Trading through the pandemic: recent trends in UK exports and imports

Economic commentary

2 December 2020

Key points

- The UK's exports have expanded at a brisk pace in the past few years, helped by solid global growth and the depreciation of sterling in the wake of the EU referendum. At the same time, the long-standing shift from goods to services has stalled, while there are signs that Brexit has already had an impact on trade with the EU.

- After steep falls earlier in the year, as the Coronavirus pandemic struck, trade flows have revived in the past few months. Indeed, the value of goods being imported into the UK is now back to normal levels. But goods exports are still markedly lower, and trade in services will not recover fully until people are able to travel again.

- Imports will continue to expand in the coming months, in response to brisk demand for consumer goods, pre-Brexit stockpiling, and purchases by the government of personal protective equipment (PPE) to facilitate the roll-out of COVID-19 vaccines. Looking further ahead, however, some important trade flows will be dampened as a result of the UK's final extrication from the EU.

The four years since 2015 have been pretty decent ones for British exporters. The UK's export earnings haven't grown so briskly since before the global recession of 2008-09. But the Covid pandemic has upset the apple cart, with trade flows falling off a cliff earlier this year. Although a revival is now under way, the recovery is far from complete, and the 'new normal' is unlikely to be exactly like the 'pre-Covid normal', not least because of Brexit. Even before the UK's formal departure from the EU at the end of January 2020, its impact was already being seen in the trade statistics. There will inevitably be more to come, with the new trading arrangements imposing extra costs, and in the near-term the negative impact on UK-EU trade is unlikely to be made good by new agreements that might be struck with other countries. The upshot is that exporters are likely to find the going rather tougher in the years ahead.

The pre-Covid normal

Let's begin with a few basics. In 2019, the value of all goods and services exported from the UK amounted to £691 billion, while imports were valued at £721 billion, giving a total of just over £1.4 trillion. With imports exceeding exports, there was a deficit of £31 billion, which was equivalent to about 1.5% of GDP. This wasn't unusual, with the UK having run a shortfall on its trade in every year since 1998. The UK is the world's second largest exporter of services, after the United States, and habitually generates a substantial surplus. But this is hardly ever enough to make up for the big shortfalls on trade in goods.

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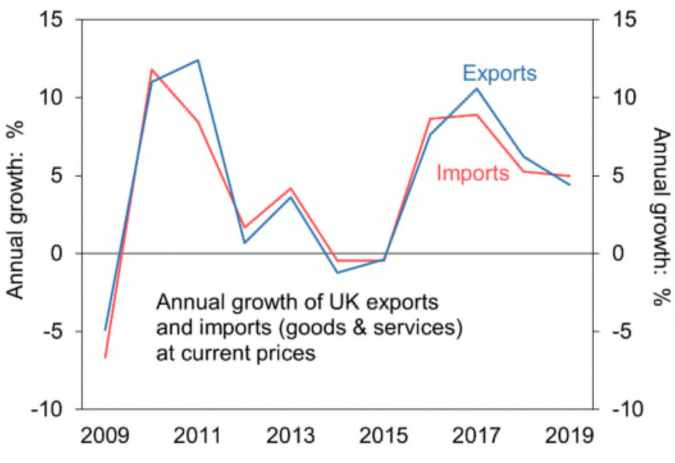
Although recent years have seen relatively lacklustre economic growth at home, with GDP expanding by less than 2% every year since 2016, the global economy has enjoyed a relatively robust streak after the wobble that emanated from China in the middle of the last decade. The competitiveness of British products and services has also been enhanced by sterling's depreciation following the EU referendum in 2016. So, after a period of sluggish export growth in the years following the recession of 2008-09 (exports even fell slightly in 2014 and in 2015), the past few years have seen a marked change of gear. The result was that in 2019 the value of total exports was nearly a third higher than it had been four years earlier.

As ever with trade data, there are some caveats. Some of the growth in the past few years has been down to a doubling in the value of oil exports during 2017 and 2018, followed by a surge of outbound gold shipments in 2019. But even taking account of these, exports in 2019 were still 29% higher than in 2015. With imports growing at a similar pace – 31% between 2015 and 2019 – the trade balance has varied little and shown no clear direction.

A key development in 2019 was an apparent surge in sales to China, propelling it into third spot in the ranking of export markets for goods. Indeed, if the £25.1 billion of exports to Mainland China is combined with the £9.4 billion that went to Hong Kong SAR, then the total of £34.5 billion wasn't far behind the £36.6 billion of goods that was shipped to second-place Germany. But before we get carried away with any notions that Britain has taken advantage of the trade spats between China and the United States, the fact is that almost all of last year's increase in exports to Mainland China was the result of gold shipments, which were negligible in 2018 then surged to around £5 billion last year. London has always been a major centre for trading in precious metals, but it's only in the past year or two that the value of inbound and outbound shipments has exploded. It should be noted that this is "non-monetary gold", and nothing to do with any movement of gold that forms part of the reserves held by the Bank of England and other central banks. In the overall ranking of export markets, taking account of services as well as goods, China remained in sixth place.

In due course, it's likely that Brexit will lead to a shift in the geographic pattern of the UK's exports and imports. EU countries will always be major trading partners, simply because they are similar economies and because they are geographically close. Yet last year saw a small decline in the value of exports to the EU, while the EU share of Britain's total trade was, at 47.3% at its lowest for at least two decades. These shares are prone to bounce around somewhat, and in any case the EU has been waning in importance as a trading partner for the UK for

Exports and imports have grown at a brisk pace since 2015



Source: ONS

at least a decade as global economic activity has tilted towards China and other emerging economies. It is likely, however, that the reconfiguration of supply chains ahead of Brexit has had an impact on the figures. This could be the result of EU-focused supply chains reducing their purchases from the UK, to avoid increased complexity, or of British firms seeking to mitigate this threat by shifting production out of the UK. In contrast, trade with the United States has continued to expand at a robust pace, with the value of bilateral flows in 2019 being more than two fifths higher than in 2015. As a result, the USA alone now accounts for almost a sixth of Britain's trade.

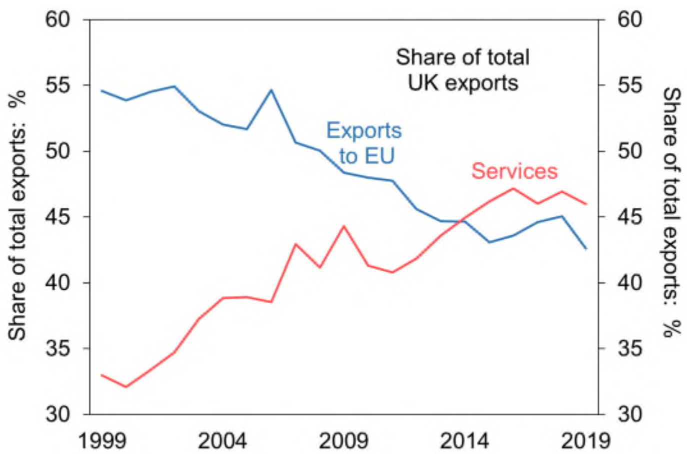
Two decades ago, the UK's exports were still dominated by goods, despite the long-standing surplus that was earned on services such as shipping, banking and finance. Until recently, it appeared that an unstoppable shift was under way, from trading in merchandise to trading in services. This was hardly unexpected, given the evolving structure of the UK's economy and also of consumer spending. Indeed, it was widely expected that by the early 2020s Britain would be the first of the major advanced economies to export more services than goods. But the process appears to have stalled since 2015, with the share of services stuck at 46-47%. In 2019, for instance, overseas sales of services rose by just 2%, as against 6% for goods, as a result of which the bumper surplus on services narrowed from £111 billion the year before to £100 billion.

Here again, Brexit may be having an impact. Earnings from services sold to EU countries fell last year, and although the decline was modest at just over 1%, it followed several years of very strong expansion. Part of the explanation was a drop of about a tenth in earnings from financial services, where the ending of 'passporting' rights for UK banks from the start of 2021 has led to considerable reorientation of activities to ensure that EU clients can still be serviced. The biggest cause of the fall, however, was a steep decline of about a fifth in the income earned from travel and tourism, reflecting lower spending by visitors from the EU.

The pandemic experience

The first evidence of the Coronavirus pandemic showed up in the UK's trade data for January, when the value of goods exports fell by 15%. This was the time when the virus was running rampant around Hubei Province in central China, leading to the lockdown in the city of Wuhan, a widespread retreat indoors by consumers across the country, and the closure of many factories. It's therefore hardly a surprise that during the months of January and February the value of merchandise shipments destined for Mainland China fell by over 60%. It was not until

The changing pattern of UK exports: less to the EU; more from services



Source: ONS

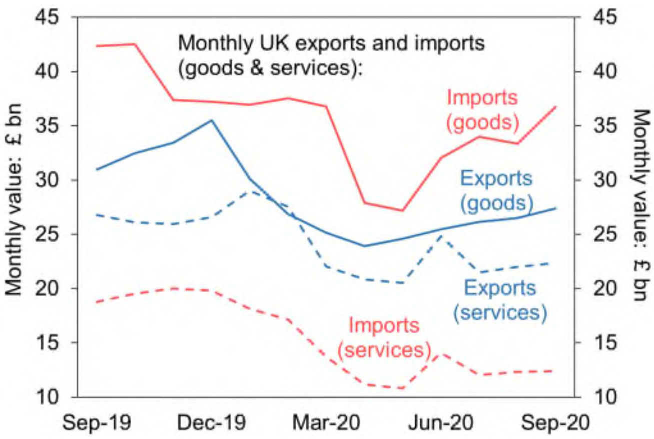
March (after children had enjoyed their half-term ski breaks) that the pandemic started to take a toll on trade in services, with the widespread cessation of travel and tourism activities being the principal culprit. As for imports of goods, it wasn't until April, by which time the UK was in a full-blown lockdown, with all non-essential shops closed, that the flow of goods imports was choked off.

April marked the nadir for exporting, with values 28% down from December. In the case of imports, the low-point wasn't reached until May, by which time values had shrunk by 33%. An unforeseen side-effect of the pandemic has been that the UK has enjoyed a rare trade surplus during most of 2020. The previously-mentioned surge in gold shipments had already narrowed the gap in the second half of 2019, but over the first nine months of this year, exports have exceeded imports by a not inconsiderable £22 billion. This doesn't mean that the balance of payments current account will be in surplus. Far from it. There's still plenty of accounting to go through to get from the trade balance to the current account, and most of it has continued to be deeply negative.

The slump in imports of services was especially marked, with a decline in value of 45% between December and April. We Brits are notoriously fond of foreign holidays (which count as 'imports' of services), and with these off the agenda from early March onwards, the amount spent on travel and tourism slumped by nearly 90%, compared to the final quarter of 2019, to a paltry £1.5 billion in the second quarter of this year. Unlike goods, where most categories saw declines, service sector trade outside of travel and tourism was only lightly impacted, and the figures for both exports and imports show no obvious signs of a major economic shock.

For businesses exporting goods, the revival started in a small way in May. By that time, the economies of China, South Korea, and some others in Asia were back on their feet, while European economies were also beginning to unlock. Imports of goods didn't begin to revive until June, which saw the re-opening of 'non-essential' shops and the resumption of activity at factories and construction sites. In June alone, the value of goods imported into the UK surged by a sixth, or by just over £5 billion. With another surge in September, goods imports were by then only 1% shy of their level in December of last year. With many consumers forced to save during the spring lockdown, demand in recent months has been brisk, with people shelling out on electronic gadgets, new furniture, including for gardens, and household appliances. In September and October, non-food retail spending was higher than it had been a year earlier. This partly explains why imports from China are likely to be higher in 2020 than they were last year. Although imports fell sharply from February, they've recovered strongly, so that in the period from January to September they were nearly 4% ahead of 2019's figures.

A decent recovery in imports … but not so much for exports



Source: ONS

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On the other hand, the recovery of goods exports has been much more muted, so that by September they were still nearly a quarter down from December's level. Supplying the sort of products that people buy during a time of lockdown isn't the UK's area of strength, and hasn't been for the past 40 years. Instead, its exports are focused on machinery, cars, aircraft, chemicals, oil, and pharmaceuticals. The trade in crude and refined oil, for instance, is still running at roughly half its pre-Covid level, thanks to lower demand from drivers, who are using their cars less often, and lower prices. Meanwhile, despite a revival in recent months, exports of cars during the first nine months of this year were more than a third down from a year earlier. In other product areas, however, such as food, beverages, and chemicals, trade has continued to flow relatively normally.

Exports to China in the first nine months of 2020 were down by a fifth, compared to 2019, though the picture is muddied by oil, where sales plunged by around two thirds. Excluding oil, the value of exports rose by just over 2%, thanks in part to stronger car sales. This is a reflection of the degree to which the recovery in China has broadened out to include consumer spending, and in any case follows a poor patch for the automotive market in 2019. In other export markets, there is a clear divide between those countries which, like the UK, have been hard hit by the pandemic, and those which have been less affected. So, apart from non-oil shipments to China, exports were markedly higher to Norway (thanks to deliveries of oil production platforms); moderately higher to Hong Kong, South Korea, and Australia; and were only fractionally lower to Taiwan. Among the larger markets, however, shipments fell by around a quarter to France, and by a fifth to the United States.

For trade in services, the recovery has been sluggish, as well as erratic, reflecting the continuing restrictions on international travel, with many "corridors" being opened up only to be closed again as the second wave made its appearance. Although some people were still keen to take their dose of Mediterranean sun, this wasn't enough to move the dial, so that by September imports of services were still nearly two fifths lower than in December, while exports were down by a sixth.

Taking goods and services together, the situation, as of September, is that exports were still 20% lower than in December, while imports were 14% down. The UK continued to trade at a surplus, but only a small one, which will probably disappear when Brits are once again able to take their holidays abroad.

Around the world, the pandemic has generated a huge rise in demand for personal protective equipment (PPE), as governments, hospitals and nursing homes have scrambled for available supplies. Here in the UK, a report from the National Audit Office (NAO) reckoned that the government has awarded contracts for PPE worth around £12.5 billion, with prices being roughly five times higher than they were before the crisis. So it's hardly surprising that recent months have seen a huge increase in imports of PPE into the UK, with inbound shipments of face coverings and masks amounting to over £2 billion in the first nine months of this year, ten times more than in the same months of 2019, of which 90% came from China. Meanwhile, trade in pharmaceutical products has been slightly lower than usual, perhaps reflecting an unfortunate consequence of the pandemic as people have deferred treatment for other medical conditions, and as elective surgery and scheduled treatments have been postponed to preserve hospital capacity. In the medical equipment category, imports have been boosted by a six-fold increase in purchases of breathing apparatus and a five-fold increase in protective goggles and spectacles.

Trade in PPE will remain at an elevated level for some months to come. Recent media reports have highlighted the delays at the port of Felixstowe, where an increase in traffic due to pre-Brexit stocking has been exacerbated by 11,000 containers of PPE being brought in to facilitate the roll-out of Covid vaccines from early next year. The development of vaccines and the need to distribute them globally will inevitably boost trade in pharmaceutical products, especially if it proves necessary to vaccinate against Covid annually.

Trade in medicines and medical products	Exports (Jan-Sep), £m		Imports (Jan-Sep), £m	
	2019	**2020**	**2019**	**2020**
Pharmaceuticals	15,901	14,267	17,023	14,372
Protective materials and clothing	503	576	1,108	5,300
of which: Misc.textile goods (incl. face coverings)	93	193	208	2,087
Medical instruments and equipment	3,652	3,441	4,657	5104
Total	20,056	18,284	22,788	24,777

Source: HMRC UKTradeInfo database, November 2020

Note: Many of the protective materials and garments are classified according to the material from which they are made, so will also include goods used for non-medical applications. Face coverings, for example, are classified under the same product code as dress patterns.

Looking to the near future, it's inevitable that the full-year trade figures for 2020 will be scarred by the effects of the pandemic, especially those for goods exports and services imports. More positively though, the latest wave of lockdowns across the UK haven't been as severe as in the spring, and have therefore had less of an impact on consumer spending, while manufacturing activity and construction sites have remained open. Trade flows in the closing months of 2019 will also be boosted by stockpiling ahead of the end of the EU transition period on 31 December, and as PPE is shipped in ahead of vaccine roll-out. Both these factors are, however, likely to fade as we go through 2021. And there will be new frictions in trading with the EU: apart from the additional costs that will be incurred in shipping goods, trade in financial services will also be negatively impacted by the loss of 'passporting' rights between the UK and the EU, while tourism and travel will not return to normal until at least mid-year. It's therefore anticipated that the flow of trade in both directions will be lower in 2021 than it was in 2019, although the negative impact on exports might be softened if sterling depreciates further.

Looking further ahead, trade with the EU will be adversely affected by Brexit, even if a trade deal of some kind is reached. No matter what deal is negotiated with the EU, it won't replace the unfettered access that has been enjoyed by UK businesses while they've been part of the Single Market. No amount of free trade agreements (FTAs) signed with other countries will make up for this. The UK has been able to roll-over some of the EU's more important FTAs, such as the deals with South Korea, Switzerland, Japan, and Canada, but this merely preserves existing market access: it doesn't offer new opportunities. Over time, these agreements may be enhanced and others will be negotiated, with talks already under way with the USA and Australia. But new FTAs are likely to take years rather than months. It will therefore be a big surprise if trade growth, especially of exports, is as brisk in the next few years as it was in the purple patch that preceded the Covid pandemic.

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