

Coherence between Balance of Payments Q3 2015 and the FDI 2014 Bulletin

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Introduction

The Office for National Statistics (ONS) published annual estimates for Foreign Direct Investment (FDI) on 3 December 2014 - [FDI bulletin for 2014](#); the release included the first estimates for 2014 from the annual FDI survey and revised estimates for 2013. As noted in that release, ONS carries out an annual FDI benchmarking process to reconcile quarterly FDI data to annual FDI survey data. Due to the short time available it has not been possible to produce reconciled quarterly FDI data in time for these to be taken into the Balance of Payments Quarter 3 (July to September) 2015 release published today (23 December 2015). These data will be incorporated into the Balance of Payments release on 30 June 2016 at the latest.

This note presents data consistent with the FDI bulletin for 2014, but on an asset and liability basis so as to be directly comparable to the Balance of Payments. This is intended to provide users with an early indication of the magnitude of the revisions to the current account once the latest annual FDI results are incorporated into Balance of Payments i.e. after the annual FDI benchmarking process is completed.

Importantly, indications of impact on the current account in this note are provided on the basis that other components of the current account will remain unchanged from the Balance of Payments Quarter 3 (July to September) 2015 whereas, in reality other components may be revised in future Balance of Payments releases, in line with the National Accounts and Balance of Payments revision policy.

If there were no other changes the overall effect of the revisions from the annual FDI survey soften the deterioration in UK direct investment earnings and the current account deficit but would not detract from the downward trend previously reported in the recent analysis of [FDI and the UK current account](#).

Coherence between Balance of Payments and FDI bulletin for 2014

The latest estimates in the published [FDI bulletin for 2014](#) include revised annual data for 2013 and new estimates from the annual survey for 2014. Incorporating these data in the Balance of Payments will result in revisions for 2013 and 2014. Current estimates for 2013 within the Balance of Payments are based on an earlier vintage of data from the annual survey; while previously published estimates for 2014 are based on data from the quarterly survey.

The quarterly survey for outward and inward FDI has 680 and 970 sampled enterprise groups respectively; these increase to 2,100 and 3,500 enterprise groups

on the annual survey. The quarterly survey gives information on the quarterly path and a timely first estimate of annual FDI, whereas the annual survey, which is less timely, utilises a large sample size and allows companies to base their returns on fully audited annual accounts, instead of management accounts that are provided on a quarterly basis.

FDI statistics published by ONS use two different principles: the asset & liability principle and directional principle. The asset & liability principle is used for the statistics presented in the Balance of Payments (BoP), Pink Book, and this note; while the directional principle is used for the statistics presented in the FDI bulletin. Further details relating to the differences between the two principles can be found in this [OECD paper](#).

Although the methodological approaches provide different statistics for the investment positions, flows and earnings, the figures for net FDI earnings (i.e. credits less debits) resulting from the two different principles are broadly comparable. However, asset & liability principle data industry classifications are based on the parent company, whereas directional principle data are based on the affiliate. Since FDI statistics treat certain industries differently, such as excluding loans and interest of the banking industry, small differences between the net earnings figures can occur.

Reconciling quarterly and annual FDI

Once annual FDI data become available, a benchmark process is applied to quarterly FDI data within the Balance of Payments. This benchmark process is an annual reconciliation between the quarterly and annual surveys utilised in the production of FDI data. In the short term, the quarterly survey is used within the Balance of Payments and then later revised when the more comprehensive annual survey data become available.

ONS carries out the FDI benchmarking process on an annual basis and at the earliest opportunity. This note presents FDI estimates for 2013 and 2014 based on the annual survey responses on an asset & liability basis for the first time. These estimates utilise the same methodological approaches used in Balance of Payments to provide users with an early indication of the impact on the current account, if all other components are unchanged. These revised estimates will be incorporated into the BoP release on 30 June 2016 at the latest.

The estimates presented in this note highlight that the decline previously reported in direct investment earnings, and the resulting downward pressure applied to the UK current account deficit remains: all else being equal, the new annual FDI estimates would suggest that the current account deficit reached 4.5% as a percentage of GDP in 2014, compared with the 5.1% estimate in Balance of Payments (published 23 December 2015).

A more in depth analysis of the drivers behind the decline in direct investment earnings can be found in a recent ONS publication, [An Analysis of Foreign Direct Investment, the key driver of the recent deterioration in the UK's Current Account](#).

FDI earnings and the current account

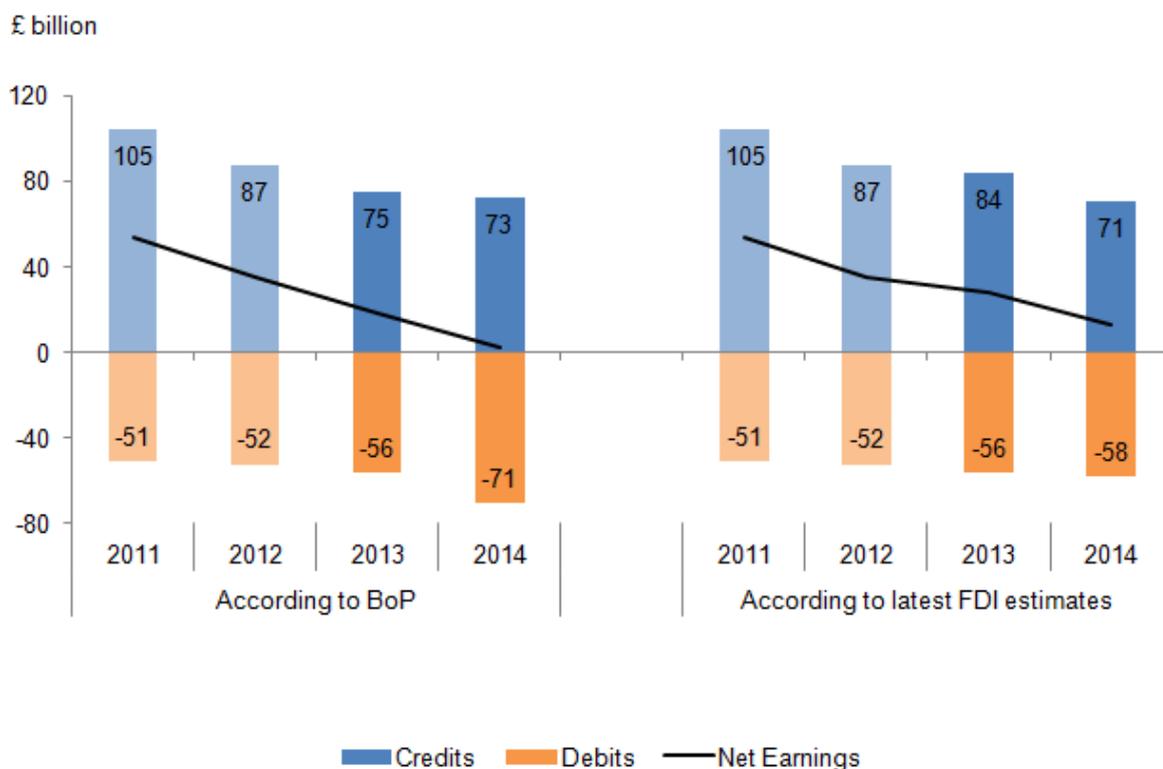
FDI estimates based on annual survey responses when incorporated will result in upward revisions to credits in 2013, from £75 billion to £84 billion; while 2014 credits are revised downwards, from £73 billion to £71 billion.

The new estimates of FDI debits see little change for 2013, remaining at £56 billion; however, there is a notable downward revision to 2014 debits, from £71 billion to £58 billion.

The overall effect of these revisions results in the balance of UK direct investment earnings rising, from £19 billion and £2 billion in 2013 and 2014 to £28 billion and £13 billion respectively.

Although the revisions soften the deteriorations previously reported in net direct investment earnings, the trend previously cited as the driver of the fall – that is, a fall in the amount the UK earns abroad and a rise in the amount overseas investors earn in the UK – remains, as seen in Figure 1.

Figure 1: Net FDI earnings according to BoP and latest FDI estimates

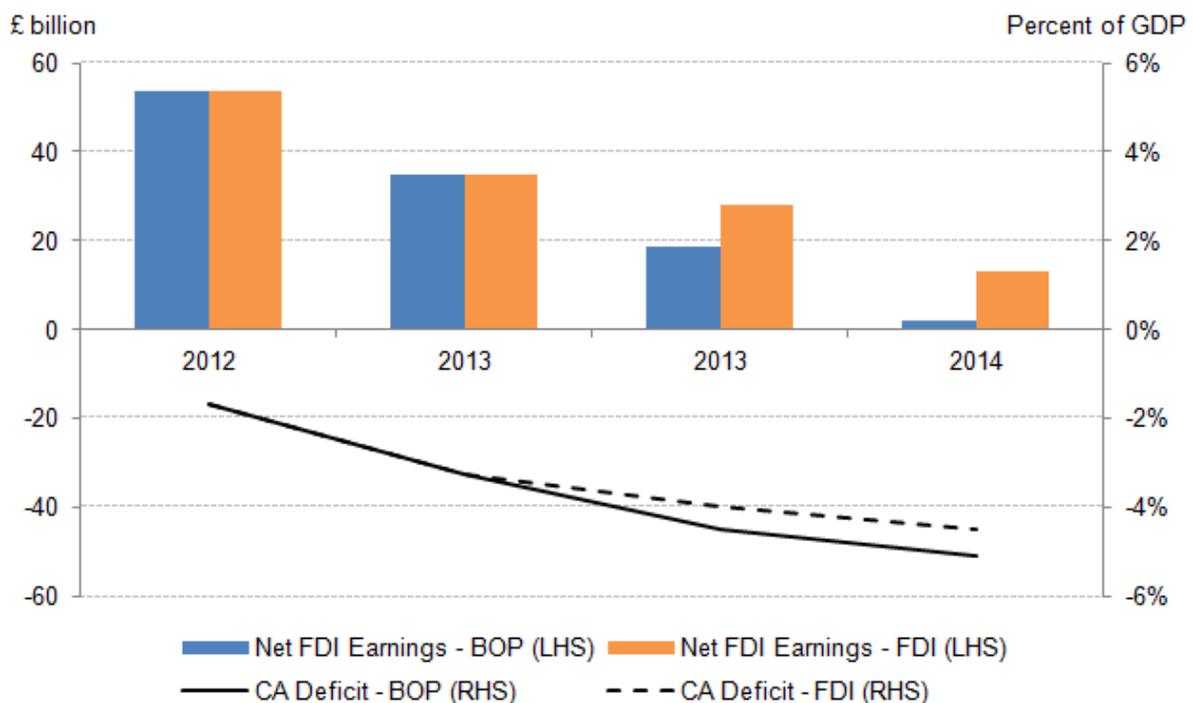


As can be seen in Figure 2, net FDI earnings (credits minus debits) according to today's Balance of Payments have deteriorated consistently since 2011, shown by the blue bars. This decline was the main driver behind the widening of the current

account deficit, from 1.7% in 2011 to 4.5% and 5.1% in 2013 and 2014 respectively – the latter representing the highest deficit recorded since comparable records began in 1948.

The incorporation of revised FDI annual data for 2013 and new data 2014 result in net FDI earnings increasing from £19 billion to £28 billion in 2013 and from £2bn to 13bn in 2014. If all other components are held constant, this would reduce the current account deficit as a percentage of nominal GDP to 4.0% and 4.5% in 2013 and 2014 respectively. However, the current account deficit in 2014 would still remain the highest on record despite incorporating revisions solely from the FDI annual survey.

Figure 2: Net FDI earnings and impact on the Current Account deficit (% of GDP)



FDI positions

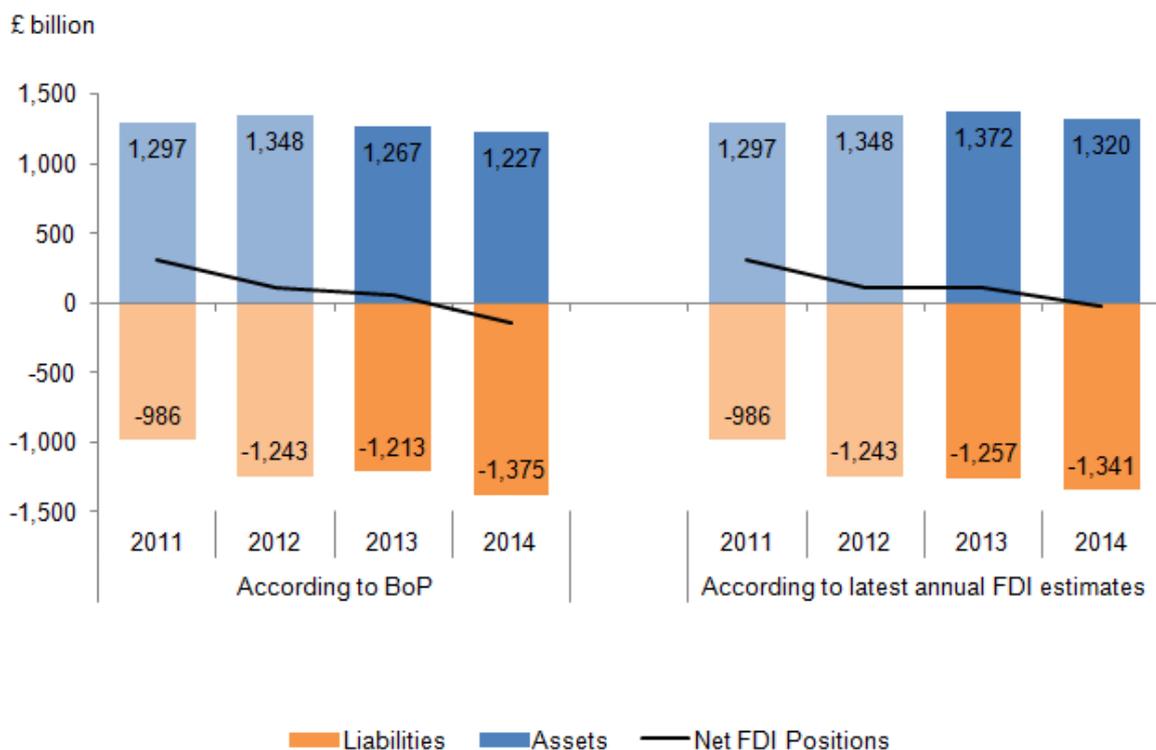
The new FDI estimates based on annual survey responses also result in revisions to FDI positions. On the assets side, new estimates result in upward revisions of £105 billion and £93 billion for 2013 and 2014, to £1,372 billion and £1,320 billion respectively.

In terms of liabilities, there is an upward revision of £44 billion in 2013 and a downward revision of £34 billion in 2014, to £1,257 billion and £1,341 billion respectively.

The overall effect of these revisions results in the deterioration previously reported in net UK FDI positions being softened; the previously published deterioration from £311 billion in 2011 to £54 billion and -£148 billion in 2013 and 2014 respectively is now revised upwards, to £115 billion and -£21 billion in 2013 and 2014 respectively, as seen in Figure 2.

Similarly to earnings, although the revisions soften the decline previously reported, the overall narrative remains the same – the value of UK FDI assets abroad has remained relatively flat since 2012, while the value of FDI into the UK has continued to increase, as shown in Figure 3. Furthermore, 2014 marks the first year that the UK net FDI position turned negative since comparable records began in 1997.

Figure 3: Net FDI positions according to BoP and latest FDI estimates

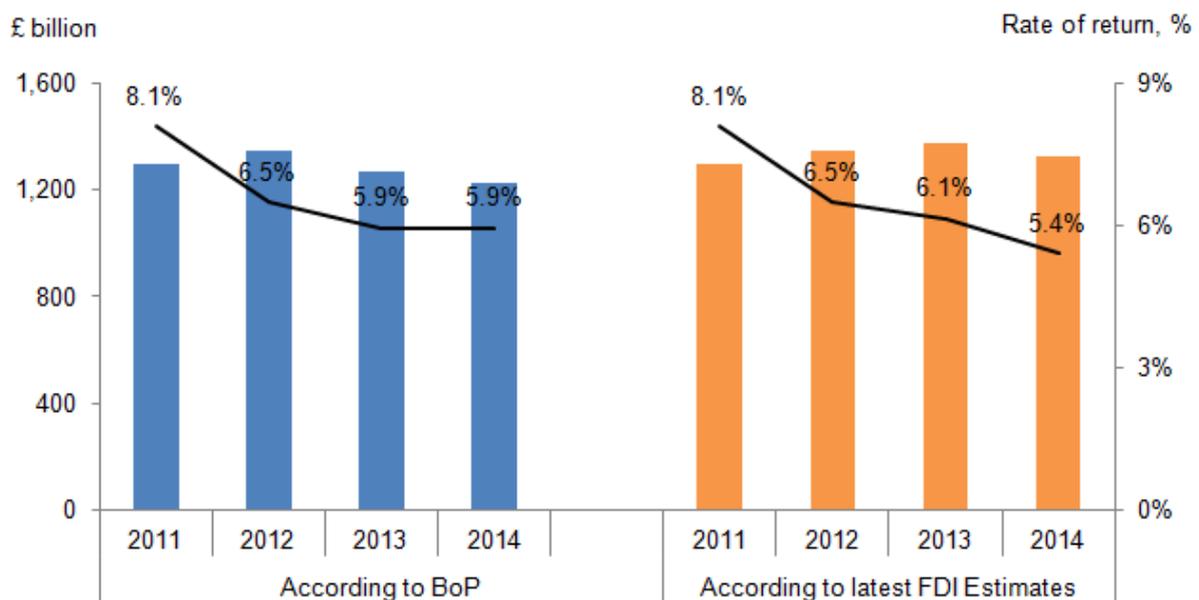


Drivers behind deterioration in net FDI earnings

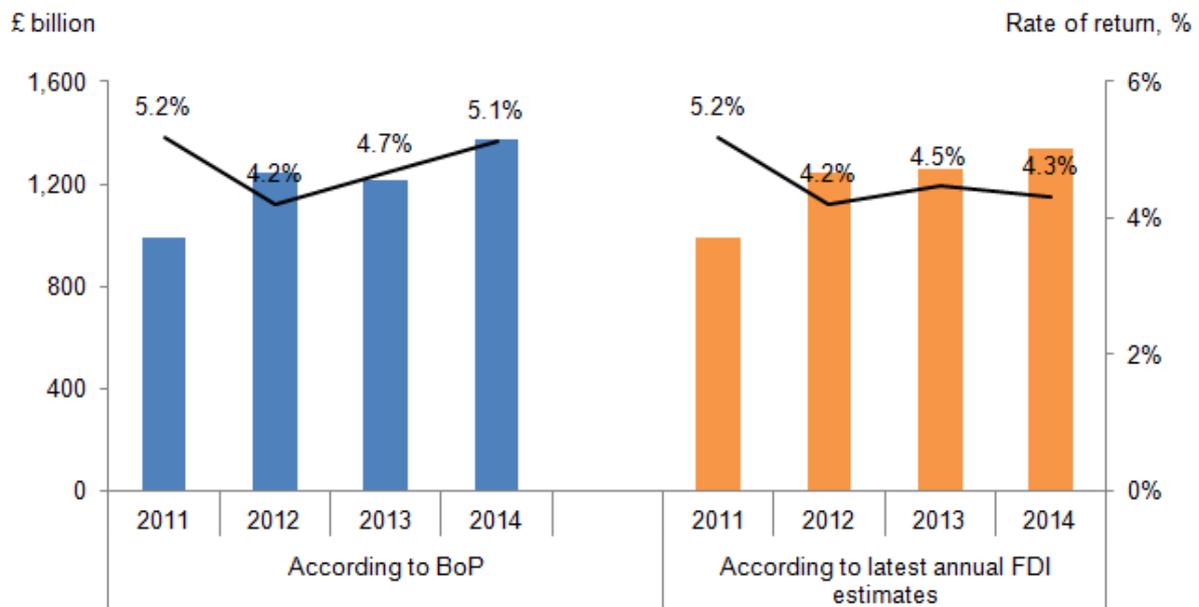
As previously reported in [analysis by ONS](#), a decline in direct investment earnings can reflect a change in the stock of income generating assets, a change in the rate of return generated by assets, or a combination of the two.

The decline in the value of credits the UK generates from its FDI assets were previously linked to a decline in the rate of return UK based investors generate on their FDI; previously reported to have fallen from 8.1% to 5.9% between 2011 and 2014. This explanation still holds in the context of the new FDI estimates, which show the rate of return FDI assets generate fell from 8.1% to 5.4% between 2011 and 2014, as shown in Figure 4.

Figure 4: Stocks of FDI assets and rates of return according to BoP and latest FDI estimates



The rise in debits foreign investors generate was previously linked to a rise in investment into the UK, with a fall in the rate of return from 5.2% to 5.1% between 2011 and 2014 slightly offsetting this. This analysis still applies when examining new FDI estimates, where the value of liabilities increased from £986 billion to £1,341 billion between 2011 and 2014, while the rate of return these liabilities generate has fallen from 5.2% to 4.3% over the same period, as shown in Figure 5.

Figure 5: Stock of FDI liabilities and rates of return according to BoP and latest FDI estimates

It is worth noting that the partial recovery previously reported in the rate of return UK based FDI generates no longer appears in the latest estimates of FDI: the rate of return was previously reported to have declined from 5.2% in 2011 to 4.2% in 2012, before recovering in 2013 and 2014. This recovery does not appear to have materialised according to new estimates, and instead the rate of return remains broadly flat between 2012 and 2014. Nevertheless, the decline in the rate of return generated by UK liabilities since 2011 is notably lower than the decline in that on UK FDI assets.

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