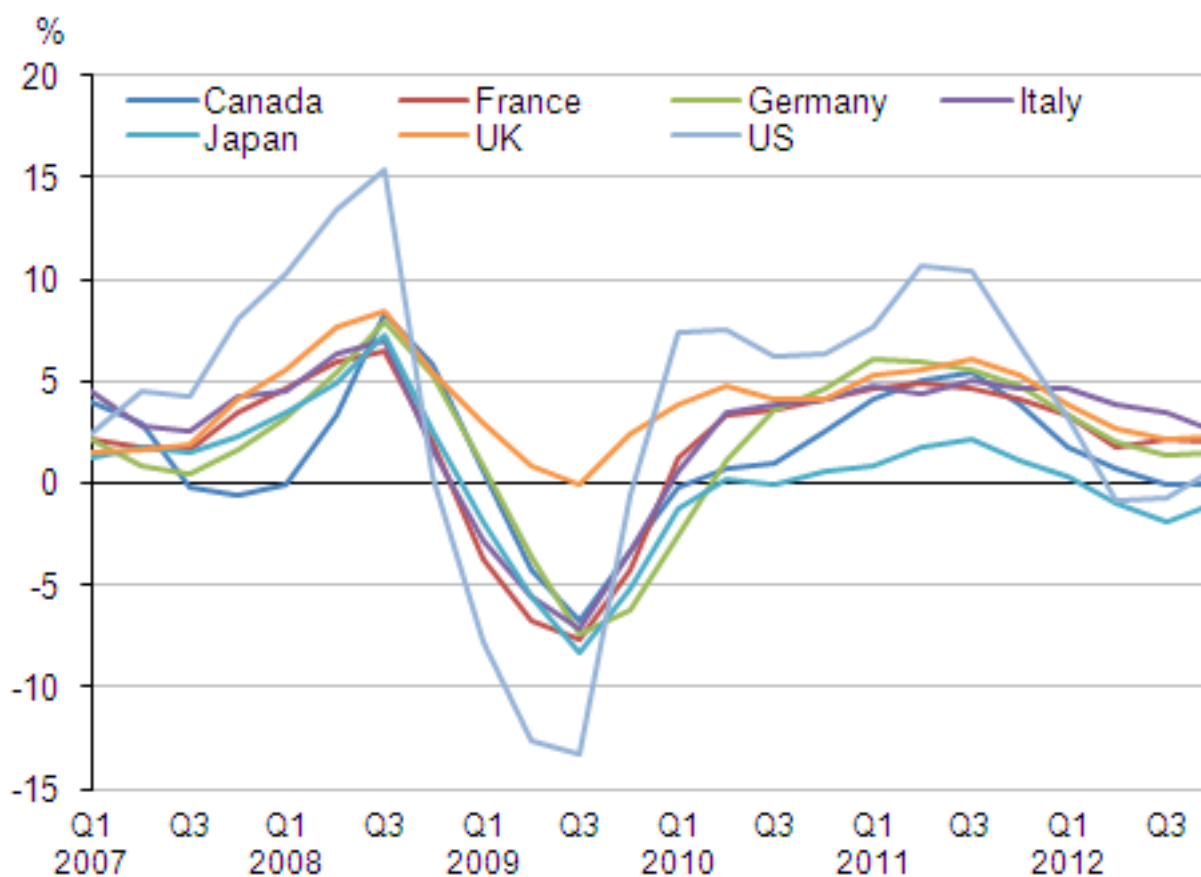
1. Source: OECD

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The UK's annual rate of producer price inflation – the prices charged by firms to wholesalers and retailers – was also the highest among the G7 in 2009, but was more in line with other G7 countries from mid-2010 onwards, as is shown in Figure 16.

**Figure 16: Annual Producer Price Index inflation rates for the G7 economies****Notes:**

1. Source: IMF

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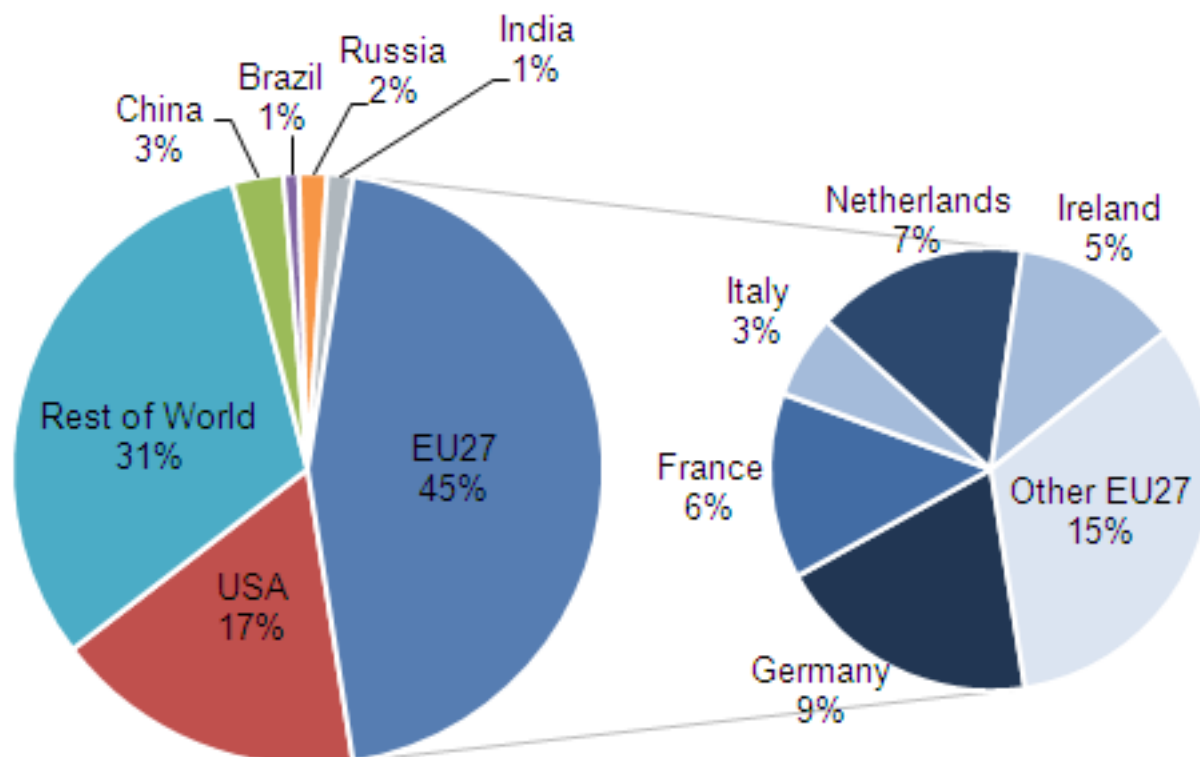
The relatively high rate of consumer price inflation in the UK in particular suggests that despite a currency depreciation reducing the relative price of UK goods for major trading partners, the overall competitiveness position will have changed less as a result of higher UK rates of inflation. These data are consistent with the changes observed in average export prices and suggest that the impact of the depreciation on the balance of trade may be smaller as a result of price movements making the UK relatively less competitive.

**Overseas Demand**

An economy's balance of trade also depends on the international demand for its products. Since the start of the economic downturn in 2008, many of the UK's export partners have suffered contractions in output, increases in unemployment and correspondingly limited demand growth. As sterling started to depreciate following the financial market shock in 2007, the impact of the change in the exchange rate may have been limited by lower demand for UK products overseas.

Figure 17 shows UK exports by their geographical destination and indicates that around 45.1% of the value of UK exports were to markets within the European Union in 2012. A further 17.1% were to the United States, while exports to China accounted for 2.8% of total exports. Within the European market, Germany (8.8%), the Netherlands (7.0%), France (6.1%) and Ireland (5.5%) account for the largest proportions of UK exports.

**Figure 17: Value of UK exports by destination, 2012**



**Notes:**

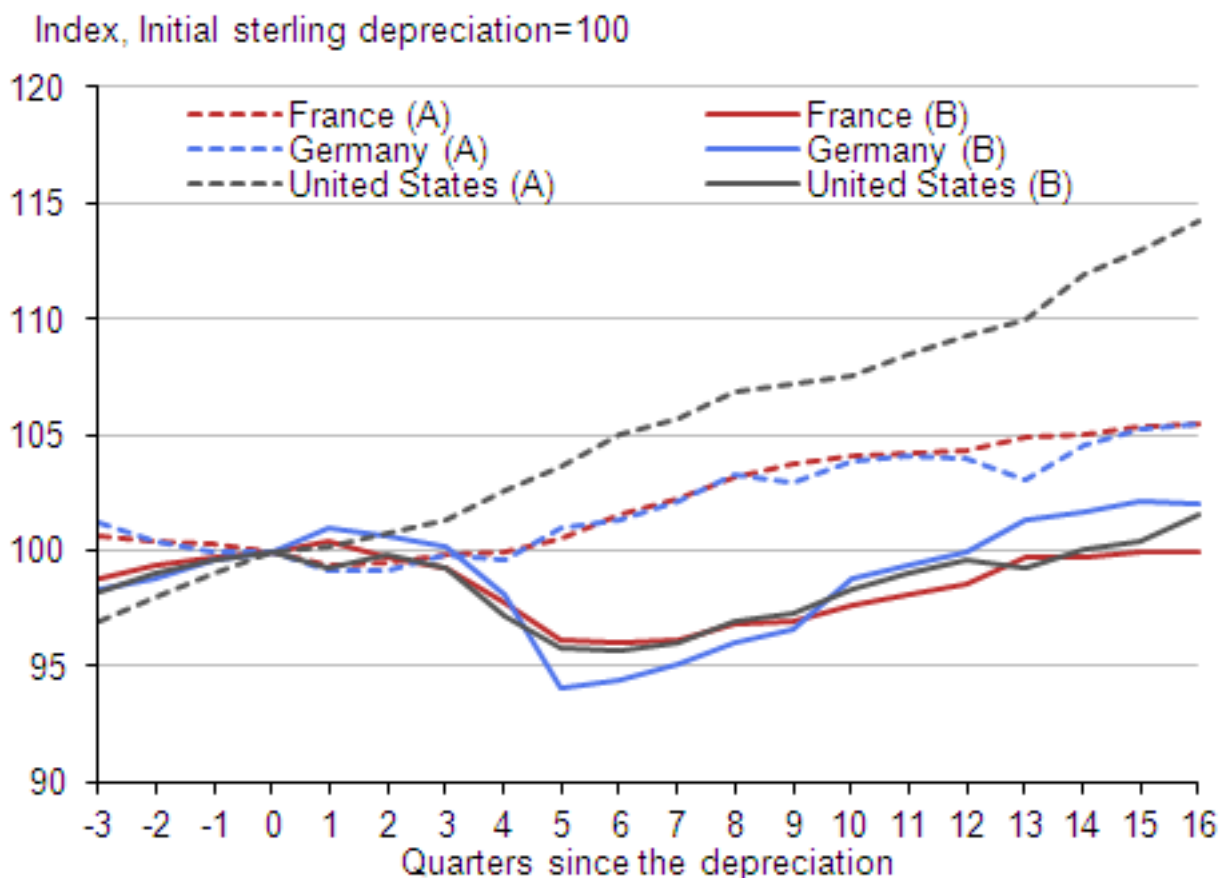
1. Source: ONS

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In contrast to the global macroeconomic conditions which prevailed following the substantial depreciation of sterling in the early 1990s, the onset of the economic downturn in 2008 limited growth in many of the UK's major export markets. Figure 18 shows the path of output in France, Germany and US, indexed to the quarters in which sterling started to depreciate. Following the depreciation in the early 1990s, output grew strongly in the US, and recovered more gently in France and Germany. However, following the more recent depreciation, all three markets suffered a substantial contraction in output. Between Q1 2008 and Q2 2009, output shrank by 3.6% in the US, 4.4% in France and by 6.6% in Germany.

**Figure 18: GDP growth in selected major trading partners following sterling depreciation, Q4 1992=100 (A) & Q4 2007=100 (B)**



**Notes:**

1. Source: ONS and OECD
2. Note: A and B series indicate the path of GDP indexed to Q4 1992 and Q4 2007 respectively

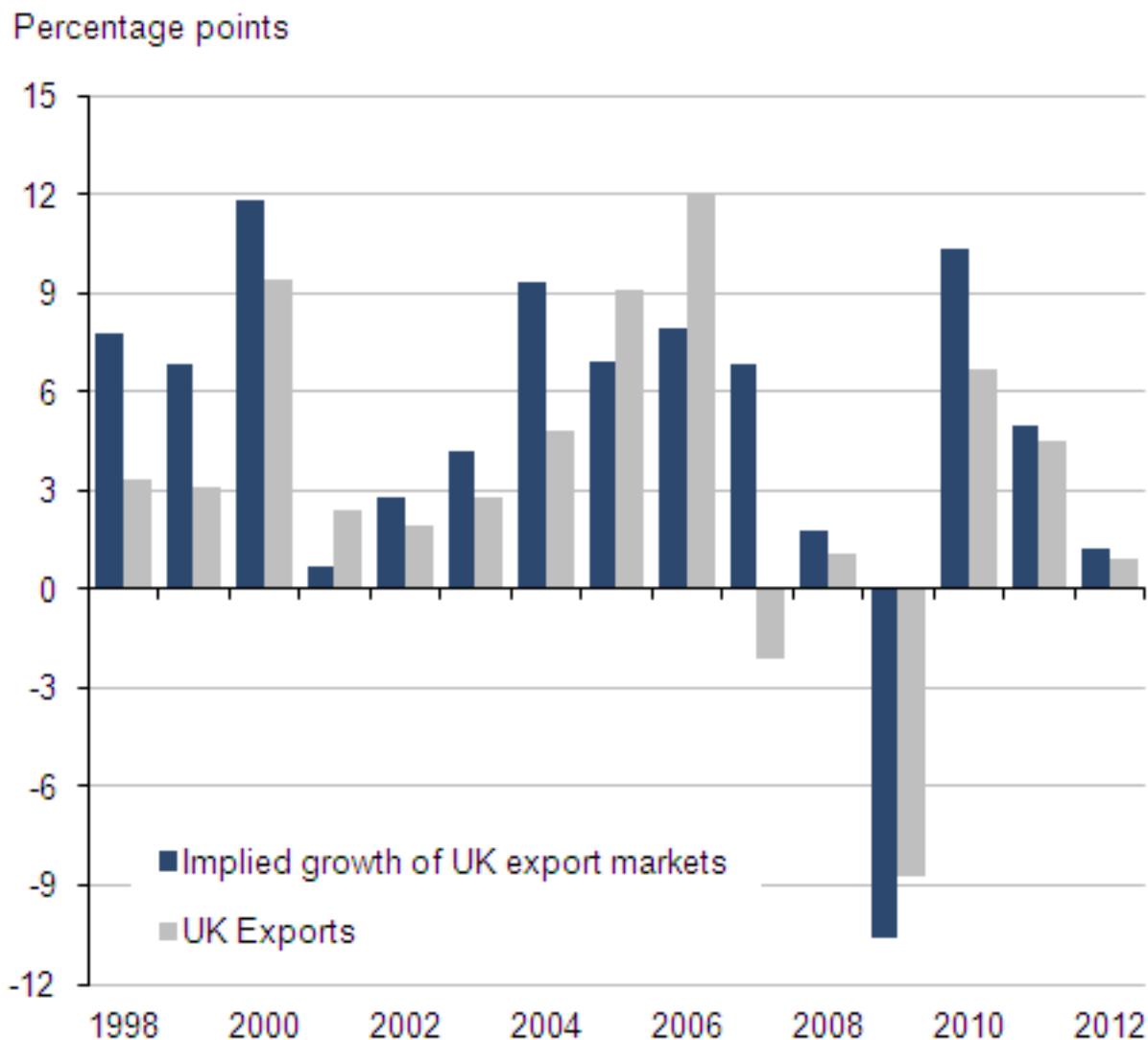
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Taken together, these data suggest that the extent of overseas demand for UK products may have been limited by prevailing global economic conditions. However, whether the UK's trade performance has been proportionate to economic conditions in its major export partners is difficult to establish.

To analyse this question more closely, ONS has calculated the growth of the UK's goods and services export markets and compared this with the realised growth of UK goods and services exports. This involves weighting the import growth rates in each partner country by their share of UK exports each period. If the volume of UK exports grew at the same pace as their export markets, then the UK maintained market share relative to international competitors. If the UK's volume of exports grew more quickly (more slowly) than its export markets, the UK is increasing (decreasing) its market share. These statistics should be interpreted with care as they aggregate diverse conditions in a large number of different markets, and are shown in Figure 19.

**Figure 19: Weighted growth rates of UK export markets and the volume of UK exports, annual, non seasonally adjusted**



**Notes:**

1. Source: ONS and IMF
2. Note: The growth rates of export markets are calculated by weighting the growth of imports in each partner country by the proportion of UK exports sent to each partner country. Stronger export market growth reflects greater exposure to economies which have growing demand for imports. Weaker export market growth reflects greater exposure to economies which have slowing or contracting demand for imports.

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(17 Kb)

These data suggest that the growth of UK exports has broadly kept pace with conditions in the UK's export markets since the onset of the economic downturn in 2008. Both the demand for and the volume of UK exports were stable during 2008 and fell markedly during 2009. However, since the trough of the economic downturn in 2009, the series have grown at broadly comparable rates.



Following a sharp rebound in international demand in 2010, both the demand for and the volume of UK exports have grown at declining rates, suggesting that international economic conditions have an important role to play in explaining the recent weakness in UK trade.

## Conclusion

The UK's trade performance since the onset of the economic downturn in 2008 has been one of the more curious developments in the UK economy. Between Q3 2007 and Q1 2009, the sterling effective exchange rate depreciated by more than 25%. However, the UK's balance of trade in goods and services was broadly unchanged during and following the depreciation.

This article sets out several possible explanations for the UK's trade performance, including the roles of global supply chains, the importance of financial services exports, commodity and other price effects, and the weakness of overseas demand. While it is beyond the scope of this article to evaluate the relative importance of these different factors, this analysis provides insights into the domestic and global economic conditions faced by the UK during and following the depreciation.

While the depreciation in sterling appears to have had little impact on the overall trade balance, there is evidence that the balance of trade in goods increased during 2009 and 2010. Exports of services, and in particular exports of financial services, appear to have been more affected by the global financial market shock in 2007, masking the performance of the balance of trade in goods.

The other factors discussed in this article, including relative price movements, may have also had an impact. The UK's increasing reliance on overseas supplies of oil in particular – for which the price elasticity of demand is quite inelastic – appears to have limited the response of the trade balance to the change in the value of sterling.

Overseas demand also appears to have played a role. Each of the UK's major trading partners suffered a contraction of output during 2008 and 2009, and a relatively slow recovery, limiting demand for exports from the UK. The UK's volume of goods and services exports have grown at broadly the same rate as the UK's major export markets since 2010. Other considerations include increased integration of the UK into global supply chains, which may have limited the ability of multinational companies to respond to the change in the price of sterling.

While it is not possible to measure the impact of these potential explanations directly, they provide some insight into domestic and global economic conditions faced by the UK during and following the depreciation, and offer a useful insight into the UK's trade performance.

## Background notes

1. Details of the policy governing the release of new data are available by visiting [www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html](http://www.statisticsauthority.gov.uk/assessment/code-of-practice/index.html) or from the Media Relations Office email: [media.relations@ons.gsi.gov.uk](mailto:media.relations@ons.gsi.gov.uk)

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