

3.3: The Balance of Payments

Balance of Payments	<p>Summary statement of a country's <u>external transactions</u> measured in monetary terms in a given time period (usually a year)</p> <p>Consists of three accounts: current, capital, financial</p> <p>Shows all payments made by the country to other countries (debits) and all payments received from other countries (credits)</p>
Credits	<p>Credit item: inflows of money from abroad (earns foreign currencies)</p> <p>Represent a foreign demand for the domestic currency in the FOREX</p>
Debits	<p>Debit item: outflows of money to abroad (requires foreign exchange payments to foreign countries)</p> <p>Represent a supply of domestic currency in the FOREX</p>
Deficit (in an amt)	<p>Occurs whenever a balance has a –ve value i.e. debits > credits</p> <p>Money outflows from expenditure is larger than money inflows from income</p>
Surplus	<p>Occurs whenever a balance has a +ve value i.e. debits < credits</p> <p>Money inflows from income is larger than money outflows from expenditure</p>
Current Account	<p>Sum of the balance of trade in goods, the balance of trade in services, net income flows and net current transfers</p>
Visible balance	<p><i>Balance of trade in goods</i></p> <p>Consists of Xs and Ms of merchandise goods (eg food, electronics)</p> <p>Value of visible X minus value of visible M</p>
Visible exports	<p>Receipts from the sale of tangible goods to the rest of the world</p>
Visible imports	<p>Payments for tangible goods that the country buys from the rest of the world</p>
Invisible balance	<p><i>Balance of trade in services</i></p> <p>Records receipts and payments wrt services rendered or received from foreigners (eg. Transportation, banking and insurance services, tourism)</p> <p>Value of invisible X minus value of invisible M</p>
Income flows	<p>Refers to all inflows into a country of wages, rent, interests and profits from abroad minus all outflows of wages, rent, interests and profits to abroad</p>

	<p>Examples:</p> <ul style="list-style-type: none"> • Repatriation of wages of workers outside country • Rental income of property abroad • Dividend income of stocks in another country • Profits that come from a subsidiary of a MNC
Current transfers	<p><i>Unilateral transfers</i></p> <p>Consist of inflows into a country due to transfers from abroad (eg. Monetary gifts, foreign aid, pensions etc) minus outflows of such transfers to other countries</p>
Capital account	Composed of inflows minus outflows of funds for capital transfers and transactions in non-produced, non-financial assets
Capital transfers	<p>Consists of inflows minus outflows for items such as:</p> <ul style="list-style-type: none"> • Debt forgiveness (cancellation of debts) • Non-life insurance claims • Investment grants (money given as a gift by govts to finance physical capital)
Transactions in free goods	<p>Consists of inflows minus outflows arising mainly from the purchase or use of natural resources that have not been produced</p> <p>Eg. Land, mineral rights, forestry rights, airspace</p>
Financial account	Composed of inflows minus outflows of funds for capital transfers and transactions in financial assets
FDI	<p>Measures inflows minus outflows of investments in <u>physical capital</u> undertaken by MNCs</p> <p>Examples of physical capital:</p> <ul style="list-style-type: none"> • Buildings and factories • Production facilities
Portfolio Investment	Includes all inflows of funds minus outflows arising from financial investments on stocks, bonds and other financial options or instruments as well as govt lending (outflows) and borrowing (inflows)
Reserve assets	Foreign currency reserves that the central bank of a country can buy or sell to influence the value of the country's currency