

Article

# Coronavirus and the effects on the UK Balance of Payments

How the global coronavirus (COVID-19) pandemic and the wider containment efforts are expected to impact on UK Balance of Payments as well as some of the challenges that National Statistical Institutes are likely to face.

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# 1 . Overview

Recent external published forecasts project that the coronavirus (COVID-19)<sup>1</sup> pandemic will cause a contraction in the UK and global economy this year larger than that experienced following the 2008 global financial crisis. Given the open nature of the UK economy, including its role as a global financial centre, it might be expected that COVID-19 pandemic will affect the UK's [Balance of Payments](#). Consistent with the [UK National Accounts](#), this provides a coherent framework to understand these effects on the UK's international transactions with the rest of the world. The aim is to highlight those international transactions that might be affected by the COVID-19 pandemic and how this could affect the net lending or borrowing position of the UK.

This is the article that explains how COVID-19 will affect the production of the UK National Accounts, including estimates of [gross domestic product](#) (GDP) and the [UK Institutional Sector Accounts](#). We have also published material on how COVID-19 might affect our estimates of [inflation](#), the [labour market](#) and [productivity](#). Taken together, these provide a holistic picture of the potential effect of COVID-19 on the UK economy, and the practical effects of how we measure it.

## More about coronavirus

- Find the latest on [coronavirus \(COVID-19\) in the UK](#).
- All ONS analysis, summarised in our [coronavirus roundup](#).
- View [all coronavirus data](#).
- Find out how we are [working safely in our studies and surveys](#).

## Notes for: Overview

1. The first case of the coronavirus (COVID-19) was reported to the [World Health Organization \(WHO\)](#) in December 2019 and was subsequently declared a public health emergency of international concern (PHEIC).

# 2 . The UK Balance of Payments framework

The UK Balance of Payments provide the conceptual framework to assess the effect on the UK's transactions with the rest of the world. There are three main features to the framework:

- the current account records international trade, cross-border income that are associated with the international ownership of financial assets and current transfers (for example, foreign aid or remittances) transactions
- the capital account records the transfer of ownership of fixed assets<sup>1</sup> and cancellation of liabilities by creditors without any counterparts being received in return; this would include any transactions that relate to debt forgiveness
- the financial account records the change of ownership in financial assets and liabilities between UK residents and the rest of the world; these reflect direct, portfolio, and other investment, as well as financial derivatives and reserve assets

This framework captures the extent to which the UK is a lender to or borrower from the rest of the world – that is, the aggregate net position of the current and capital accounts – and how net borrowing is funded or net lending is invested. This is captured by recording changes in the net acquisition of foreign assets and net incurrence of liabilities to the rest of the world. The financial accounts is seen as the counterpart to the current and capital accounts.

The UK Balance of Payments framework is complimented by the international investment position (IIP). This records the total stocks of foreign assets and liabilities held by residents of a country. Changes in the IIP between two periods are equal to the financial account transactions and other flows such as revaluation effects (for example, fluctuations in exchange rates or equity markets) and other changes in volume (for example, debt write-offs).

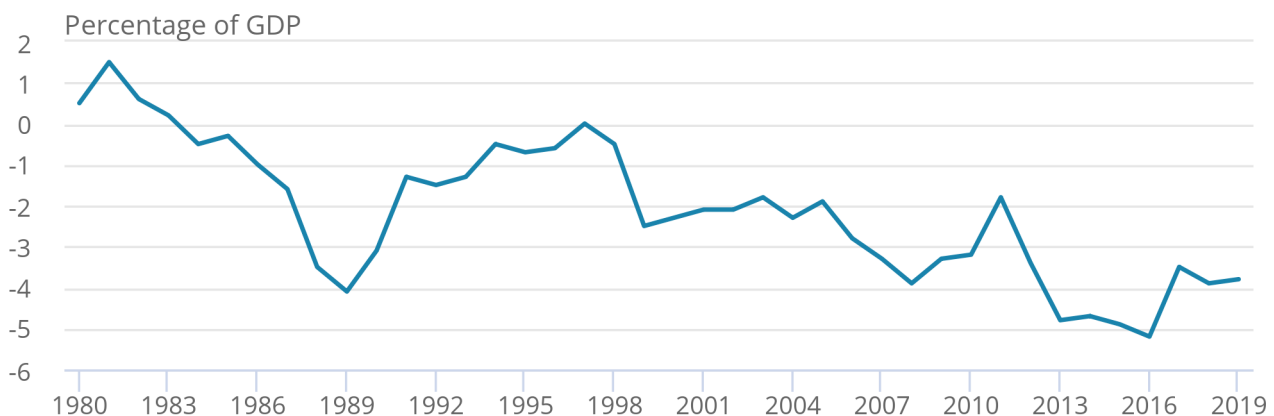
The UK has historically run a current account deficit (Figure 1), which must be financed by net financial inflows. For a net borrower like the UK, financing can be achieved by net increasing the foreign liabilities that are held by the rest of the world and/or net disinvesting in previously-owned foreign assets. It is these flows that we consider in how these might be affected by the coronavirus (COVID-19) pandemic. However, irrespective of net financing needs, there may also be an effect on gross transactions. The value of the UK's gross international financial transactions are very large relative to its net financing needs. It is these flows that we consider in assessing the impact of the COVID-19 pandemic.

**Figure 1: The UK has historically run a current account deficit**

UK, 1980 to 2019

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UK, 1980 to 2019



Source: Office for National Statistics

It is important to recognise that total borrowing must be matched by total lending. For every claim, there is a debtor and a creditor. The extent to which the UK's external position is affected by COVID-19 needs to be considered in this broader context. For example, if domestic sectors increase their net borrowing position, net lending by the rest of the world must increase.

## Notes for: The UK Balance of Payments framework

1. This also includes the transfers of funds associated with the acquisition or disposal of fixed assets.

## 3 . Understanding the international effects of the coronavirus (COVID-19)

Recent external published forecasts project a contraction in the UK and global economy this year that would be larger than that experienced in the 2008 global financial crisis. For example, the [International Monetary Fund \(IMF\)](#) forecasts a fall of 3.0% in the global economy this year. It cites how “domestic disruptions spill over to trading partners through trade and global value chain linkages”, further amplified through international financial linkages. The effects of the coronavirus (COVID-19) pandemic are also highlighted by the [Bank of England Monetary Policy Report \(PDF, 4.76MB\)](#) and the [Office for Budget Responsibility \(PDF, 383KB\)](#)<sup>1</sup>, while the initial [official estimates](#) that have been published so far show an unprecedented fall in UK gross domestic product (GDP).

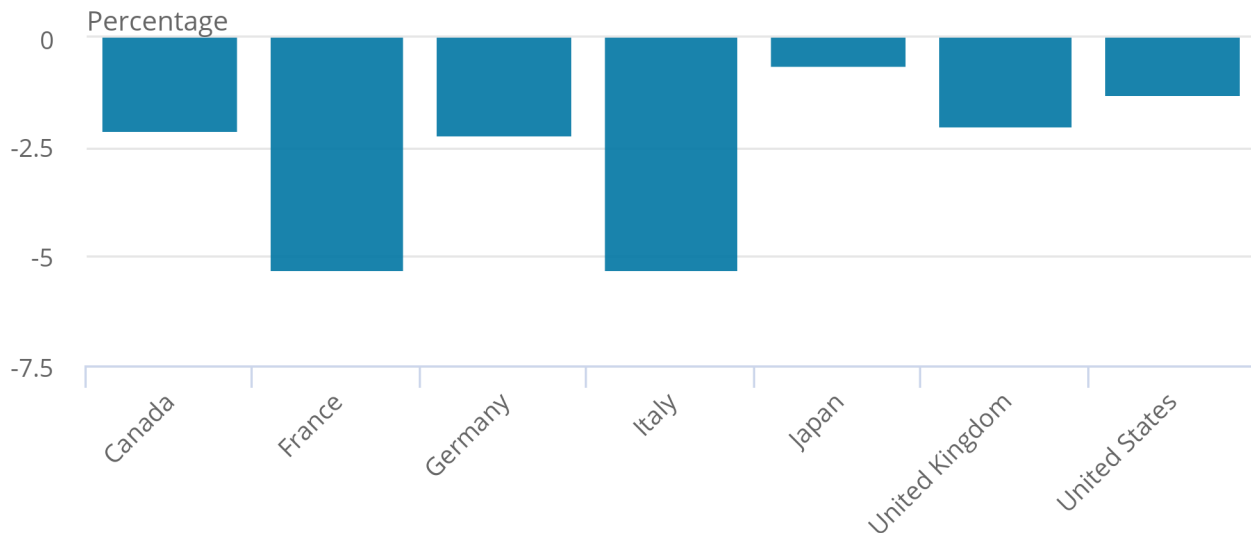
[Recent analysis](#) has explained how the UK economy would likely be affected by COVID-19, including how much of the global economy will experience significant disruptions to trade and global value chains this year. Forecasters expect there to be a sharp contraction in world trade this year, while there will also likely be pronounced movements in financial capital flows, as observed in early 2020. Figure 2 provides some early insight into the effects on the global economy so far, showing how the G7 economies have experienced a contraction in the first quarter of this year. The fall in gross domestic product (GDP) is expected to be larger in the second quarter. The Bank of England estimates that world GDP<sup>2</sup> could fall by over 20% in the second quarter of this year.

**Figure 2: A contraction in GDP of the G7 countries in the first three months of 2020**

Real GDP in G7 countries, Quarter 1 (Jan to Dec) 2020

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Real GDP in G7 countries, Quarter 1 (Jan to Dec) 2020



Source: Organisation for Economic Co-operation and Development

Notes:

1. All figures correct as of 12 June 2020.

In global financial markets at the height of the outbreak of COVID-19, there was considerable uncertainty and volatility. Some of these financial indicators have since stabilized following sizeable policy responses. Financial flows were affected, as was the case in previous episodes of heightened uncertainty such as the global financial crisis and the eurozone debt crisis. It might be that we will see a move away from equities to those financial investments that are considered less risky, such as bonds and cash, until there is more certainty around the outlook for the UK and global economy. Nonetheless, protracted economic uncertainty might provide have provided opportunities for speculative financial activity increasing gross transactions.

We look at the anticipated economic effects of the COVID-19 pandemic on the UK through the framework of the UK Balance of Payments. This is to explain how these effects on the gross and net international transactions would be recorded. As such, these are not to be considered as forecasts but rather as illustrative examples, particularly as there will be much uncertainty around how this may play out in practice. We will provide a more informed picture of the effects when these are published.

Some examples of those that are likely to be affected include the following.

## Trade

Gross trade flows into and out of the UK will likely be affected, with the COVID-19 pandemic affecting the demand and supply of goods and services. A contraction in the global economy reduces the demand for UK exports, all else equal, while lower domestic demand reduces UK imports.

The expected lower levels of domestic production would most likely lead to a fall in intermediate inputs, including those that are imported. There may also be effects upon the timing and composition of trade flows. For example, it is possible that there might be some stockpiling of inventories in anticipation of the supply chain disruptions. This might lead to some of these gross trade flows being brought forward to some extent and/or a shift in those goods and services that are traded to reflect the health response to COVID-19.

The restrictions on physical movements that have been imposed and the lockdown of production in many countries will likely lead to disruptions to global value chains. This might be reflected in a shift in the patterns of international trade. It might also lead to a lower trade intensity of demand which would be reflected in lower levels of gross trade flows for a given level of GDP.

Cross-border services are delivered through [modes of supply](#), many of which will be affected to a varying extent by COVID-19. For example, the effects of physical restrictions might be marked for travel and transport services, which would affect the ability of tourists and students to consumer their respective international services. Alternatively, these restrictions affect the ability of UK and foreign individuals to provide their services in other countries.

## Investment income

There may be an impact on income on foreign equity investment that UK and international investors hold. This might reflect a change in that corporation's profits or its accumulated retained earnings, which will be related to the performance of the global economy. It might also reflect the decision to make fewer dividend payments to preserve capital. It is also likely that the income on debt investment will also be affected, reflecting lower interest rates in many countries.

## Current and capital transfers

Current transfers include foreign aid and remittances receipts, which are likely to be affected by the broader impact of COVID-19. For example, the voluntary and involuntary restrictions in place has impacted upon certain industries in many countries. Migrant workers are prevalent in some of those industries, which could impact on level of remittances payments. This might reflect any fall in labour demand in those industries, or that migrant workers may return to their home countries in response to the pandemic. Any co-ordinated international policy response on debt forgiveness would be reflected in capital transfers.

## Financial flows

Financial flows are inherently volatile in nature, particularly in times of heightened uncertainty. The response in financial markets to COVID-19 has led to pronounced movements in international capital flows. The latest [Financial Stability Report \(PDF, 4.88MB\)](#) highlights how COVID-19 has led to a "sudden repricing of financial assets, deterioration of market liquidity and increased volatility" and how there has been a shift in investor appetite to safe and more liquid assets, highlighting "an abrupt and extreme dash for cash". Being a global financial centre, there will be implications for gross financial flows into and out of the UK.

In response to the COVID-19 pandemic, there have been large [fiscal and monetary policy packages](#) implemented in the UK and in other countries. The implementation of large fiscal stimulus packages will lead to an increase the supply of government-backed debt to finance these interventions, possibly impacting upon asset and liability transactions in the UK financial accounts.

New foreign direct investment (FDI) acquisitions might reduce until there is less uncertainty and confidence returns to the economy and the financial position of companies. Businesses may increasingly retain any profit they make, increasing re-invested earnings. Alternatively, firms may draw on previously retained earnings in order to repatriate profits back to their headquarters. Similarly, intra-group cash flows may increase in the form of capital injections or loans on favourable terms to help with the financial position in the new operating environment.

## International investment position

The UK's external balance sheet not only reflect financial transactions, but the impact of revaluation effects and other changes in volume. [Previous analysis](#) explains how movements in the UK's international investment position have been particularly pronounced around large movements in the exchange rate and/or stock markets, reflecting how these impact upon the value of the UK's external assets and liabilities. These financial movements have been particularly marked in response to COVID-19.

### Notes for: Understanding the international effects of the coronavirus (COVID-19)

1. The Bank of England has produced a scenario in which the UK economy contracts by 25% in the second quarter of this year. The Office for Budget Responsibility has produced a reference scenario in which real GDP falls by 35% in the same period.
2. This is a UK-weighted estimate of world gross domestic product (GDP), which reflects the UK's export share for that country and its expected GDP.

## 4 . Practical challenges

Early estimates of these flows and stocks in the UK Balance of Payments framework are subject to data revisions, reflecting the inherent trade-off between timeliness and accuracy. As we incorporate more comprehensive information from a wide range of surveys and administrative records, those initial estimates are revised.

[Recent analysis](#) has highlighted the compilation challenges we expect to face in producing the UK National Accounts, including that it is likely the data content of these early estimates will be lower than typically is the case. Those challenges that relate to imputation and forecasts are as pertinent in how we compile the UK Balance of Payments, given the potential effects on restricted survey samples, lower response rates and lower quality administrative information.

The [International Monetary Fund \(PDF, 269KB\)](#) provides further information that helps countries consider how to compile the UK Balance of Payments components, including advice on data collection and compilation to ensure the continuation in its production. To mitigate these challenges, we are using a range of collection methods to ensure we have the highest quality and most representative data possible. In line with international best practice, we have focused on key respondents and key industries affected by coronavirus (COVID-19) with many large respondents contacted directly.

Given these known challenges, we will focus resources on the main transactions that are likely to be affected, including looking at alternatives for how this information can be collected where necessary. External indicators will provide further insights on how financial markets are responding and how this might be impacting upon the recording of the UK Balance of Payments. We will look to collect wider intelligence and/or apply our best judgement, where necessary, reflecting this when we produce reconciled estimates of the UK Balance of Payments.

## Trade in goods

Our estimates of goods trade are largely produced using HMRC records, which we expect to have minimal effect on collection from the COVID-19 pandemic. To supplement these data deliveries, we are looking at wider management information on a weekly basis, which include the number of declarations, trader counts and trade values. This is only available for non-EU trade movements only, as EU trade movements are not available on such a frequency given the different collection system ([Intrastat](#)) for those estimates. We expect trade in goods to be the most reliable component of our international transactions, though we will continue to look into whether there are any effects on the collecting and processing of customs declarations and Intrastat collection.

## Trade in services

We expect there to be more pronounced effects on our estimates of cross-border trade in services, which are collected through a range of surveys. The International Trade in Services (ITIS) comprises around half of the total trade in services estimates. Early evidence points to lower response rates, so we have developed statistical estimation models to help in the quality assurance of ITIS survey returns we have received so far. This looks at alternative data sources such as the Index of Services (IoS), Index of Production (IoP), external indicators and information from other ONS surveys.

We have traditionally collected some travel-related services through the International Passenger Survey (IPS). However, the imposition of social distancing has led to the suspension of such in-person conducted surveys.

For Quarter 1 (Jan to Mar) 2020, we have been able to use monthly IPS data for January and February, using partial responses for March to model that monthly figure. While we recognise that March data will have a lower response than typical, we have quality assured the data against other travel data sources to ensure the estimate reflects the changing picture for travel services.

For April onwards, we have been working with our Data Science Campus to create new estimates using alternative data sources. We have looked to include a diverse range of data sources as possible, including Civil Aviation Authority, Eurotunnel, Consumer Prices Index including owner occupiers' housing costs (CPIH), airline stock figures and aggregated and anonymised foreign-issued card spend. We will continue to develop these estimates over the coming months and any improvements may result in larger than usual revisions for travel services.

## International investment

In response to the COVID-19 pandemic, the Bank of England has published guidance to reporting financial institutions on the reporting of statistical returns which emphasised the need to collect timely, good quality estimates. Furthermore, the guidance also requested that reporting firms contact the Bank if they foresaw any difficulties in meeting reporting deadlines or they anticipated a fall in data quality. The Bank has also tried to limit the number of queries sent to firms in an attempt to alleviate the reporting burden. Early indications show there has been minimal effect on statistical data collections, with forms reported on time and of the normal high standard.

To compile to most representative view of investment activity, we have prioritised data collection efforts for the Foreign Direct Investment survey towards companies with the highest net book value and have moved all paper responders fully online from Quarter 2 (Apr to June) 2020 onwards.

## Production challenges

There are a couple of production challenges that we are aware of, which will require further consideration.



The net lending/borrowing position of the UK can be measured either from the current and capital accounts or from the financial accounts. In theory, these two net positions match. However, in practice, this conceptual equivalence is a challenge and so there will be a statistical discrepancy that reconciles these estimates. Given these current production challenges, it is possible that the level of statistical uncertainty will be higher and so this statistical discrepancy could be larger than normal.

Changes between end-periods reflect financial transactions, revaluation effects and other changes in volume (collectively known as “flows”). [Recent analysis](#) has highlighted that exchange rate movements can impact upon the value of the UK’s external balance sheet, as there is a currency mismatch in the gross financial asset and financial liability positions. The market values of external assets and liabilities arise from changes in market prices of financial assets, such as equity and debt traded on stock markets. Movements in financial markets have been particularly marked in response to COVID-19, so there may be additional challenges in producing reconciled flows and stocks positions.

## 5 . Conclusions

The coronavirus (COVID-19) pandemic is having significant economic and financial impacts on global trade and financial linkages. We have reflected on some of the developments that have taken place so far, which we will continue to monitor. The UK Balance of Payments provide a coherent framework to assess the international impacts, including those on trade, investment income, current and capital transfers and financial flows.

It is important to note that we do not consider the likely effects highlighted here as forecasts, nor have we provided an exhaustive list of all the effects that will be experienced. Instead, we have highlighted some of the possible effects we might see in response to COVID-19, explaining some of the main channels through which the UK’s international transactions is likely to be affected. We will provide a more informed picture of the effects when the UK Balance of Payments are published.

Compilers will face significant practical challenges in producing the UK Balance of Payments, which may lead to higher levels of uncertainty. We have explained the main issues that we expect to encounter and some of the steps that we are taking to help better understand and, where possible, tackle these challenges. We will continue to work with other National Statistics Institutes, central banks and international organisations in looking to implement best practice in response to these challenges. The compilation of these estimates will be monitored closely, as we look to ensure that we are able to capture these effects.