4.1.7 Balance of payments

a) Components of the balance of payments
   - *The current account*
   - *The capital and financial accounts*

b) Causes of deficits and surpluses on the current account
c) Measures to reduce a country's imbalance on the current account
d) Significance of global trade imbalances

- Balance of payments: a record of all flows of money into and out of a country
- Parts of the balance of payments:
  - Trade in goods deficit
  - Trade in services surplus
  - (Primary income) Investment and employment income: net income from businesses overseas set up by UK companies surplus
  - (Secondary income) Transfers: movements of money between countries which aren't paying for goods and services such as aid deficit
- Capital account: includes transfers of non-monetary and fixed assets. The most important part is the flow of the assets of migrants.
- Financial account: involves the movement of financial assets
- Parts of the financial account:
  - FDI
  - Portfolio investment
  - Financial derivatives
  - Reserve assets
- Income from the financial account such as interest is recorded in the current account
- The current account should balance the capital and financial accounts. However, due to errors and omissions, they don't always balances so a balancing figure is needed
- Long term financial and capital flows: usually quite predictable such as FDI and portfolio investment
- Short term financial and capital flows: eg hot money. They are based on speculation and people trying to quickly make money by moving currencies
- Causes of a balance of payments deficit:
  - High levels of consumer spending: if the YED for imports is high then there will be a greater increase in imports
  - Poor international competitiveness: developing countries have lower costs of production
  - Appreciation of the currency will make goods more expensive
  - Inflation makes exports more expensive and less competitive
  - External shocks: a rise in the price of raw materials means a country will pay more for these imports at least in the short-run
- Consequences of a balance of payments deficit:
  - Can be a signal of uncompetitiveness or that people are wealthy and can afford imports
  - Depreciation in the currency, leading to imported inflation
  - Loss of jobs in the domestic market

- Consequences of a balance of payments surplus:
    - Can be a signal of competitiveness or that there is a lack of domestic demand
    - May be an overreliance on exports
    - Appreciation of the currency, or undervalued currency which creates inflation
    - May attract protectionist response
- Policies to correct a balance of payments deficit:
    - Policies to reduce inflation such as supply-side policies and deflationary policy
    - Protectionism
    - Devaluation in the exchange rate
    - Policies to reduce economic growth