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Home from the Holidays

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As Britain returns from the holiday break this year, followed inevitably by the sound of credit card bills falling onto the doormat, there may be a greater feeling of dread than usual.

If you have travelled to the US or Europe, you will be acutely aware that not only has the “pound in your pocket” changed shape this year but so too has its value when exchanged into US Dollars or Euros. In fact, since June 2016, the pound is worth about a fifth less than it was.

The depreciation against the USD started way back in 2008 when a pound sterling bought you $2. Against the Euro, sterling devaluation only commenced in 2015, well before the Brexit vote, when a pound would buy EUR1.44 against EUR1.08 today.

Britain has enjoyed a devaluation recently that is significantly larger than the 14% devaluation that Harold Wilson engineered back in 1967.

In normal circumstances two consequences would follow:

- Inflation would tend to rise as the cost of imported goods rose and
- The deficit on the trade account would fall, sharply, reflecting goods substitution at home and the greater competitiveness or cheapness of British goods on world markets.

A devaluation is often one of the key policy recommendations made to uncompetitive countries to help kickstart their economies.

Interestingly this time around, the economies that arguably should be looking to devalue e.g. Greece but perhaps the other southern European economies cannot devalue due to their membership of the Euro but more importantly and despite all the hardship since the crisis their electorates clearly do not want to devalue i.e. leave the Euro.

Simultaneously, the British rate of inflation has yet to be seriously impacted and the trade account has deteriorated over the summer despite the significant negative shock to the UK terms of trade.

One of the reasons behind this is that Britain is very dependent on foreign direct investment. Wherever you stand on the Brexit issue in the medium term, the current uncertainty surrounding Britain’s future relationship with its key export markets is resulting in foreign corporations deferring investment.

As clarity begins to emerge from the fog of the Brexit negotiations, foreign corporations should begin to echo foreign visitors to Britain this year who “can’t believe it’s so cheap!” and restart their investment programmes boosting growth.

In the meantime, aided by climate change, British wines are doing very well. We have the chalky terroir, the rain and increasingly the sun. Drink British, it’s a cheap and cheerful way to start the Autumn and help the trade account.

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