

Balance of Payments



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Definition of the balance of payments



- The measurement of different forms of international economic transactions between the residents of a country and foreign residents
 - The resident is an economic concept, and it includes individuals, firms, nonprofit communities, and the government
- The statistical record of a country's international transactions over a certain period of time presented in the form of double-entry bookkeeping
- The statistical statement that summarizes economic transactions between residents and non-residents for a certain period of time and for a specific economy. The basic structure of the balance of payments includes the current, capital and financial accounts, of which foreign exchange reserves are a part

Importance of the balance of payments



- BOP influences and is influenced by other variables, such as gross domestic product, employment levels, price levels, exchange rates, and interest rates
- Government policymakers need the data of BOP to evaluate the general competitiveness of domestic industries, to set the exchange or interest rate, to determine the monetary and fiscal policy, etc.
- BOP data is also important for MNEs as it is a gauge of a nation's competitiveness or health

Importance of the balance of payments



- For a multinational enterprise, both home and host country BOP data is important because:
 - BOP is an indication of pressure on a country's foreign exchange rate
 - Change in a country's BOP may signal the imposition or removal of controls in various sorts of payments, e.g., removal of the capital outflow control may reduce the balance of the financial account in BOP
 - A forecast of a country's market potential (especially in the short run), e.g., a country with trade deficit may welcome investments that can increase its exports

Typical BOP transactions



- Each of the following represents an international economic transaction that is counted in and captured in the Czechia's BOP:
 - A Czech subsidiary of a foreign multinational enterprise acts as a distributor for the enterprise's products and sells the goods in the Czech market
 - A firm based in Czechia manages the construction of a major water treatment facility in a foreign country
 - The Czech subsidiary of a foreign firm pays profits (usually by distributing dividends to shareholders) back to the parent firm in its home (foreign) country
 - A Dutch mutual fund purchases a Czech corporate bond through an investment broker in Czechia

Main principles of BOP compilation



- Double-entry bookkeeping, i.e. each transaction is recorded by at least two entries of the same value, first as income (credit entry) and the second time as an expense (debit entry)
- The BOP must balance
 - It cannot be in disequilibrium unless something has not been counted or has been counted improperly
 - It is incorrect to state that the BOP is in disequilibrium
- Recording of only those transactions which take place between residents and non-residents
 - The economic interest of the participants in the transaction is decisive for the determination of residence

Main principles of BOP compilation



- Recording of flows on an accrual basis, i.e. at the time at which economic value is created, transformed, exchanged, transferred, or extinguished, in the case of receivables and liabilities on a change of ownership
- Valuation of transactions at market prices
- Changes which do not represent transactions (for example influences of exchange rate fluctuations, price fluctuations and so on) are not recorded in the balance of payments
- Transactions executed in foreign currencies are converted to the home currency at the exchange rate valid at the time of transaction or average exchange rate for the reported period

Conceptual changes in BOP compilation



- In 2014 countries launched implementation of the sixth edition of the Balance of Payments and International Investment Position Manual (BPM6) released by the International Monetary Fund in 2009
 - This follows the fifth edition (BPM5) released in 1993
- BPM6 provides a standard framework enhancing international comparability of data through internationally adopted guidelines
- BPM6 is consistent with all versions of the System of National Accounts (2008 SNA, ESA 2010, BD4)
- BPM6 logically connects BOP with the country's international investment position

Main changes introduced with BPM6



- New terms introduced
 - „Primary income“ and „secondary income“ in the current account
 - „Net acquisition of financial assets“ and „net incurrence of liabilities“ instead of „debits“ and „credits“ in the financial account
 - „Net lending/net borrowing“ as the balancing item for the financial account or the current and capital accounts together
- Presentation of foreign direct investment is now on a „gross“ basis (asset/liabilities principle) instead of former „directional principle“, which would net out reverse investment
- Sign convention changed in the financial account
 - Positive signs are no longer used for inflows and negative signs for outflows
 - A positive number indicates an increase in assets or liabilities and a negative number the opposite (a decrease)

Comparison of the sign convention



BOP accounts	BPM5	BPM6
Current account, revenues	+	+
Current account, expenditures	-	+
Balance on Current account	Revenues+Expenditures = +/-	Revenues-Expenditures = +/-
Revenues on capital transfers	+	+
Expenditures on capital transfers	-	+
Balance on Capital account	Revenues+Expenditures = +/-	Revenues-Expenditures = +/-
Net acquisition of financial assets (net domestic/foreign capital inflows in BPM5)	-	+
Net incurrence of financial assets (net domestic/foreign capital inflows in BPM5)	+	+
Balance on Financial account	Capital inflows + Capital outflows = +/-	Net acquisition of financial assets - Net incurrence of financial assets = +/-

Comparison of BOP structure



BPM5	BPM6
Current account	Current account
Trade balance (Goods)	Goods and services
Balance of services	
Balance of incomes	Primary income
Current transfers	Secondary income
Capital account	Capital account
Financial account	Financial account
	incl. Official reserve assets
Balance of errors and omissions	Net lending (+) / net borrowing (-)
Change of official reserves	Net errors and omissions

Comparison of basic BOP identities



- BPM5 identity

Current account + Capital account + Financial account + Errors and omissions = - (Change of official reserve assets)

- BPM6 identity

Current account + Capital Account + Net errors and omissions = Financial account

Net lending (+) / net borrowing (-) + Net errors and omissions = Financial account

Simplified BOP structure



1 – Current account
1.A – Goods and services
1.B – Primary income
1.C – Secondary income
2 – Capital account
3 – Financial account
3.1 – Direct investment
3.2 – Portfolio investment
3.3 – Financial derivatives (other than reserves) and employee stock options
3.4 – Other investment
3.5 – Reserve assets
4.3 – Net lending (+) / net borrowing (-) (balance from current and capital account)
4.4 – Net lending (+) / net borrowing (-) (balance from financial account)
4.5 – Net errors and omissions

Structure of the current account



CURRENT ACCOUNT	
Goods and services	Primary income
<i>Trade balance (goods)</i>	<i>Compensation of employees</i>
<i>Services</i>	<i>Investment income</i>
Manufacturing services	Direct investment
Maintenance and repair services	Dividends
Transport	Interest
Travel	Portfolio investment
Construction	Other investment
Insurance	<i>Reserve assets</i>
Financial services	
ICT services	Secondary income
Operating leasing services	
Other business services	
Personal, cultural services	
Government goods and services	

Current account



- The current account shows flows of goods, services, primary income, and secondary income between residents and nonresidents
- The current account typically dominated by the balance of goods and services and particularly by the trade balance (goods)
- The primary income account presents amounts payable and receivable in return for temporary use to another entity of financial resources, labor, or non-produced nonfinancial assets
- The secondary income account shows redistribution of income generated by one economy to another
 - Personal transfers, an expansion of the previous concept of “workers’ remittance”, are still the foremost item of this account

Current account balance in selected countries



Chart 1: Deficits lowered

The 'Fragile Five' have reduced their current account deficits to various degrees from 2012 levels

Current account balance (% of GDP)

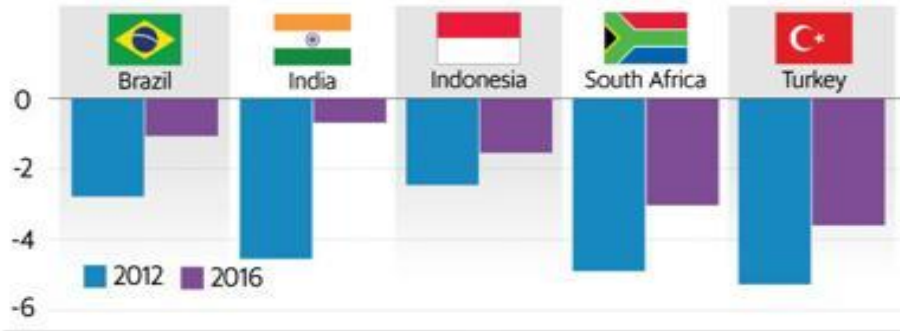
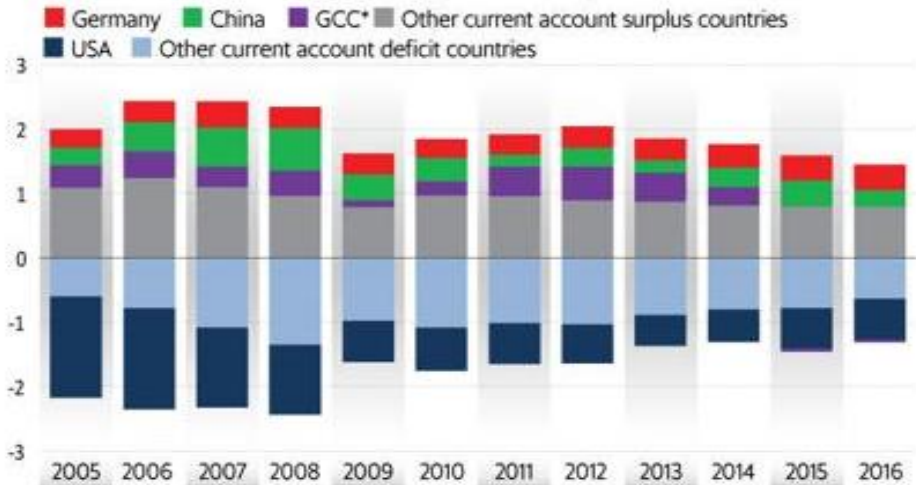
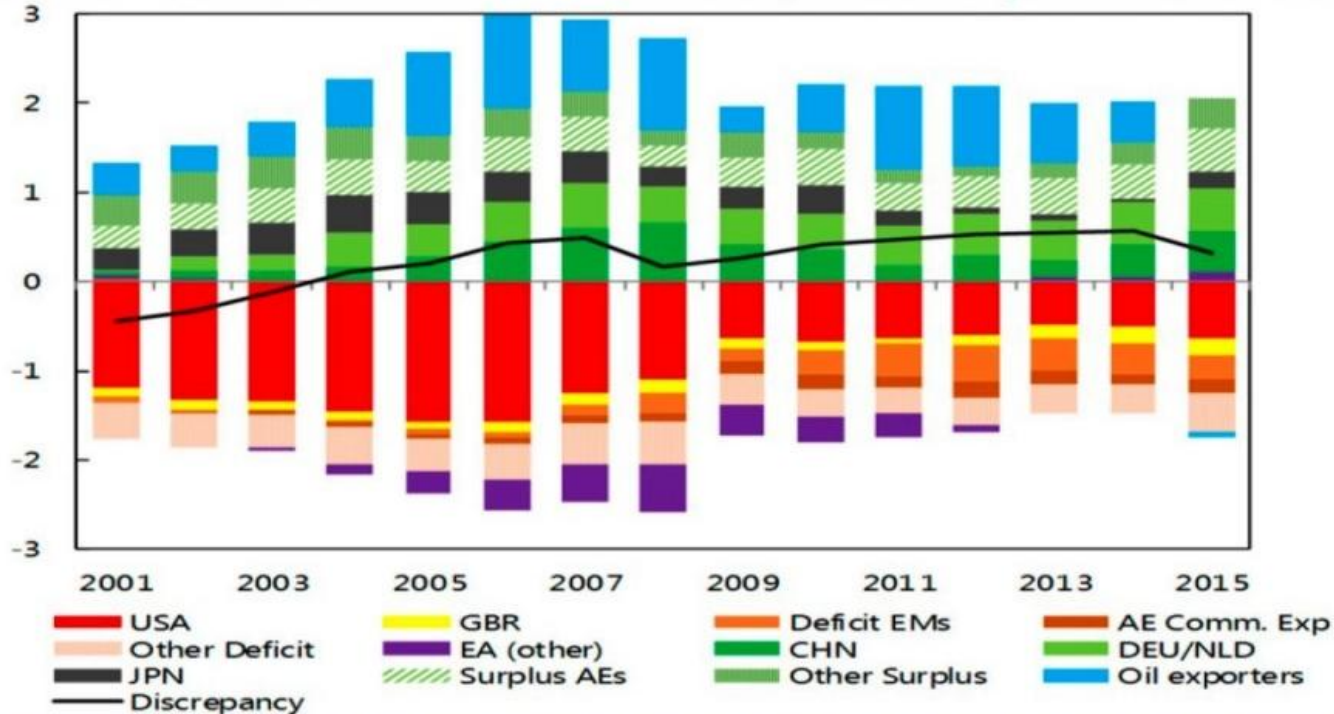


Chart 2: Current account balance

US has run current account deficits for several decades in a row, while countries like China and Germany have a surplus



Current account imbalances (% of world GDP)



Note: Surplus AEs: Korea, Hong Kong SAR, Singapore, Sweden, Switzerland, Taiwan POC; AE Commodity Exporters: Australia, Canada, New Zealand; Deficit EMs: Brazil, India, Indonesia, Mexico, South Africa, Turkey; Oil exporters: WEO definition plus Norway

Source: IMF, 2016 External Sector Report, July 2016.

Structure of the financial account

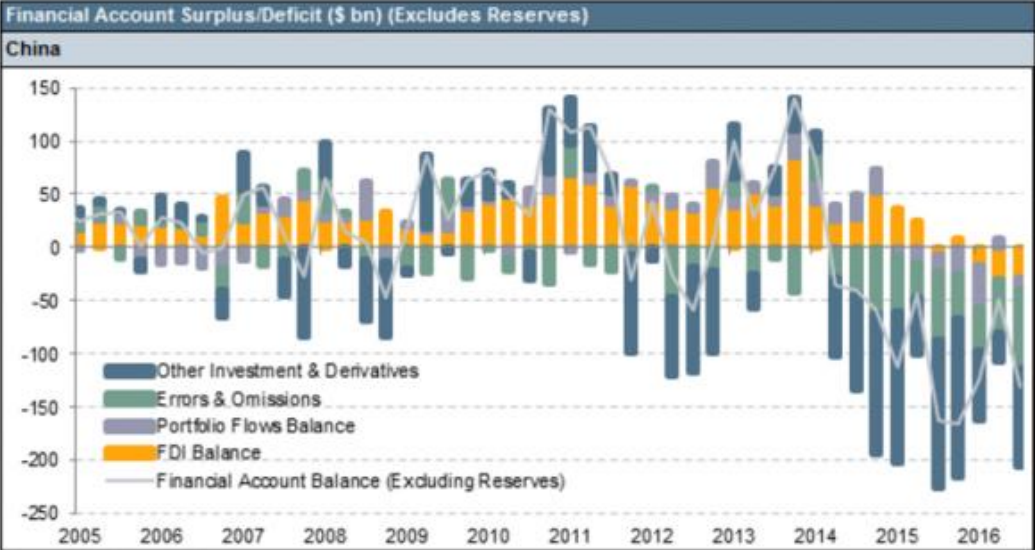


FINANCIAL ACCOUNT	
Direct investment – assets	Other investment – assets
<i>Equity capital and investment fund shares</i>	<i>Currency and deposits</i>
<i>Intercompany lending</i>	<i>Loans</i>
Direct investment – liabilities	<i>Trade credit and advances</i>
<i>Equity capital and investment fund shares</i>	<i>Other</i>
<i>Intercompany lending</i>	Other investment – liabilities
Portfolio investment – assets	<i>Currency and deposits</i>
<i>Equity capital and investment fund shares</i>	<i>Loans</i>
<i>Debt securities</i>	<i>Trade credit and advances</i>
Portfolio investment – liabilities	<i>Other</i>
<i>Equity capital and investment fund shares</i>	Reserve assets
<i>Debt securities</i>	
Derivatives – assets	
Derivatives – liabilities	

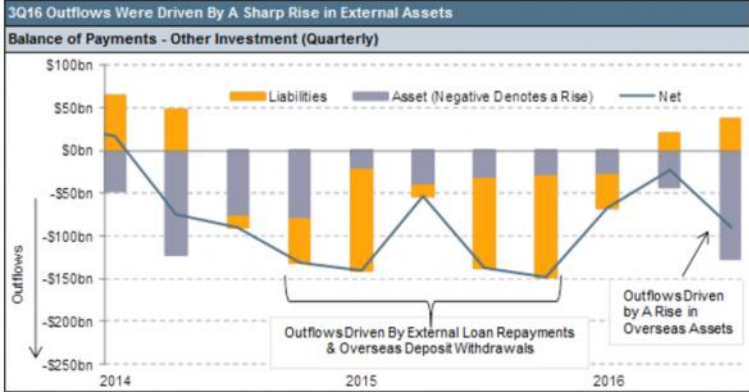


- The financial account shows acquisitions of assets and liabilities, identified under the categories
- Direct investment – in which the investor exerts some explicit degree of control over the assets (at least 10 % of equity capital)
- Portfolio investment – in which the investor has no control over the assets
- Financial derivatives – contract that derives its value from the performance of an underlying entity (futures, options, swaps)
- Other investment – consists of various short-term and long-term trade credits and advances, cross-border loans, currency deposits, bank deposits and other financial assets and liabilities

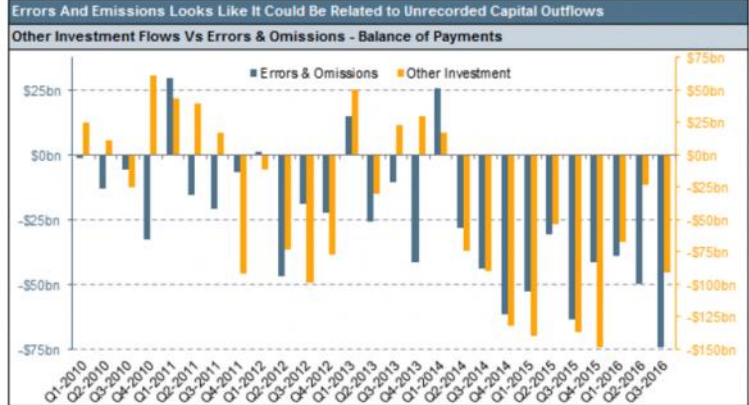
Financial account in China



Source: SAFE, Haver, CreditSights



Source: SAFE, Haver, CreditSights



Source: SAFE, Haver, CreditSights

Official reserve assets – top 20 countries

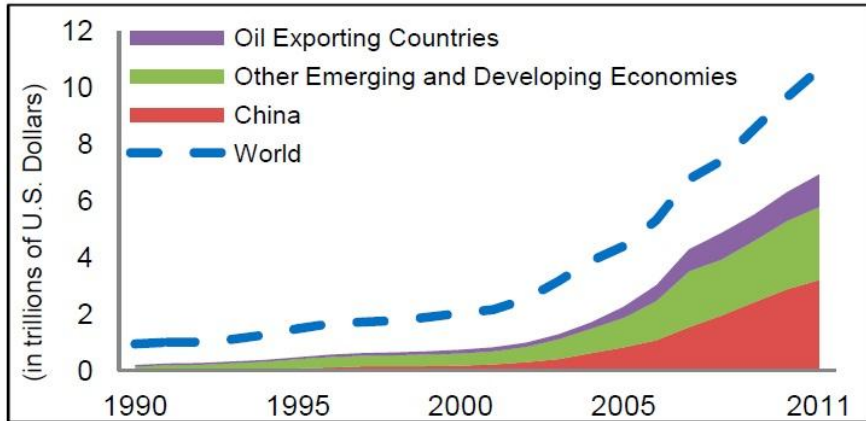


Rank ↕	Country or region ↕	Foreign-exchange reserves (Millions of US\$) ↕	Figures as of ↕
1	China (Hong Kong and Macau not included)	3,091,527	August 2017 ^[1]
2	Japan	1,249,847	June 30, 2017 ^[2]
3	Switzerland	786,172	July 2017 ^[3]
4	Saudi Arabia	487,000	August 2017 ^[4]
5	Taiwan	446,426	August 2017 ^{[5][6][7]}
6	Russia	427,300	08 September 2017 ^{[8][9]}
7	Hong Kong, China	413,300	July 2017 ^[10]
8	India	400,296.8	20 October 2017 ^[11]
9	South Korea	378,469	4 June 2017 ^{[12][13]}
10	Brazil	381,132	04 October 2017 ^{[14][15]}
11	Singapore	273,114	August 2017 ^{[5][16]}
12	Thailand	226,179	August 2017 ^{[17][18][19]}
13	Germany	200,394	April 2016 ^[20]
14	Mexico	176,852	October 2016 ^{[21][22]}
15	United Kingdom	163,503	March 2016 ^[23]
16	France	153,891	March 2016 ^[24]
17	Czech Republic	146,325	September 2017 ^{[5][25]}
18	Italy	143,183	March 2016 ^[26]
19	Iran	135,500	31 December 2016 ^[5]
20	Indonesia	128,890	8 September 2017 ^{[27][28]}

Development of foreign reserves



Figure 1. Global Reserves¹

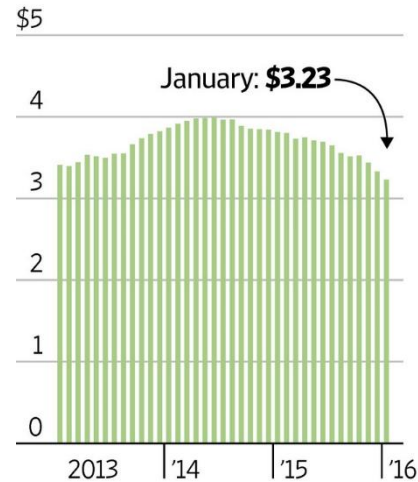


Source: IMF *International Financial Statistics*.

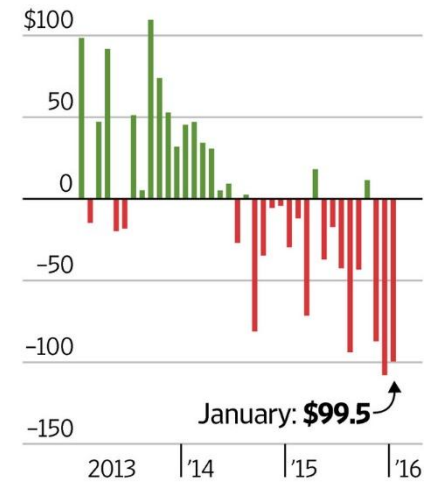
¹Total reserves minus gold.

Beijing's interventions to defend the yuan has eaten into the world's largest currency stockpile.

China's foreign reserves, in trillions of dollars



Monthly change, in billions of dollars

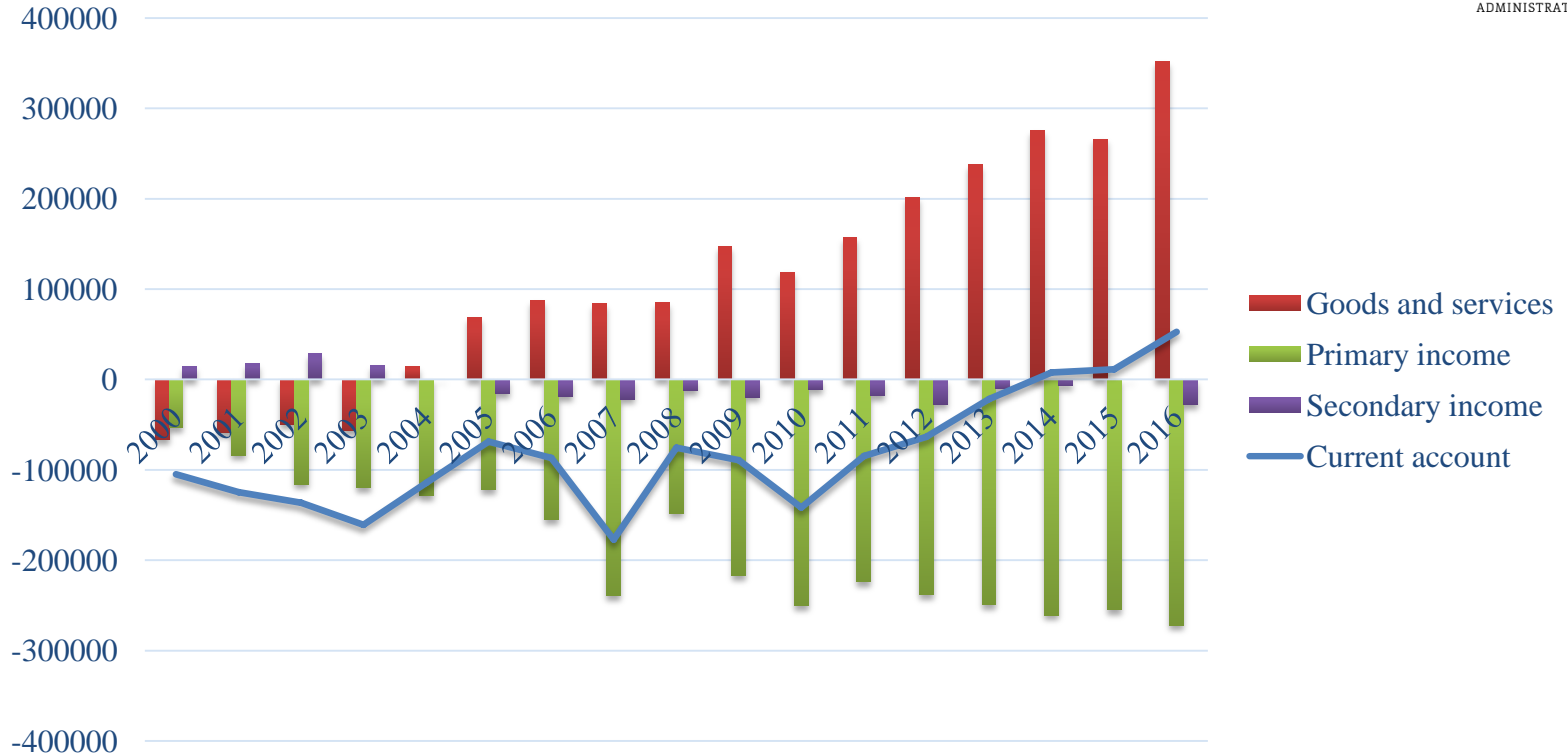


Balance of payments of Czechia (mil. CZK)

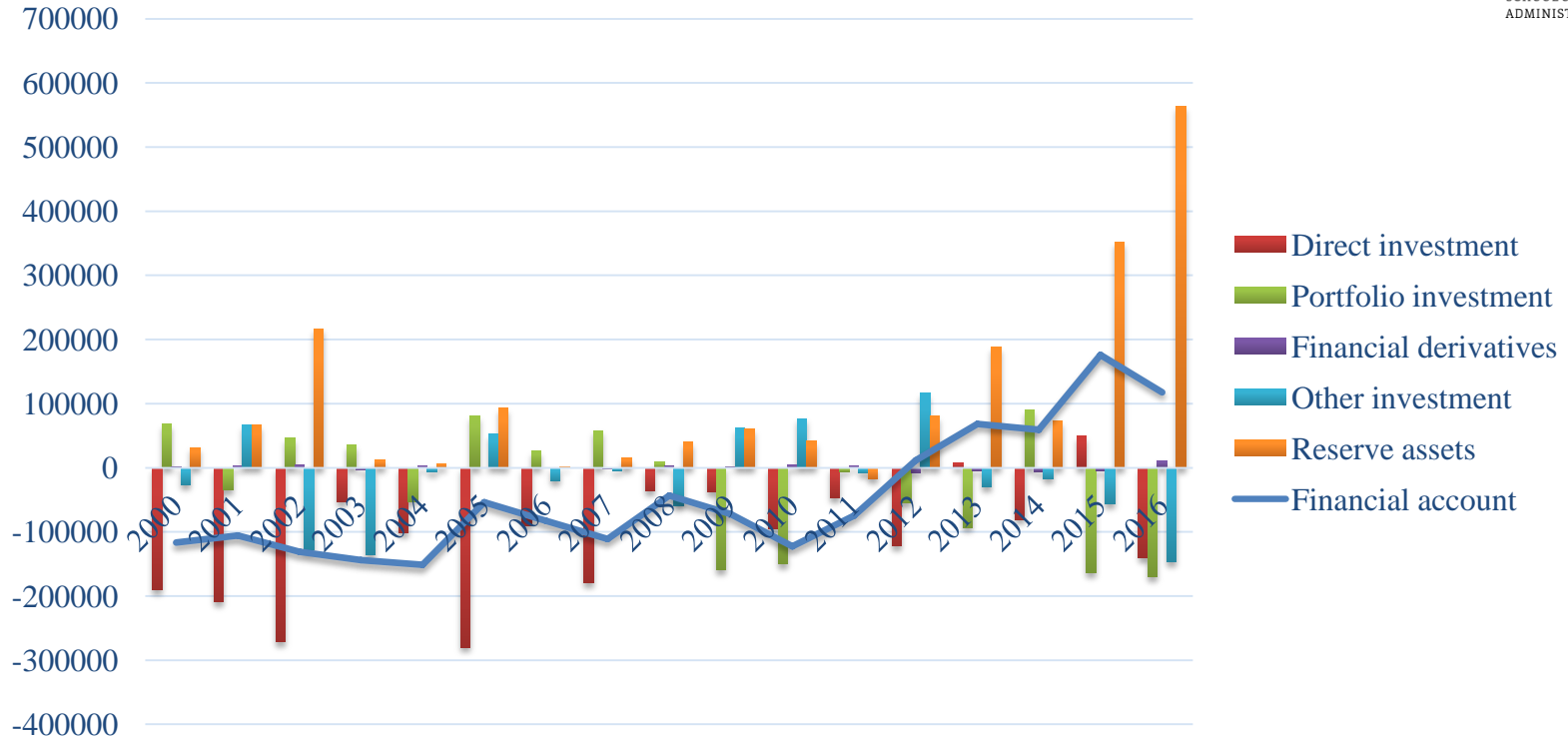


	2010	2011	2012	2013	2014	2015	2016
1 – Current account	-141 776,5	-84 800,8	-63 313,0	-21 784,4	7 882,6	11 283,1	52 641,9
1.A – Goods and services	118 865,3	156 759,2	201 424,3	237 332,5	275 601,6	266 069,9	351 695,9
1.B – Primary income	-249 929,8	-223 345,4	-237 527,8	-249 018,7	-260 789,0	-254 838,1	-271 762,0
1.C – Secondary income	-10 712,0	-18 214,6	-27 209,4	-10 098,1	-6 930,1	51,4	-27 292,0
2 – Capital account	37 596,4	12 710,1	53 011,0	82 436,6	32 318,6	101 895,3	53 509,7
3 – Financial account	-122 338,9	-74 763,6	11 688,7	68 307,5	59 416,2	175 781,9	117 678,4
3.1 – Direct investment	-94 990,5	-46 804,8	-121 261,1	7 437,5	-80 382,8	49 748,1	-140 957,2
3.2 – Portfolio investment	-150 353,3	-5 780,7	-54 847,6	-92 837,9	90 268,9	-164 135,0	-169 532,4
3.3 – Financial derivatives (other than reserves) and employee stock options	4 747,8	3 673,8	-8 617,8	-4 736,8	-6 046,2	-4 769,9	11 291,1
3.4 – Other investment	76 832,2	-8 622,1	115 941,8	-29 746,7	-17 546,4	-56 366,8	-146 644,2
3.5 – Reserve assets	41 424,9	-17 229,7	80 473,5	188 191,5	73 122,7	351 305,5	563 521,2
4.3 – Net lending (+) / net borrowing (-) (balance from current and capital account)	-104 180,1	-72 090,7	-10 302,0	60 652,2	40 201,2	113 178,3	106 151,6
4.4 – Net lending (+) / net borrowing (-) (balance from financial account)	-122 338,9	-74 763,6	11 688,7	68 307,5	59 416,2	175 781,9	117 678,4
4.5 – Net errors and omissions	-18 158,8	-2 673,0	21 990,7	7 655,3	19 214,9	62 603,5	11 526,8

Current account of Czechia (mil. CZK)



Financial account of Czechia (mil. CZK)





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