Balance of Payments and Foreign Exchange

• **A nation's balance of payments** records all the transactions that take place between its residents and the residents of a foreign nation. These include: merchandise exports and imports, tourist spending, purchases and sales of shipping and insurance services, interest and dividend payments received, purchases and sales of financial or real assets, and so on.

A simplified balance sheet for the US might look like this:

Figures shown in billion (1996)

Current Account				
US goods export	$+612			
US goods imports	—803			
Balance of Trade in Merchandise		$—191		
US exports of services	+237			
US imports of services	—157			
Balance of Trade in Services		+80		
Balance on goods and services			$—111	
Net Investment income	+3			
Net Transfers	—40			
Balance of Current Account				**$ —148**
Capital Account				
Foreign purchases of Assets in the US	+157			
US purchases of Assets Abroad	—376			
Balance of Capital Account				**+141**
Official Reserves Account				**+ 7**
				$ 0

The current account includes:

• Balance Of Trade in merchandise exports and imports ($—191)
• Balance Of Trade in services exports and imports ($+80)
• Net Investment income is the difference between dividend and interest payments coming into and going out of the US ($+3)
• Net transfers reflects net aid and grants both public and private between the US and the rest of the world. This would include foreign aid given to foreign nations by US and pensions paid to people living abroad. ($—40)

The capital account includes:

• Real investments are direct purchases of real estate and businesses.
• Financial investments are direct investments like stocks and bonds that reflect indirect claims on physical assets.
• Purchases of US assets would create a demand for dollars and would be a positive entry in the capital account.($+157)
• Purchases of foreign assets by Americans would create a supply of dollars in exchange for foreign currency and would be a negative entry in the capital account. (—$376).

The official reserve account represents:

• the exchange of foreign exchange reserves when the balance on the capital account does not offset the balance on the current account.
• A positive number indicates an export of foreign exchange reserves which represents a decrease in US official holdings of foreign exchange. (+$7)

Balance of Payments:

• A **deficit** occurs when the sum of the balances of the current and capital accounts is **negative**
• A **surplus** occurs when the sum of the balances of the current and capital accounts is **positive**
• Persistent deficit balance of payments are trouble since reserves were be depleted in time. Some policies to correct the problem are: currency depreciation, trade barriers, reduction of budget deficits to lower interest rates, easy money policy by the FED and others.