

BALANCE OF PAYMENTS

Class 12

Meaning

- ▶ **Balance of payments(BoP)** is a statement of accounts showing all monetary transaction (or economic transaction) of a country with the rest of world during a period of time, generally one year.
- ▶ **I) Export and Import of goods.** It is called 'merchandise' or 'visible trade'.
- ▶ **II) Export and Import of services,** It is called 'invisible trade'. Because services cannot be seen.
- ▶ **III) International sale and purchase of financial assets.**(stock & bonds)
- ▶ **IV) International sale and purchase of real assets.**(plant & machinery)

Components of BoP Account



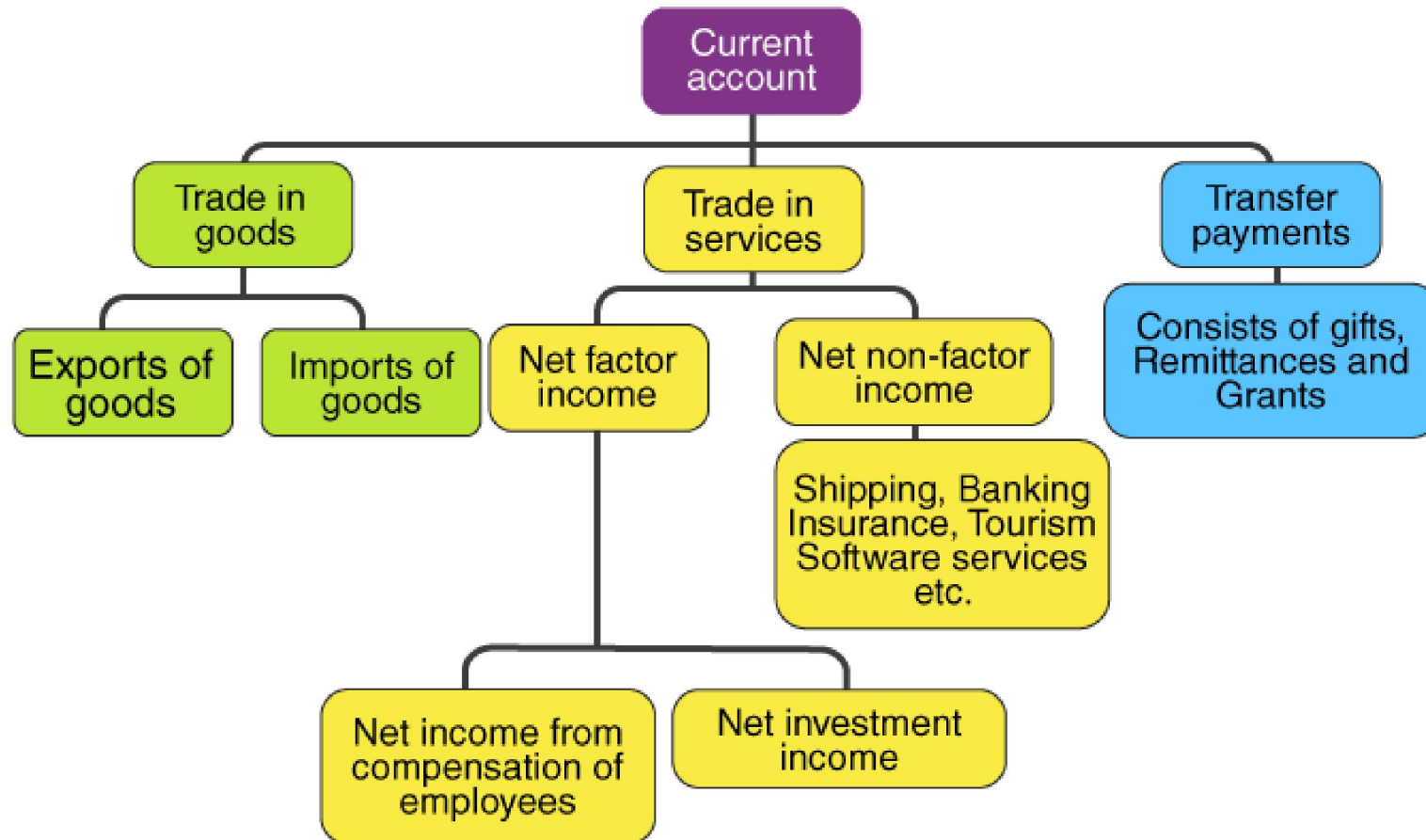
CURRENT ACCOUNT

Records receipts and payments of foreign exchange of a country on account of such transaction which do not impact assets -liability status of a country in a relation to rest of world.

COMPONENTS:-

- ▶ I) Export and import of good.
- ▶ II) Export and import of services.
 - ▶ (a) **Factor services** : Which leads to factor payment or factor income for example Compensation of employees & Investment income Rent, interest, profit
 - ▶ (b) **Non factor services**: includes all services other than factor services for example insurance and banking services.
- ▶ III) Current transfers: 'Transfers for free'. These are unilateral transfers made by way of gifts, grants and remittances by the residents settled abroad.

COMPONENTS OF CURRENT ACCOUNT



Important Note:-

- ▶ **(i) Exports of goods and services** are recorded as a positives(+) items as these cause flow of foreign exchange into the domestic economy.
- ▶ **(ii) Imports of goods and services** are recorded as a negative (-) items as these cause flow of foreign exchange out of the domestic economy.
- ▶ **(iii) All receipts on account of transfers** are recorded as positive (+) items, while payments are recorded as negative (-) items

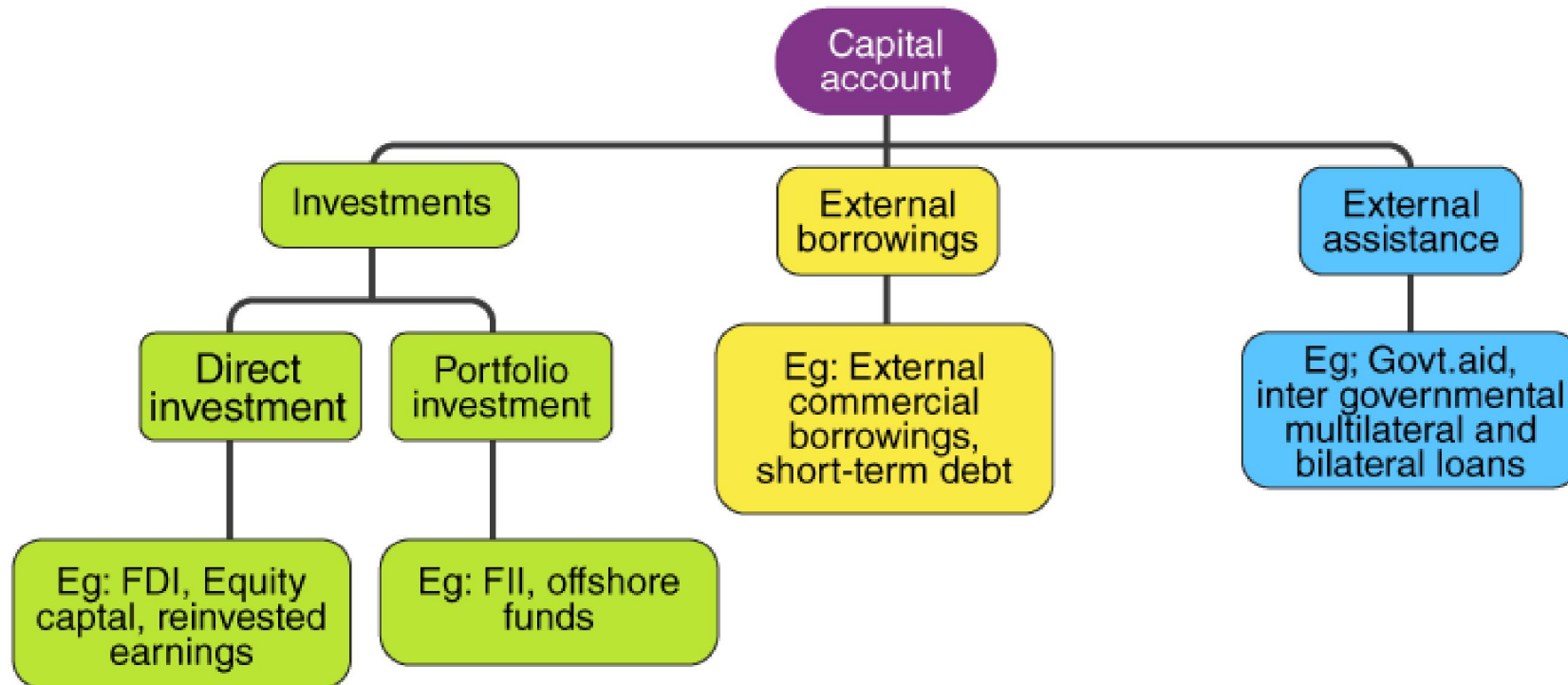
Capital Account

Records receipts and payments of foreign exchange of a country on account of such transaction which impact asset-liability status of a country in relation to rest of the world.

COMPONENTS

- (I) Borrowings
- (II) Foreign Investment
- (III) NRI deposits
- (IV) Banking Capital
- (V) Short-term debt.

COMPONENTS OF CAPITAL ACCOUNT



1:-Borrowing:-

Borrowing is split as:

- ▶ External commercial borrowing, and
- ▶ External assistance
- ▶ The principal difference between the two is that while **external commercial borrowing** is available at market rate of interest(in the international money market), **external assistance** is available at the concessional rate of interest.
- ▶ Borrowings from ROW raise our **liability** to the ROW. But note it carefully that it is recorded as a 'credit item' in the capital account of BoP.
- ▶ Borrowing of the ROW(or lending to ROW) would be recorded as 'debit item' in the capital account as it cause flow of foreign exchange from our country to the ROW.

2:- Foreign Investment

- ▶ Portfolio investment, and
- ▶ Foreign direct investment(FDI)
- ▶ Portfolio Investment basically refers to foreign institutional investment(FII). It is investment by ROW in shares and bonds of the domestic companies.
- ▶ II) Foreign Direct Foreign investment is spilt as:
 - ▶ I) Investment relates to ownership of enterprises(in domestic economy) by the ROW.
 - ▶ Example: Walmart stores in India

Foreign Direct Investment vs Foreign Institutional Investor



FDI

(Foreign Direct Investment)



FII

(Foreign Institutional Investor)

Other Components of Capital Account

NRI Deposits:-

- ▶ 'NRI deposits' is also a significant constituents of capital account. However, here a note of caution is essential:
- ▶ It also need to be noted that money sent by the NRI to their families in India is to treated as 'current transfers, and are recorded in the current account BoP.
- ▶ Only deposits held by NRI in the domestic economy are to be treated as a component of capital account

4) Banking Capital(other than NRI Deposits)

- ▶ It refers to 'foreign assets' held by the commercial banks.
- ▶ Owing to drawdown of foreign assets of commercial banks(commercial banks converting their foreign assets into liquidity), inflow of foreign exchange into the domestic economy tends to rise.

5) Short-term Trade Credit

- ▶ It is another important component of capital account. It arises on account of purchase in the international market without making immediate payment.
- ▶ Repayment of short term debt to ROW lead to outflow of foreign exchange to the ROW. Accordingly it is recorded in the capital account with a negative sign.
- ▶ Inward flow of foreign exchange (from ROW), on the other hand, is recorded with positive sign.

Official Reserve Account (indicating reserves of Forex with the RBI)

- ▶ The overall balance is finally reflected in the Official Reserve Account of the RBI. Because, RBI is the custodian of forex reserves of the country, and forex reserves of the country are routed through the RBI.
- ▶ If overall balance is positive, it cause increase in official reserves;
- ▶ If overall balance is negative, it cause decrease in official reserves.

Autonomous and Accommodating items of BoP Account

- ▶ **Autonomous items** refers to such BoP transactions which are undertaken with a view to making profit.
- ▶ It is due to these transactions that there is a BoP deficit/surplus.
- ▶ **Accommodating items** on the other hand ,refer to such transactions which are undertaken by the central bank of a country with a view to correcting BoP imbalance and restoring BoP equilibrium.
- ▶ It is important to note that accommodating items do not cause any movement of goods and services across the borders. These relate only to yhe movement of official reserves with a view to correcting BoP imbalance

Autonomous items and Accommodating items -The Difference

Autonomous items	Accommodating items
Autonomous items refers to such BoP transactions which are undertaken for consideration of Profit	Accommodating items are free from the consideration of profit.
Autonomous items are the cause of BoP imbalance(BoP surplus or BoP deficit)	Accommodating items are meant to restore BoP balance.
Autonomous items may involve the movement of goods across the border(like export and import of consumer or capital goods)	Accommodating items do not involve the movement of goods across the borders. These items only involve the movement of official reserves with RBI
Autonomous items are classified as 'above the line' items of BoP	Accommodating items are classified as 'below the line items of BoP'

Significance of BoP Accounts

- ▶ 1) Financial status of Domestic Economy:- In relation to rest of the world . Borrowing reveals dependence on rest of the world. It points to backwardness of domestic economy
- ▶ 2) Net Factor Income from Abroad:- BoP data offers information on NFYA . It is an important component of National Income
- ▶ 3) Net Exports:- BoP accounts show exports and imports of a country. Rise in 'X-M' leads to rise in AD. It impacts on output and employment in the domestic economy.
- ▶ 4) Market Potential :- BoP reflect market potential in the domestic economy. It is reflected by the size of foreign investment. Larger size of foreign investment points to high market potential in the economy

Introductory macroeconomics

Topic Deleted

Unit	Topic Deleted
Unit 2: Money and Banking	Control of credit through Bank rate, CRR, SLR, Repo Rate and Reserve Repo Rate, Open market operations, Marginal requirements
Unit5: Balance of Payments	Balance of Payments-Deficit meaning Determination of exchange rate in a free market.

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THANK YOU