

Lecture 4. The Balance of Payments in Practice

Applied International Economics.

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Objectives

- Learn how the balance of payments works in the real world.
- Learn to download data from the IMF BoP statistics database.
- Use our obtained data to answer some questions.

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A little bit of history



Historically, the Balance of Payments (BoP) has served as a means to record *economic transactions* between a country and the rest of the world. Nowadays, countries that are members of the IMF (which is basically the whole world), are required to submit their BoP in a certain way. For the purpose of this class, we will study the BPM6 presentation of the BoP and the analytical presentation of the BoP.



Structure



How is the BoP organized?



The BoP has three main components:

- 1 Current Account
- 2 Capital Account
- 3 Financial Account

How is the BoP organized? (continued)

The BoP has three main components:

1 Current Account

- Goods and Services
- Primary Income
- Secondary Income

2 Capital Account

3 Financial Account

How is the BoP organized? (continued)

The BoP has three main components:

1 Current Account

- Goods and Services (import and exports)
- Primary Income (wages, rent, interest payments)
- Secondary Income (insurance claims, current transfers¹, international cooperation)

2 Capital Account

3 Financial Account

¹For LAC, this is mostly remittances.

Formally, we would have the following identity:

$$CA_t = NX_t + Pl_t + Sl_t, \quad (1)$$

where we NX_t are the net exports in time t , and Pl_t and Sl_t are the net primary income and secondary income, respectively. Compared to our Lecture 1, where we have that:

$$CA_t = y_t - c_t + (1 + r)b_t \quad (2)$$

In our small open economy world, any consumption that cannot be produced domestically, must be consumed from abroad (import), therefore:

$$NX_t = y_t - c_t,$$

and $(1 + r)b_t$ is the net income from abroad.

How is the BoP organized? (continued)

The BoP has three main components:

- 1 Current Account
- 2 Capital Account
 - Transfer of ownership of fixed assets, patents, or leases.
- 3 Financial Account

How is the BoP organized? (continued)

The BoP has three main components:

- 1 Current Account
- 2 Capital Account
- 3 Financial Account
 - Direct Investment (FDI)
 - Portfolio Investment
 - Other Investment
 - Reserve Assets

How is the BoP organized? (continued)

The BoP has three main components:

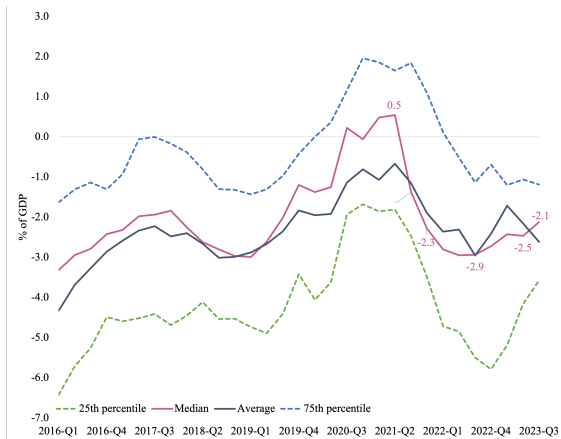
1 Current Account

2 Capital Account

3 Financial Account

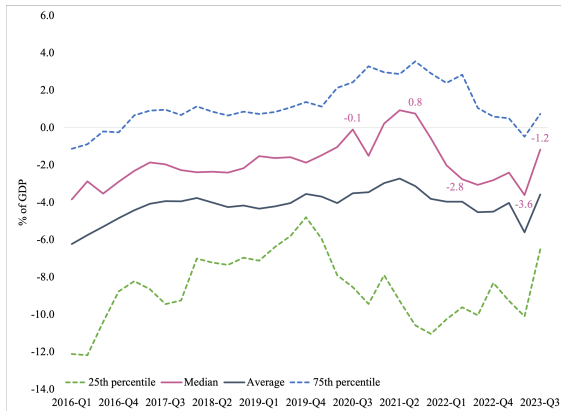
- Direct Investment (equity capital, reinvested earnings, other capital, claims and liabilities to affiliated enterprises)
- Portfolio Investment (equity investments, debt securities)
- Other Investment (trade credits, loans, currency and deposits, other assets)
- Reserve Assets (monetary gold, SDRs, reserve positions in the IMF, foreign exchange)

Figure 1: Current Account Balance, LAC (% GDP)



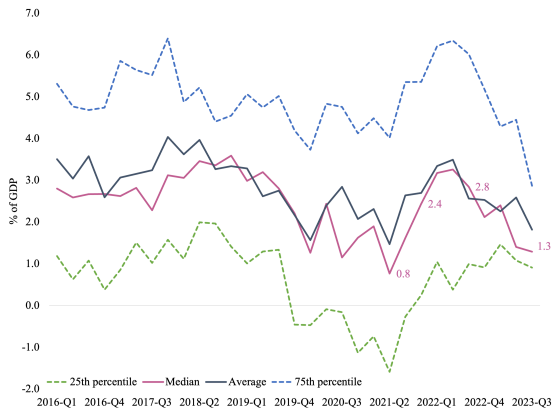
Source: Author's elaboration using IMF BoP Statistics and national sources.

Figure 2: Trade Balance, LAC (% GDP)



Source: Author's elaboration using IMF BoP Statistics and national sources.

Figure 3: Financial Account Balance, LAC (% GDP)



Source: Author's elaboration using IMF BoP Statistics and national sources.