EC201 Macroeconomics 2, Term 1 2025
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Suggested Solutions to the Pre-class Review questions (section A) (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.

Suggested Solutions

(a) The import of merchandise from Spain deteriorates the U.K. trade balance. The payment by check improves the U.K. financial account correspondingly, because it amounts to the sale of an asset.

Table 1: U.K. International Transactions Account

Current Account	-120,000
Trade Balance	-120,000
Income Balance	0
Net Unilateral Transfers	0
Financial Account	120,000

(b) Since this transaction takes place between two British companies, it causes no change in the overall level of U.K.-owned assets abroad; therefore, the financial account is unaffected. So is the current account.

Table 2: U.K. International Transactions Account

Current Account	0
Financial Account	0

(c) The export of merchandise to France improves the U.S. trade balance. The payment by check deteriorates the financial account correspondingly, because it amounts to a decrease in foreign-owned assets in the U.S. (i.e. a reduction in the French consumer's deposit at the New York bank). Assuming that the value of the transaction is X dollars, the U.S. international transactions account looks as follows.

Table 3: U.S. International Transactions Account

Current Account	X
Trade Balance	X
Income Balance	0
Net Unilateral Transfers	0
Financial Account	-X

(d) Two different transactions take place. First, the sale of the subsidiary in the U.S. is an internal transaction that leaves the U.S. external wealth unchanged: therefore, both the current and the financial account remain unaffected. Second, the purchase of a French company gives rise to two entries in the financial account: an increase in U.S.-owned assets in France (which deteriorates the U.S. financial account) and an increase in French-owned dollars (which improves the U.S. financial account). These two effects cancel out: both the current and the financial account are zero. Assuming that the value of the transaction is X dollars, the U.S. international transactions account looks as follows.

Table 4: U.S. International Transactions Account

Current Account	0
Financial Account	0
Increase in foreign-owned assets in the U.S.	X
Increase in U.S.-owned assets abroad	-X

(e) Spending money on accommodation in Australia by Chinese nationals amounts to importing a service, so it deteriorates the China's trade balance and the current account. The payment by credit card represents the sale of an asset, so it improves the China's financial account accordingly.

Table 5: China's International Transactions Account

Current Account	-2,500
Trade Balance	-2,500
Income Balance	0
Net Unilateral Transfers	0
Financial Account	2,500

(f) Foreign aid gives rise to two offsetting entries in the current account: an export of goods (which improves the Norwegian merchandise trade balance) and a unilateral transfer to waive the corresponding payment (which deteriorates the Norwegian net unilateral transfers account). Since that the value of the transaction is 1000 million NOK, the Norwegian international transactions account looks as follows.

Table 6: Norway: International Transactions Account (in NOK)

Current Account	0
Trade Balance	1000 millions
Income Balance	0
Net Unilateral Transfers	-1000 millions
Financial Account	0