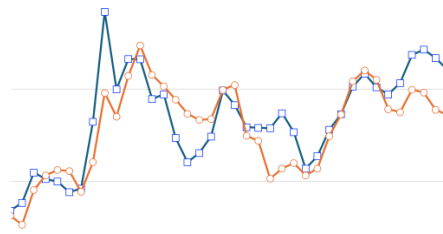


Imports Exports



5 1970 1975 1980 1985 1990 1995 2000

# Managing the UK economy

## Fiscal and monetary policy since 1945

AY 2024-25

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Week 3 seminar

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Department of Political  
Economy

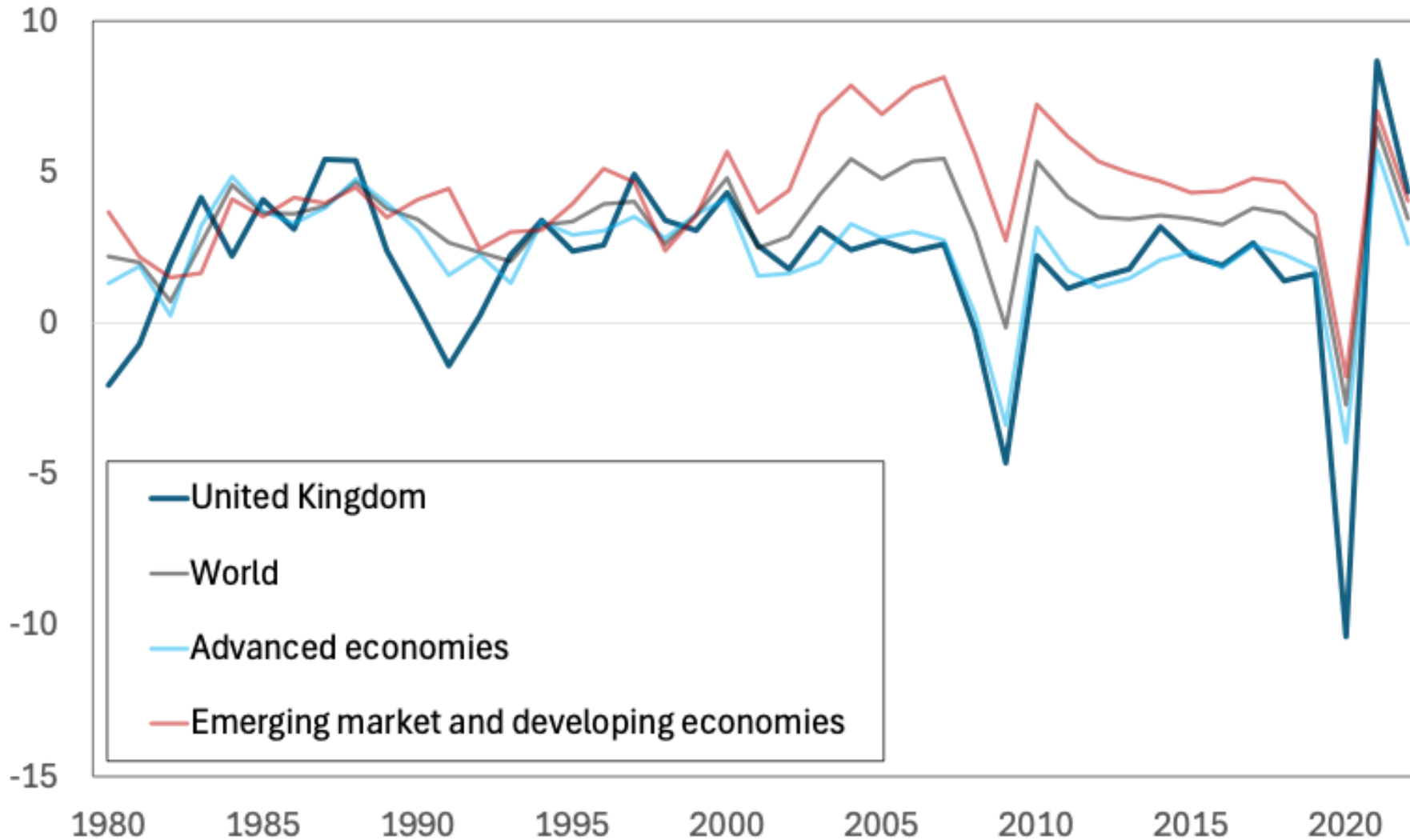
Instructor: Daniele Girardi

# The UK is an open economy

- Open to trade
  - UK buyers can choose between domestic & foreign goods.
  - UK firms can sell their products to UK customers and to foreigners
- Open to financial flows:
  - UK investors can choose between domestic and foreign financial assets.
  - Foreign investors can trade UK financial assets.
- Open to labor & fixed capital movements
  - UK firms can relocate their production abroad.
  - Foreign firms can open production plants in UK
  - Workers can move in and out of the UK.



# International links are important for the UK economy

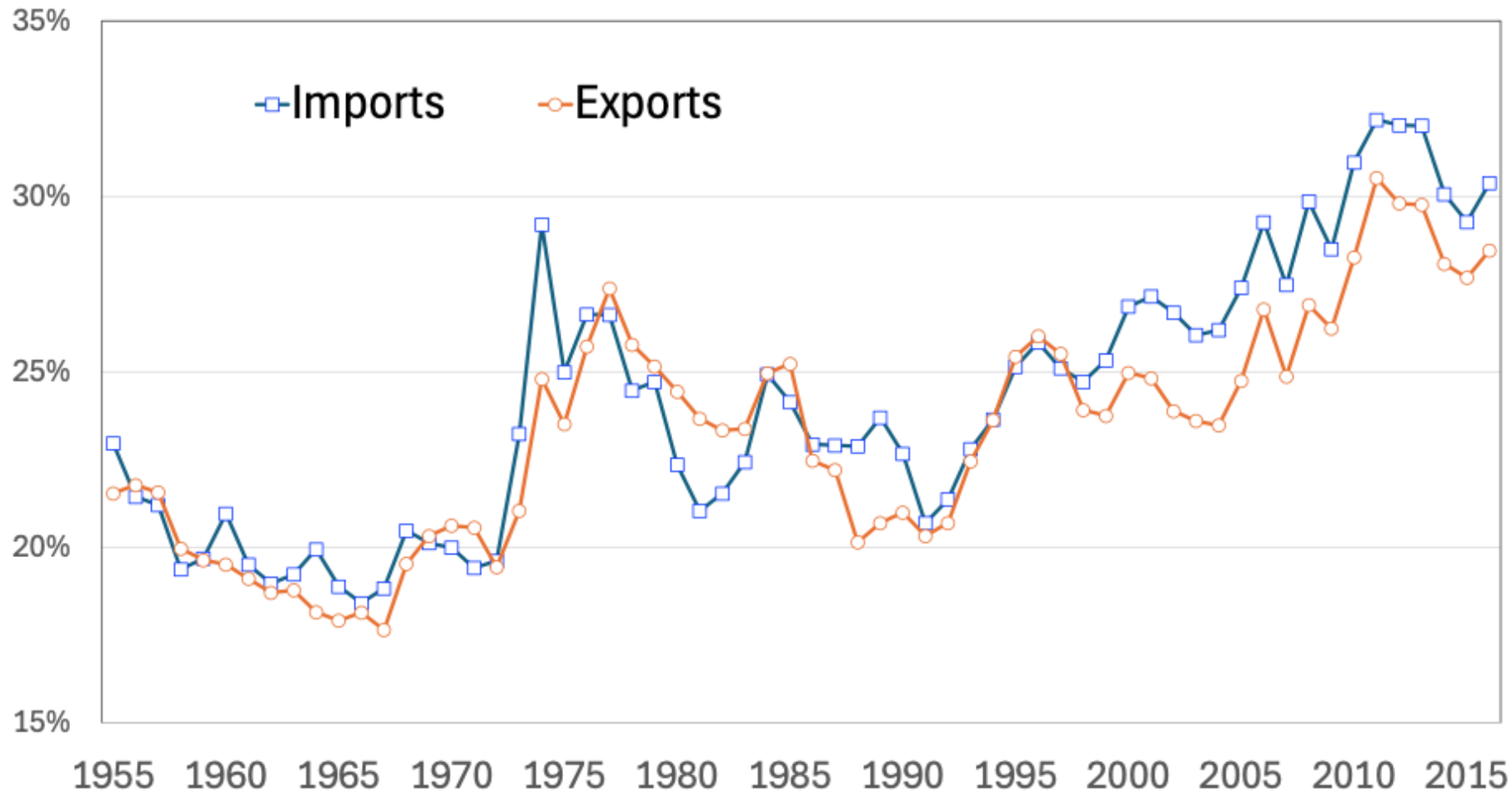


## Real GDP growth

(source: IMF World Economic Outlook Database, Apr 2024)

<https://www.imf.org/en/Publications/WEO/weo-database/2024/April>

# UK exports & imports (as a % of GDP)



UK economy has opened up over time.

Since late 1990s runs a trade deficit.

*How is the trade deficit financed?*

# International financial flows

- *Openness in financial markets.*
- 1980s-2000s: *Liberalization* of international capital markets.
- *Foreign exchange market*: buying and selling foreign currency.
- International financial flows allow countries to finance trade deficits/surpluses.
- UK economic history since 1945 has been punctuated with *foreign exchange* crises.



# The balance of payments

*A set of accounts that summarize a country's transactions with the rest of the world.*

- Current account
  - Trade balance (exports - imports)
  - Income balance (income payments)
- Financial (or capital) account
  - Net transfers (foreign aid, ...)
  - Asset purchases to/from rest of the world
- Current Account + Financial Account = 0

# US balance of payments in 2018 (billions of USD)

<b>Current Account</b>		
<b>Exports</b>	<b>2,500</b>	
<b>Imports</b>	<b>3,122</b>	
<b>Trade balance (deficit = minus sign)(1)</b>		<b>– 622</b>
<b>Income received</b>	<b>1,200</b>	
<b>Income paid</b>	<b>1,067</b>	
<b>Net income (2)</b>		<b>133</b>
<b>Current account balance (1) + (2) (deficit = minus sign)</b>		<b>– 489</b>
<b>Financial Account</b>		
<b>Net capital transfers (3)</b>	<b>9</b>	
<b>Increase in foreign holdings of US assets (4)</b>	<b>811</b>	
<b>Increase in US holdings of foreign assets (5)</b>	<b>301</b>	
<b>Financial account balance (7) = (3) + (4) – (5)</b>		<b>519</b>
<b>Statistical discrepancy: financial account – current account balance</b>		<b>30</b>

Source: US Bureau of Economic Analysis, US International Transactions, Table. 17.1.

# UK balance of payments in 2022 (£ billions)

Current Account		
Exports	833.8	
Imports	901.8	
	<b>Trade balance</b>	<b>-68.0</b>
Income received		314.4
Income paid		324.7
	<b>Net income</b>	<b>-10.3</b>
	<b>Current account balance</b>	<b>-78.3</b>
Financial (or capital) account		
Net capital transfers	3.1	
Increase in foreign holdings of UK assets		237.0
Increase in UK holdings of foreign assets		172.6
	<b>Financial account balance</b>	<b>+61.3</b>
	<b>Statistical discrepancy</b>	<b>17.0</b>



# The balance of payments

- The financial account includes purchases and sales of Central Bank foreign exchange (or gold) reserves.
- When other financial flows do not close the current account deficit (or surplus), the Central Bank runs down (or increases) its forex reserves.
- Often, we talk of ‘balance of payments deficit’ (a bit of a misnomer) when the Central Bank loses substantial reserves.
- This usually happens when the Central Bank is trying to maintain a fixed exchange rate, or to avoid depreciation.

# The nominal exchange rate

- The price of the domestic currency in terms of the foreign currency

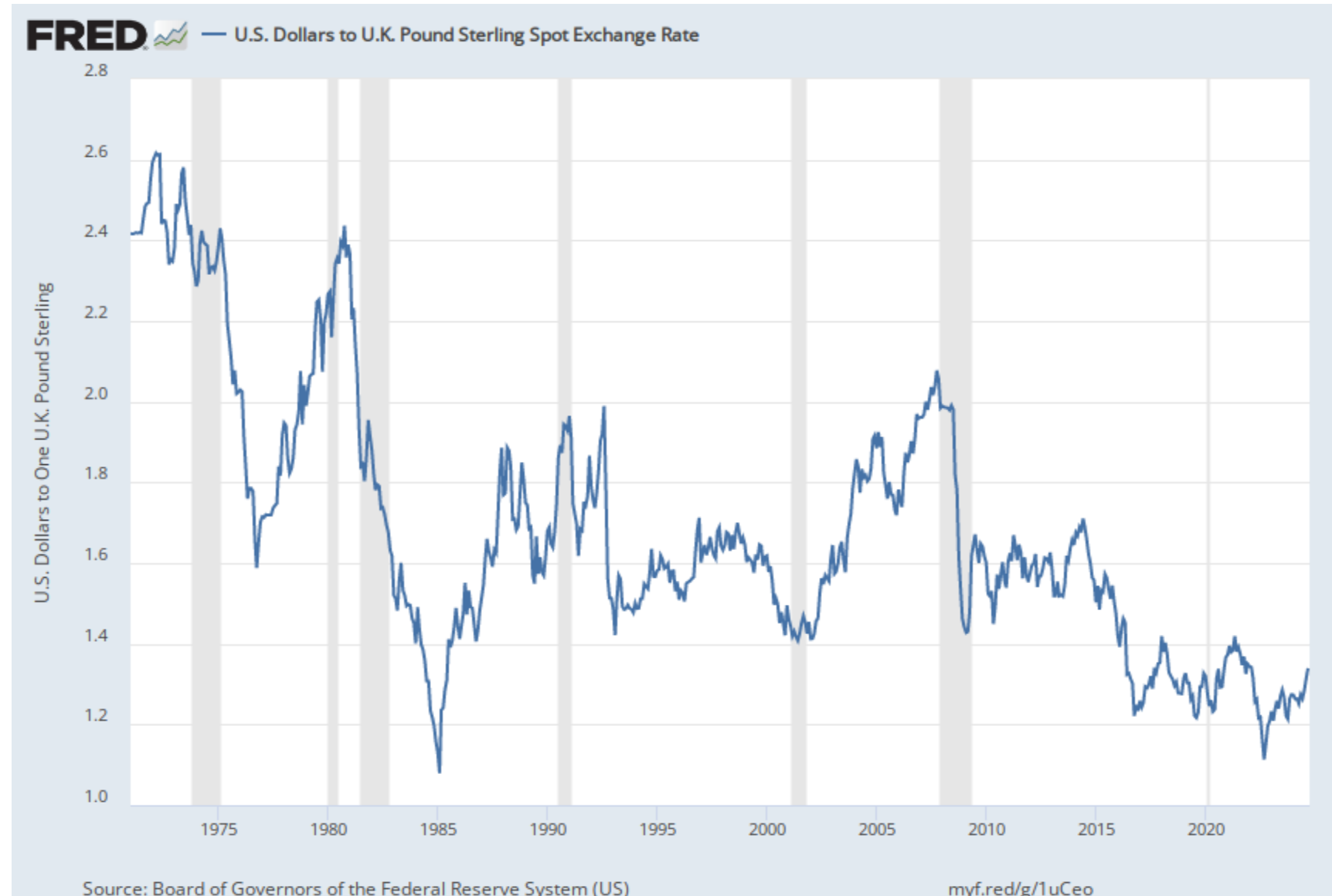
1 UK pound = 1.31 US Dollars

- *Appreciation*: increase in value of domestic currency.
- *Depreciation*: decrease in value of domestic currency.



# GBP/USD exchange rate

- Value of one UK pound in terms of US dollars.
- 2.41 in January 1971.
- 1.31 in Oct 2024.
- Long-term *depreciation* of the pound.
- Large short-term fluctuations.



# How much **foreign currency** can you get for..

## US dollar to £1



## Euro to £1



## Canadian dollar to £1



## Australian dollar to £1



# Exchange rate regimes

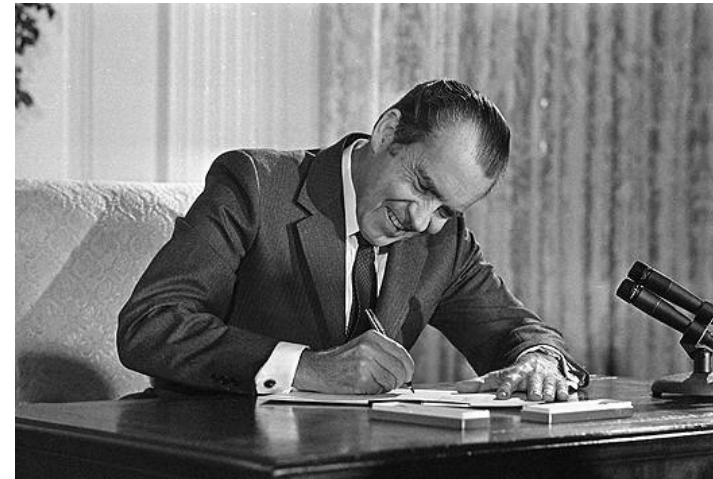
- Flexible (or free-floating) exchange rate
- Managed exchange rate
  - Fixed
  - Crawling peg
  - Bands



- Changes in a managed ER are called *devaluations/revaluations*.

# Global exchange rate regimes

- *1870-World War I*: Gold standard
- *1944-1973*: Bretton Woods system
- *Post-1973*: different E.R. regimes in different countries.



# United Kingdom - exchange rate regimes

**1925-1931:** Fixed in terms of gold (gold standard).

**1931-1940:** Floating.

**1940-1972:** Fixed (Bretton Woods system).

**1972-1990:** Floating.

**1990-1992:** Band w/ European currencies (ERM)

**1992-onwards:** Floating.



**Thank you for your attention**