

The Balance of Payments

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- *Balance of Payments (BOP):*

measures all international economic transactions b/n residents & foreign residents.

- Monetary and fiscal policy must take the BOP into account at the national level
- BOP data may be important
 - Indicates pressure on exchange rate
 - May signal imposition/ removal of controls over payments, dividends, interest.
 - Helps forecast country's market potential

Balance of Payments

A. Current Account

- A. Net exports/imports goods&services (Balance of Trade)
- B. Net Income (investment income from direct portfolio investment plus employee compensation)
- C. Net transfers (sums sent home by migrant abroad)

B. Capital Account

Capital transfers related to purchase and sale of fixed assets such as real estate

C. Financial Account

- A. Net foreign direct investment
- B. Net portfolio investment
- C. Other financial items

Basic Balance = A+B+C

D. Net Errors and Omissions

Missing data such as illegal transfers

Overall Balance = A+B+C+D

E. Reserves and Related Items

Changes in official monetary reserves including gold and foreign exchange reserves

Σ (A:E) = Overall Balance

BOP Accounting

- The BOP must balance
- How to measure international economic activity?
 - Is it an international economic transaction?
 - How do flow of goods/services/assets/money translate in debits & credits?
 - Bookkeeping procedures for BOP?
- Mistakes are common...
- BOP is **a flow statement**, not a stock statement.
 - Main transactions in BOP:
 - Exchange of real assets.
 - Exchange of financial assets.

The Current Account

- Goods Trade or *Balance of Trade (BOT)* – export/import of goods.
- Services Trade – export/import of services (financial, construction, and tourism).
- Income – predominately *current income* associated with investments made in previous periods, + wages & salaries paid to non-resident workers.
- Current Transfers – financial settlements due to change in ownership of real resources or financial items. Any transfer b/n countries which is one-way, a gift or a grant.
- CA typically dominated by export/import of goods, for this reason *Balance of Trade (BOT)* is widely quoted.

The Capital/Financial Account

- **Capital account**: transfers of fixed assets, real estate, acquisitions/disposal of non-produced/non-financial assets
- **Financial account**: three components; classified by degree of control,
 - **Direct Investment** – Net balance of capital which is dispersed from and into US for the purpose of exerting control over assets.
 - E.g. US company acquires foreign company stake (-)
 - Foreign company acquires US company stake (+)
 - **foreign direct investment (FDI)**: 10%+ of voting shares acquired.

The Other Accounts

- Net Errors and Omissions – Account is used to account for statistical errors and/or untraceable monies within a country
- Official Reserves (ORA) – total reserves held by official monetary authorities within a country.
 - Comprised of major currencies used in international trade and financial transactions, & reserve accounts (SDR) held @ IMF.
 - Important indicator for countries w/ fixed exchange rate regimes
 - Need to maintain parity rate w/ official reserves.

THANK YOU