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Why the devaluation of Sterling has not led to export-led growth | The UK economy is restored to growth and even the IMF agrees. Both the IMF and the UK's Office for Budgetary Responsibility (OBR) forecast that the UK economy will grow at a rate of 2.4% during 2014. International organisations have tended to become progressively less positive with their forecasts as the year progresses since the financial crisis, and it is acknowledged that for the UK, it is largely the result of a catch up process from a really steep decline. Even so, the recent improvements in the UK's unemployment statistics suggest that a recovery is beginning to take hold.

One thing is completely clear to all commentators, however. Exports have not contributed to the positive outlook despite a near 20% devaluation of Sterling between 2007 and 2009. Under normal circumstances, economists would expect exports to increase over the period but instead, exports have grown by just under 11% in total over the past six years; any improvement in total trade growth has come from increases in imports, which have grown by over 26% over the same time period, helping to explain the deteriorating balance of trade which has also been a feature of the post-downturn period. Delta Economics is further forecasting that this trend is likely to continue with no significant uptick in exports until 2018, and even then accompanied by increases in imports that worsen the deficit. As the Delta Economics forecast is in current prices and takes into account currency elasticity of trade, this suggests that UK trade will not benefit significantly if the currency does devalue.

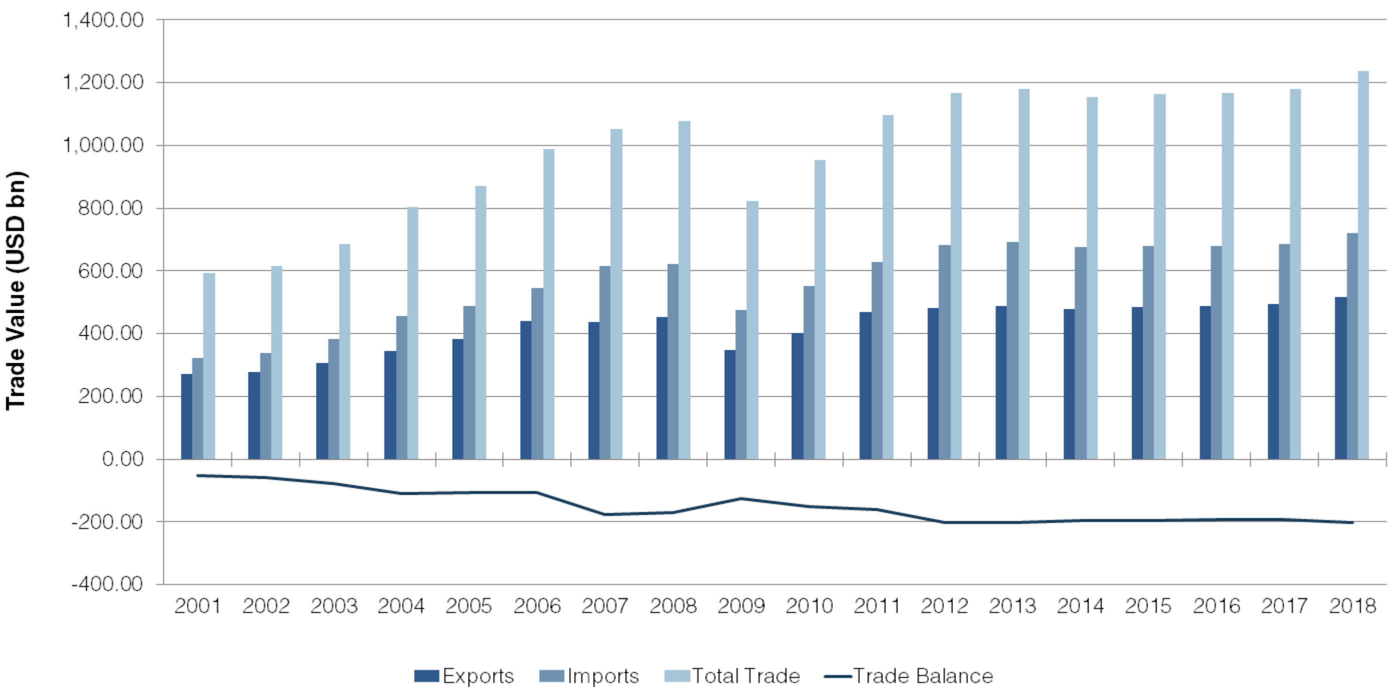

Figure 1 | UK Trade since the financial crisis (2007-2018) Source | DeltaMetrics 2014

The correlation between the UK's currency elasticity of trade and trade itself is extremely low at -0.1044. In other words, because the correlation itself is so weak and negative, the impact is likely to be small but the opposite way which we might expect it to go: imports will increase, despite being more expensive, while exports may even decline with a currency devaluation. Contrast this to Germany where the correlation

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between currency elasticity of trade and trade itself is 0.9960 or the USA where the correlation is 0.9301: in other words, if the currency appreciates then export trade is almost bound to go down and import trade is almost bound to go up – exactly as would be expected.

The result for the UK is clear from the post-crisis data: the month-on-month value of Sterling against both the Euro and the Dollar has deteriorated but imports have increased faster than exports. Total trade is largely unaffected, as shown in Figure 2.

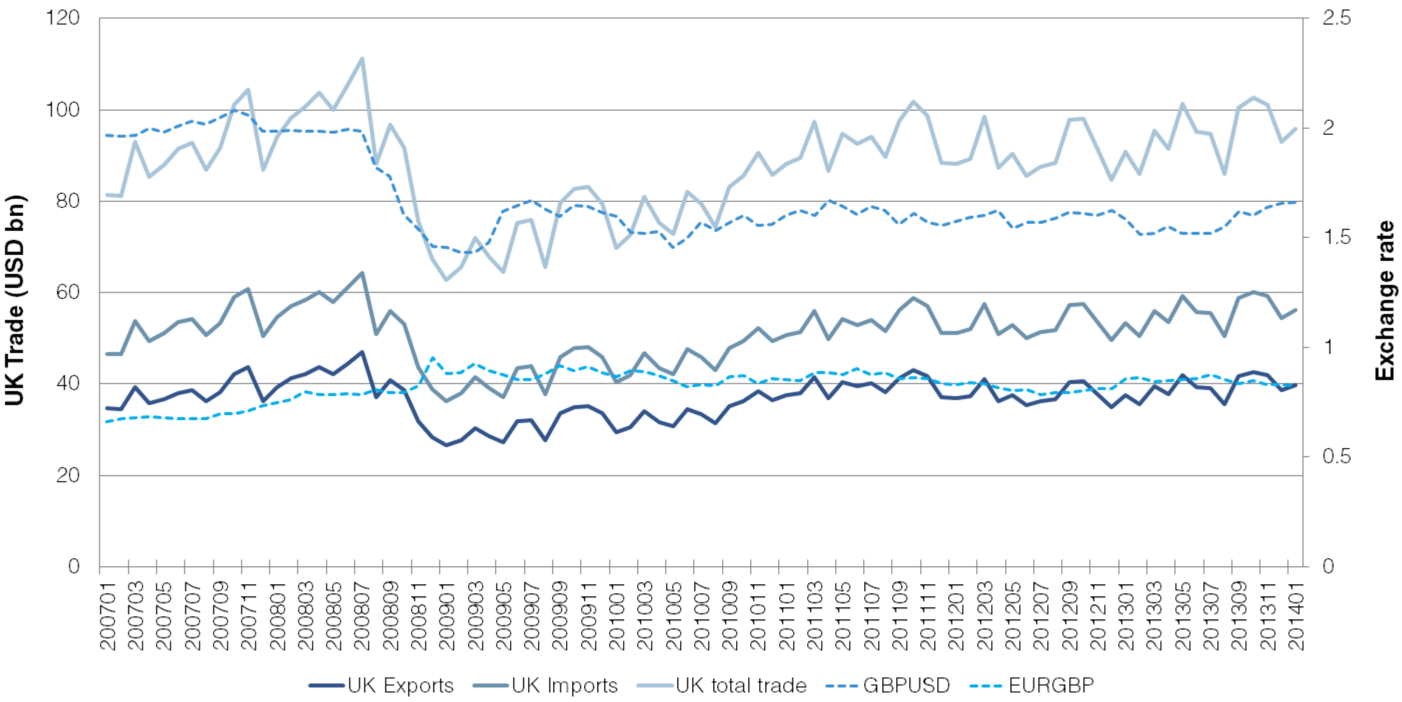

Figure 2 | The post-crisis relationship between UK trade and Sterling values versus USD and Euro (January 2007 - January 2014) Source | DeltaMetrics 2014

The correlation between exports and the value of Sterling versus the USD is mildly positive at 0.4316 but for the value of Sterling versus the Euro is mildly negative at -0.3470. What this illustrates more than anything is that there is only a very weak relationship between total trade and currency values at an aggregate trade level.

More than this, the types of goods that the UK exports are remarkably impervious to currency fluctuations as well. This is illustrated in Figure 3, which breaks this down to HS 22 section level the relationship between key aggregate export sectors and partners and the value of the currency. The UK's top exports are mineral fuels with the Netherlands as our largest partner, and vehicles generally, including cars, goods vehicles, jets and jet engines and all car components. Germany and China are large and fast growing partners in this aggregated grouping.

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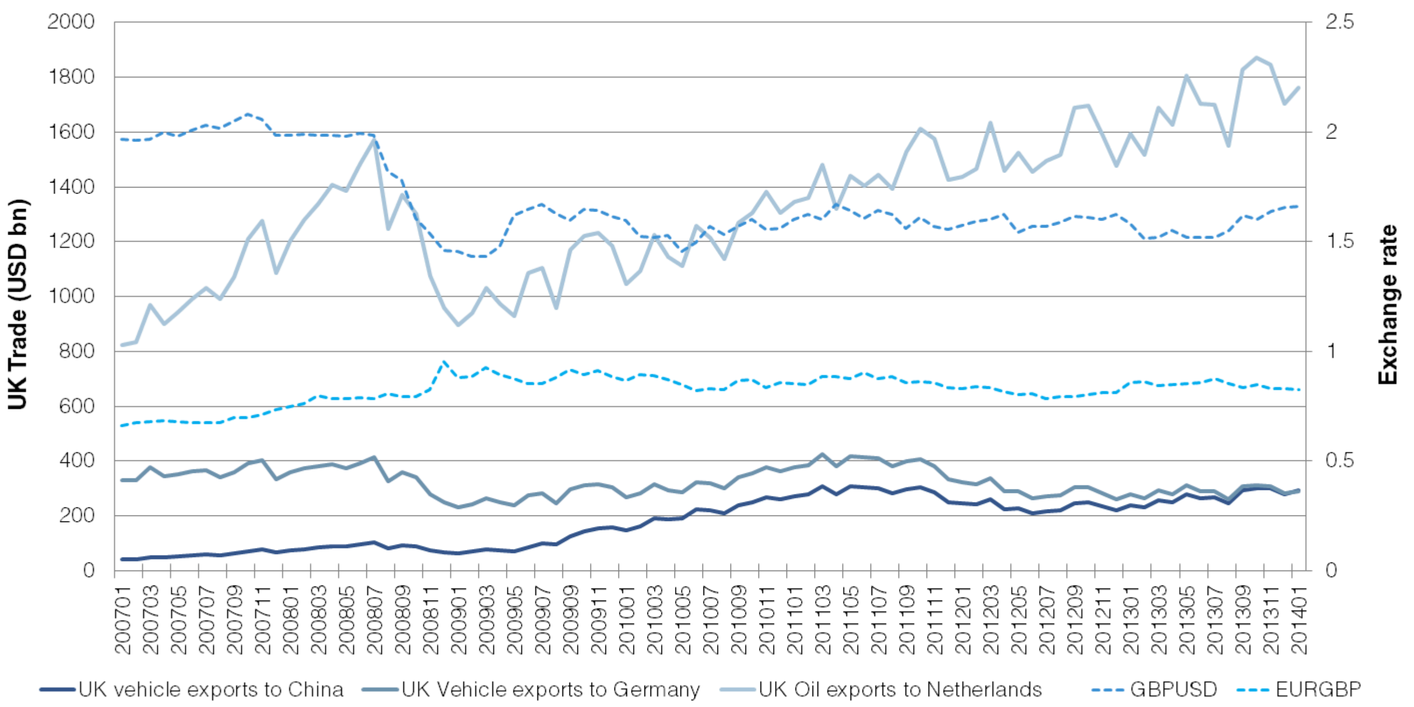

Figure 3 | The post-crisis relationship between key UK export sectors and currency movements (January 2007 - January 2014) Source | DeltaMetrics 2014

Again what this shows is the remarkable lack of correlation between exports by sector and partner and the value of Sterling. The correlation between these sectors and the value of Sterling against the Euro is very low while for the value of Sterling against the US Dollar it is mildly positive for vehicles to Germany at 0.5579 and mildly negative for vehicles to China at -0.5894. For oil to the Netherlands, meanwhile, the correlation with the USD is loose but negative at -0.2783.

UK exports have benefited relatively little from Sterling's devaluation simply because the correlations between UK trade on aggregate and at a more detailed sectoral level are too weak to suggest that there is any causal relationship between the two. This does not mean that there is no correlation at all: Delta Economics' own asset price modelling demonstrates clear predictive relationships between trade corridors elsewhere and the value of Sterling over time. The problem for policy, however, is that currency devaluation itself has only limited influence over UK exports. Equally, policies to promote GDP by creating a short-term consumer bubble through, for example, stimulating the housing market, may actually work to pull in imports rather than create the long-term conditions under which exports will grow.

A potential reason for this is the relationship between trade and GDP in the UK, which is strongly correlated with UK trade at 0.9987. This high level of correlation with GDP is the same for other nations as well (whether developed or emerging). But as a highly open economy, the GDP-based drivers of trade in the UK are shorter-term factors like a rise in consumer demand (with the resultant impact on imports) to a far greater extent than they are in other developed nations. This is the reason why trade has not recovered in the UK despite currency devaluation and any attempt to correct this will need a substantial commitment to long-term GDP growth.

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The implications of this alongside the weak currency correlation is clear: if a currency devaluation is likely to have limited effects on exports, then measures to promote long term GDP growth through competitiveness are essential. Correlations between skills and innovation and UK trade are equally as weak as they are for the relationship with currency. This is in stark contrast with other nations like Germany, France, the US and even India, where the correlations between both GDP and long-term growth drivers like skills and innovation are above 0.8900 in all cases. There is no short-term fix to the UK's exports problems because it, in so many ways, is a case apart.