2.1.4 Balance of payments

a) Components of the balance of payments, with particular reference to the current account, and the balance of trade in goods and services
b) Current account deficits and surpluses
c) The relationship between current account imbalances and other macroeconomic objectives
d) The interconnectedness of economies through international trade

- Current account: It records payments for transactions between countries in the present year (other than investments or speculation) and comprises:
  - Net trade in goods (visible trade) and services (invisible trade)
  - Net investment income (interest, profit and dividends)
  - Net transfers such as foreign aid or tax payments to foreign governments
- Exports and imports: Exports are an inflow of money and imports are an outflow of money
- Balance of payments: A record of international payments over the course of a year (money in and out)
- Net credit:
  1. Goods and services out
  2. Income and transfers from abroad
- Net debit:
  1. Good and services in
  2. Income and transfers out
- Components of the balance of payments:
  - Current account
  - Financial account
  - Capital account
  - Net errors and emissions
- Financial account: it covers claims on or liabilities to non-residents, specifically with regard to financial assets.
  - Portfolio investments: shares and government bonds
  - FDI
  - Reserves: currency or gold
- Capital account: it shows the net change in physical or financial asset ownership for a nation
- Net errors and emissions: the balance of payments will almost inevitably show a net credit or a net debit. That balance is the result of errors and omissions in compilation of statements.
- A current account deficit of the balance of payments occurs when more money is flowing out of the country than is flowing in
- A current account surplus of the balance of payments occurs when more money is flowing into the country than is flowing out
- Causes of a current account deficit:
  1. The currency is too strong relative to other countries

2. Price competitiveness: High rates of inflation and wages relative to other countries
3. High development growth means more imports
4. Volatile global prices
5. Recession in major trade partner countries
6. Non-price competitiveness: low levels of capital investment and research, weaknesses in design, performance or branding

- Causes of a current account surplus:
    1. The currency is weak relative to other countries
    2. Price competitiveness: low rates of inflation and wages relative to other countries
    3. Low level of growth so difficult to import incentivising exporting
    4. Global market booms increasing demand for exports
- International trade: Countries become interdependent for income and resources for goods and services
- Effect of interdependence of trade:
    1. It can be beneficial as countries cooperate with each other
    2. It be damaging as trade blocs become powerful so developing countries can't trade fairly
- In recessions the current account falls as people are spending less
- By selling more exports to foreign countries, the UK will have a greater inflow of money into the circular flow of income. This will increase AD and improve the rate of economic growth.