



LECTURE TEN - PART TWO



Balance of Payments Accounting

- Distinguish between the **current** account and the **capital** account in our balance of payments.

The Trade Identity Equation

If a country runs a trade deficit in its **current** account, it must balance that deficit with inflows into its **capital** account!

US BALANCE OF PAYMENTS	Credits	Debits	Net Credits or Debits
Current Account			
a. Merchandise Trade Balance			-191
U.S. Goods Exports	612		
U.S. Goods Imports		-803	
b. Fees for Services			80
U.S. Exports of Services	237		
U.S. Imports of Services		-157	
Balance on Goods and Services			-111
c. Net Investment Income			3
Income earned by U.S. Investors holding foreign assets	206		
Income earned by foreigners holding U.S. assets.		-203	
d. Unilateral Transfers			-40
Balance on the Current Account			-148
Capital Account			
a. Foreign purchases of assets in the United States	517		
b. U.S. purchases of assets abroad		-376	
Balance on Foreign/U.S. Purchases			141
c. Official reserves			7
Balance on Capital Account			-148
Sum of Current and Capital Accounts			-0-

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The merchandise trade balance reflects trade in commodities such as food and fuels and manufactured goods.

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- ✦ Fees for services include shipping, financial services, and foreign travel.
- ✦ This category has been growing in recent years as the U.S. has shifted from a manufacturing economy to a more service-orientated economy.

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- ✦ The \$206 billion represents the amount of income earned by Americans holding foreign assets.
- ✦ The debit of \$203 billion represents the amount of income earned by foreigners holding U.S. assets.

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The Capital Account

- One part of the capital account shows “official-reserve changes.”
- When all countries have purely market-determined exchange rates, the category equals zero.
- When countries “intervene” in foreign exchange markets, they attempt to affect the exchange rate by buying and selling foreign currencies.

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- ✦ Capital out-flows and in-flows track **real** assets like hotels and factories and **financial** assets such as stocks and bonds.
- ✦ Foreign purchases of U.S. assets represent capital in-flows.
- ✦ Examples: The purchase of government bonds by a German pension fund, the buying of American stock by a Dutch mutual fund, or the acquisition of a factory in a Pennsylvania by Japanese investors.

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US BALANCE OF PAYMENTS

Credits

Debits

Net Credits or Debits

✦ When U.S. investors purchase assets abroad like hotel chains or foreign stocks, this results in capital out-flows and a debit such as the \$376 billion in the table.

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