Andrew Bailey: State of trade

Speech by Mr Andrew Bailey, Governor of the Bank of England, at the Irish Association of Investment Managers Annual Dinner 2025, Dublin, 29 May 2025.

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It is a great pleasure to be in Dublin, and I want to start by thanking the Irish Association of Investment Managers for inviting me again to speak. I say again because I also have to begin with an apology, for standing you up last year at short notice when the General Election was called in the UK. And so, my other thanks is to my fellow Governor Gabriel, for stepping in last year when I withdrew at short notice.

Not much has happened in the last year. To keep it topical, I am going to use my time to talk about trade, both in goods and in financial services. This is not only topical but highly relevant, because Ireland and the UK are both open economies, with long-established trade connections, and likewise strong connections in financial services.

Trade matters. It matters at both the economy-wide or macro level, and at the level of individual firms, the micro level. And, almost needless to say, the two are closely linked.

I am going to start by laying out key elements of the big picture, before moving on to talk about financial services. My starting point is two key elements of the macro dimension of trade. In many past times in talking about trade it would have been easy to pass over them, as points that are not contested. I think they need repeating today.

The first point is that trade supports output in the economy – and it is good for economic welfare. As I will come on to, there are important qualifications to this point, but they don't invalidate it. From Adam Smith onwards, it has broadly been accepted that trade supports specialisation and efficiency of production and it enables knowledge transfer, and these features support productivity and economic growth.

The second point is that we should not expect trade between countries to be in balance all of the time. The whole world should be in balance – because it is a closed system as we have not found and started trading with extra-terrestrial life yet. But as individual countries, we are not closed, as Ireland and the UK demonstrate. Unfortunately, the world's exports and imports don't usually equal each other, but that's down to our counting not ET.

However, since trade balances between countries don't balance – and they should not be expected to do so, - what determines the balances and patterns of trade? At the whole economy, or macro, level the answer is that trade is determined by the balance between a country's saving and investment – macroeconomic fundamentals. And, these are shaped by factors such as business conditions and cycles, productivity growth, savings behaviour, interest rates, fiscal policy choices and exchange rates. In other words, trade is an outcome of the big driving forces of economies, and if we want to affect trade patterns on a lasting basis, that's where we should look.

Well, up to a point, yes. I am conscious that what I have just said is a rather a textbook espousal of the case for free trade. No apologies, I do believe in free trade. But, I'm also aware that things are not that simple – the story doesn't end there. Trade patterns are also shaped by national policies, particularly industrial policies, and by the rules–based world trading system that seeks to set the guardrails for such policies.

Now, the argument, as I interpret it, of the US Administration is that those rules have been stretched beyond breaking point, and actions have to be taken to put this right.

As I read it, there are two parts to this argument.

The first is that the rules of the world trade system – based around the World Trade Organisation – have broken down, and are in need of reform. IMF staff have pointed to more use of industrial policies around the world in recent years, and argued that these should only be used for very limited domestic objectives such as local market failures, but that has not been the case of late, and that this practice will and has exacerbated trade tensions. More concretely, between 2009 and 2022 China implemented around 5,400 so-called subsidy policies, which were concentrated in priority sectors, i.e., ones that matter. This was equal to about two-thirds of all the subsidy measures adopted by G20 advanced economies combined.

The macro story on trade is influenced by what goes on at the micro level, and we can't see these two as distinct. There has been an increase in the use of industrial policies – one country has been active on this front, but it's not alone.

The second point is around how the rules of engagement of the world trade system have come under pressure from new developments which have affected all of us. Let me briefly set out two which are closely linked. First, before the outbreak of Covid world trade had grown rapidly, more rapidly than world output, and in doing so the supply chains for final products had become much more complicated, but also efficient in the sense that they had exploited the benefits of trade.

This meant that a lot more of world trade comprised so-called intermediate goods – inputs to the final product, but not the product itself. This exploited one of the longest standing principles of free trade – so-called comparative advantage. In other words, produce stuff where it is most efficient relatively speaking to do so, accepting that the relative point means that no country should specialise in everything. Over time, the trade system has become more and more refined – we have heard the phrase "just in time delivery". This was highly efficient, until it wasn't.

Covid dealt a blow to the efficiency of the trade system. Even though initial pandemic-related supply chain disruption was resolved quite rapidly, as we recovered from Covid these trading patterns and systems did not return to normal as quickly and fully as we expected.

Why was that? There were no doubt a number of reasons, but a large one is the growth of national security concerns as a threat to the efficiency of trade. In reality, sadly, Russia's illegal war in Ukraine provided real evidence of the disruption that can happen, and is one factor behind a growing threat from national security to our assumptions on frictionless trade. To be clear, national security concerns are not a good reason to retreat indiscriminately from global trade. The best way to ensure resilience to geopolitical risk is not by reshoring production, but by diversifying supply chains among reliable partners who abide by international law.

Viewed from the perspective of a central bank responsible for monetary policy, the inevitable conclusion is that we cannot assume that the supply sides of our economies behave as efficiently as they did before Covid. And this was a substantial cause of the very difficult upsurge in inflation.

I am going to conclude on broader trade with a number of points, and then say something on financial services. Four points strike me as very important on trade.

First, while I am an unshaken believer in free trade, I do accept that the system has come under too much strain, we have to work hard now to rebuild it, and it is incorrect to dismiss those who argue for restrictions on trade as just wrong-headed. We need to understand what lies behind these arguments. That said, I want to get back to an open trading system.

Second, to solve the issues we face, we need to look at the macro level – the big economic drivers that I mentioned earlier, and call out where and why we think there are unsustainable trade imbalances. We need to strengthen the IMF's surveillance in order to improve the process for calling out unsustainable trade imbalances. But we must also look at the micro-level – the rules based world trade system - and work out what we need to do to solve this problem and make it more effective again.

Third, if it is believed that tariff action is needed to create the shock and awe to get these issues on to the table and dealt with, then something has gone wrong with the multilateral system, and we need to deal with that.

Fourth, creating a sustainable world trading system matters to all of us. It matters to countries like Ireland and the UK, which are highly open economies, and have been throughout their development. And it matters to central bankers and economic policymakers because our jobs are much harder if we face more inflexible and uncertain supply side conditions in our economies, as we appear to do today.

Almost all of the attention in recent months in the area of trade has been on goods trade – tangible stuff. Tariffs are a tool whose use is largely confined to the world of goods trade. But, there are two other important features of the trade world. First, alongside trade in goods sits trade in services-intangibles. For the UK, the latest numbers indicate that the total volume of trade was made up of 54% goods and 46% services. For Ireland the numbers are 28% goods and 72% services.

Financial services are an important part of trade in services and particularly so for Ireland and the UK.

The second important feature of the trade world is that alongside tariffs sit non-tariff barriers. These are all sorts of obstacles to trade, some put in place deliberately, some are features with their origin in other objectives than affecting the flow of trade, and others which are just there who knows why. Non-tariff barriers to trade are by no means limited to trade in services, but they are the dominant form of restriction in that world.

This brings me to Brexit. I have to start with an important disclaimer. As a public servant, I take no position on Brexit per se – it was a decision of the British people, and has been put into effect. That said, our evolving trading and regulatory relationship with the EU requires many judgements on the most effective way to do so – what delivers the most effective outcome.

I want to make two important points in this context. The first relates more to trade in goods, the second to financial services. Let me start with goods. I said earlier that trade enhances and supports economic activity.

It follows that if the level of trade is lowered by some action, it will have an effect to reduce productivity growth and thus overall growth. Just as tariffs, by increasing the cost, can reduce the scale of trade, the same goes for the type of non-tariff barrier that Brexit has created. Now to reiterate, this does not mean that Brexit is wrong, because there can be other reasons for it, but it does suggest, I think powerfully, that we should do all we can to minimise negative effects on trade.

The evidence on Brexit suggests that in the UK the changing trade relationship has weighed on the level of potential supply.

I conclude from this that, just as the Windsor Agreement on trade involving the UK and Ireland was a welcome step forward, so too are the initiatives of the current UK Government to rebuild trade between the UK and EU, and of course there is a very particular important aspect here for the UK and Ireland.

Let me turn to financial services. There is often an impression given that the flow of trade in financial services is predominantly from the UK to the EU. In other words, the UK is an exporter of financial services. This creates the notion of a one-way street, and that leads to the image of a dependency, and from there the notion of the dependency in some sense being unhealthy starts to come in.

My strong view is that – contrary to this one way idea – the relationship goes both ways, and that is a good thing. And, this is very well illustrated by the relationship between Ireland and the UK in the area of financial services.

Let me draw out the two-way street point some more, using the example of the 2022 shock to Liability Driven Investment funds connected to UK pension funds, so-called LDI funds. The LDI episode occurred when UK financial assets saw a significant repricing, with a particular impact on long-dated gilts. The Financial Policy Committee at the Bank of England judged that UK financial stability was at risk due to dysfunction in the gilt market and recommended that the Bank take action. This action took the form of intervening via temporary purchases of long-dated gilts.

Many of the funds involved were domiciled in other jurisdictions, including here in Ireland and Luxembourg. To be very clear, domicile was not a part of the problem. But, it had to help to enable the solution, and it did. A co-ordinated response between the UK, Ireland and Luxembourg was essential, and I am very grateful to the Central Bank of Ireland and the authorities in Luxembourg for helping us to respond effectively.

There have been important lessons from the LDI episode, which are increasingly relevant in the context of the increased market volatility we have seen in recent weeks following the US announcement on trade tariffs last month. Together, working with other UK regulators, the Central Bank of Ireland and the authorities in Luxembourg, we have taken action to build resilience in LDI funds. And I hope this close cooperation can continue as we seek to navigate another two way street by building more resilience into money market funds in the EU and the UK, as we strengthen our domestic rules.

The benefits of open financial markets as well as the dependencies also tend to go both ways.

The UK and EU are both seeking to strengthen our domestic capital markets. The EU's Savings and Investment Union agenda and the UK government's reforms to pensions are both seeking to direct savings towards productive investment. These are important measures, not least given the pressing need for financing some of the common structural challenges we face in the UK and EU – for example, defence and security, demographics, and the technological and climate transitions.

But strengthening domestic capital markets is only part of the story. The scale of investment needed requires access to global capital, supported by open financial markets. The alternative is fragmentation, which we have unfortunately seen in the global economy in recent years, which reduces the size of markets, and makes them inherently less stable. Fragmentation also increases the cost of capital, undermining growth and investment. Financial market openness, built on a foundation of robust global standards and trust, is a much better alternative.

To repeat, open financial markets are a good thing. As with goods trade, open financial markets support economic growth as well as increasing investment and reducing the cost of capital. So the benefits of open financial markets, as well as the dependencies, tend to go both ways, so a two-way street; and working together effectively is the best way.

As such, there is merit in seeking to increase the openness of our financial markets by reducing non-tariff barriers.

The Bank of England and the Central Bank of Ireland enjoy a very strong relationship, which is built on trust and respect, fostered by close cooperation and coordination and a steadfast commitment to shared values and working together in international bodies to promote global standards. And, my strong view is that this type of work benefits the industries that we oversee. The message that I get consistently, and rightly, is that firms want robust but fair and consistent regulatory standards which will support both stability and competition, and set the level playing field on which they operate.

Thank you.

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