

EC201 Macroeconomics 2, Term 1 2025
University of Warwick
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Support and Feedback Class 1 (week 3)
Global Imbalances

A. Pre-Class Review Questions

1. **[Balance of Payments Accounting]** Describe how each of the following transactions affects the Balance of Payments of a country in question. (Recall that each transaction gives rise to two entries in the Balance-of-Payments Accounts.)
 - (a) A U.K. university buys several park benches from Spain and pays with a £120,000 check.
 - (b) Nick Brattle, from Leamington Spa, buys 5,000.00 pounds worth of Jaguar stock from HSBC London, paying in pound sterling.
 - (c) A French consumer imports American blue jeans and pays with a check drawn on a U.S. bank in New York.
 - (d) An American company sells a subsidiary in the United States and with the proceeds buys a French company.
 - (e) Two friends from China travel to Australia and spend AUD 3,000 on accommodation during their vacation. How does this affect China's balance of payments?
 - (f) Norway sends medicine, blankets, tents, and nonperishable food worth 1 billion NOK to victims of an earthquake in a foreign country.

B. In-Class Questions

This question is about the balance of payments of a country named Outland.

1. Outland starts 2015 with holdings of 100 shares of the German car company Volkswagen. These securities are denominated in euros. The rest of the world holds 200 units of dollar-denominated bonds issued by the Outlandian government. At the beginning of 2015, the price of each Volkswagen share is 1 euro and the price of each unit of Outlandian bond is 2 dollars. The exchange rate is 1.5 dollars per euro. Compute the net international investment position (NIIP) of Outland at the beginning of 2015.
2. During 2015, Outland exports toys for 7 dollars and imports shirts for 9 euros. The rate of return on the Volkswagen shares was 5 percent and the rate of return on Outlandian bonds was 1 percent. Residents of Outland received money from relatives living abroad for a total of 3 euros and the government of Outland gave 4 dollars to a hospital in Guyana. Calculate the Outlandian trade balance, net investment income, and net unilateral transfers in 2015. What was the current account in that year? What is the Outlandian NIIP at the end of 2015 expressed in dollars.
3. Suppose that at the end of 2015, Outland holds 110 Volkswagen shares. How many units of Outlandian government bonds are held in the rest of the world? Assume that during 2015, all financial transactions were performed at the beginning-of-year prices and exchange rate.

4. To answer this question, start with the international asset and liability positions calculated in the previous item. Suppose that at the end of 2015, the price of a Volkswagen share falls by 20 percent and the dollar appreciates by 10 percent. Calculate the end-of-year NIIP of Outland in dollars.

C. Self-study Questions

1. Indicate whether the statement is true, false, or uncertain and explain why.
 - (a) The net international investment position of South Africa was -70.5 billion USD in 2010 and -19.7 billion USD in 2011. The current account in 2011 was -10.1 billion USD. There must be an error in the official numbers. The correct figure should be a net international investment position of -80.6 billion USD in 2011.
 - (b) The fact that the United States made large valuation gains on average over the past 30 years means that the rest of the world as a whole made equally large valuation losses. After all, this is a zero sum game.
 - (c) The United States has large unrecorded foreign asset holdings.
2. Consider the Figure below reporting the Current Account to GDP ratios for the GIPS (Greece, Ireland, Portugal, Spain).

Figure 5: Current Account to GDP Ratios of the GIPS

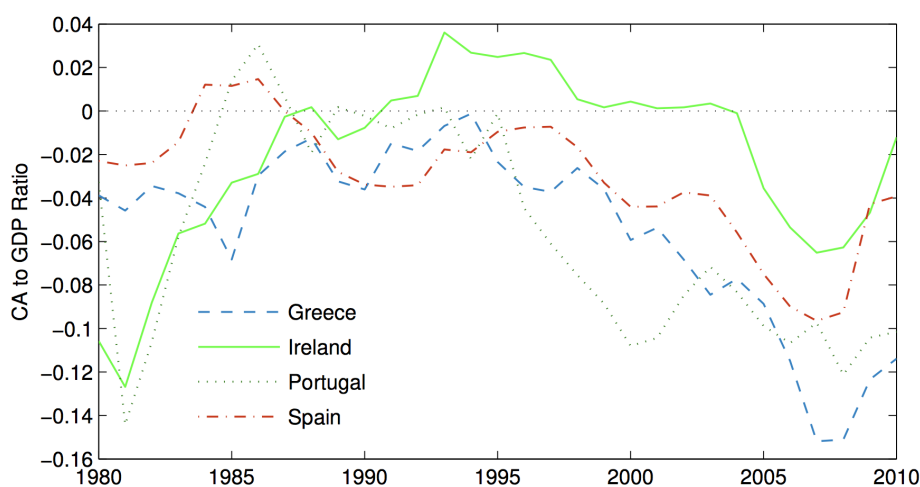


Figure 1: Current Account to GDP ratios for GIPS countries

- (a) From this figure, could you infer how Net Foreign Asset Positions for these countries has evolved in the reported three decades?
- (b) Assume it was the year 2005 and you looked at CA for the GIPS countries. Now with the benefit of hindsight, what early signs of balance of payments trouble do you detect.
- (c) Which of the GIPS countries were still running CA deficits after the onset of the financial crisis in 2009 and 2010. Who do you think is financing those current account deficits—the foreign private creditors or foreign governments?