Balance of Payment

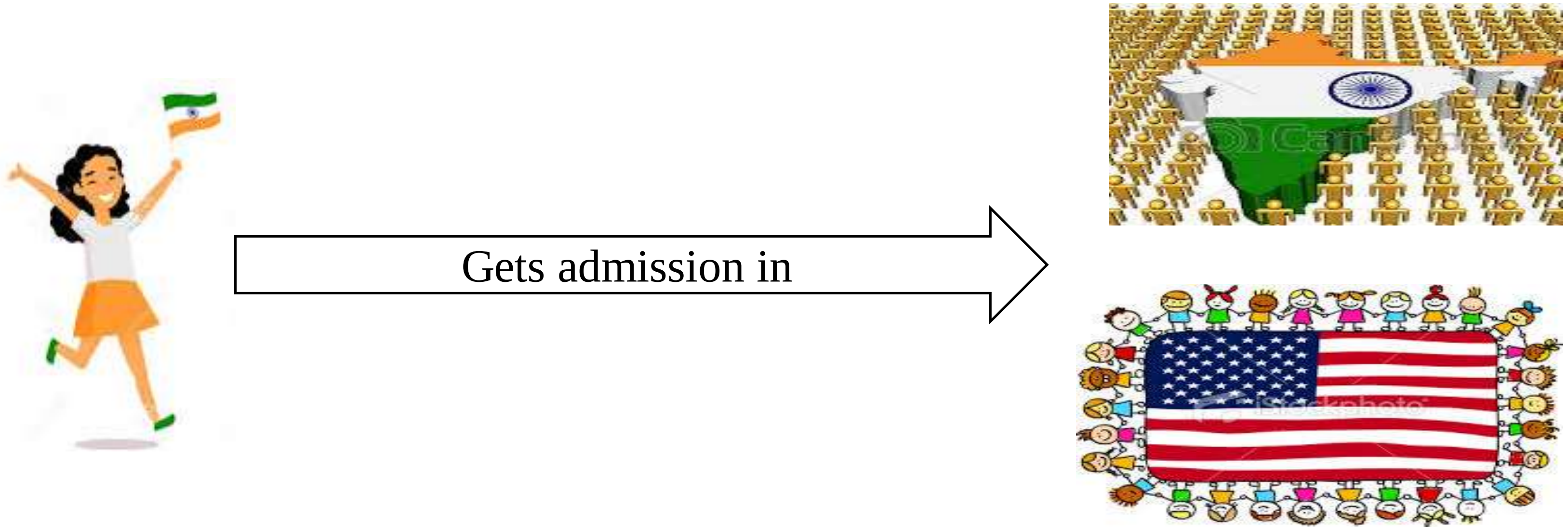
Ms. Sugandhi Gupta

Assistant professor, Department of B.Com Banking & Insurance

S.I.E.S College of Commerce & Economics

Email for comments, suggestions and copyright issues – sugandhi.vgupta@gmail.com

Balance of Payment

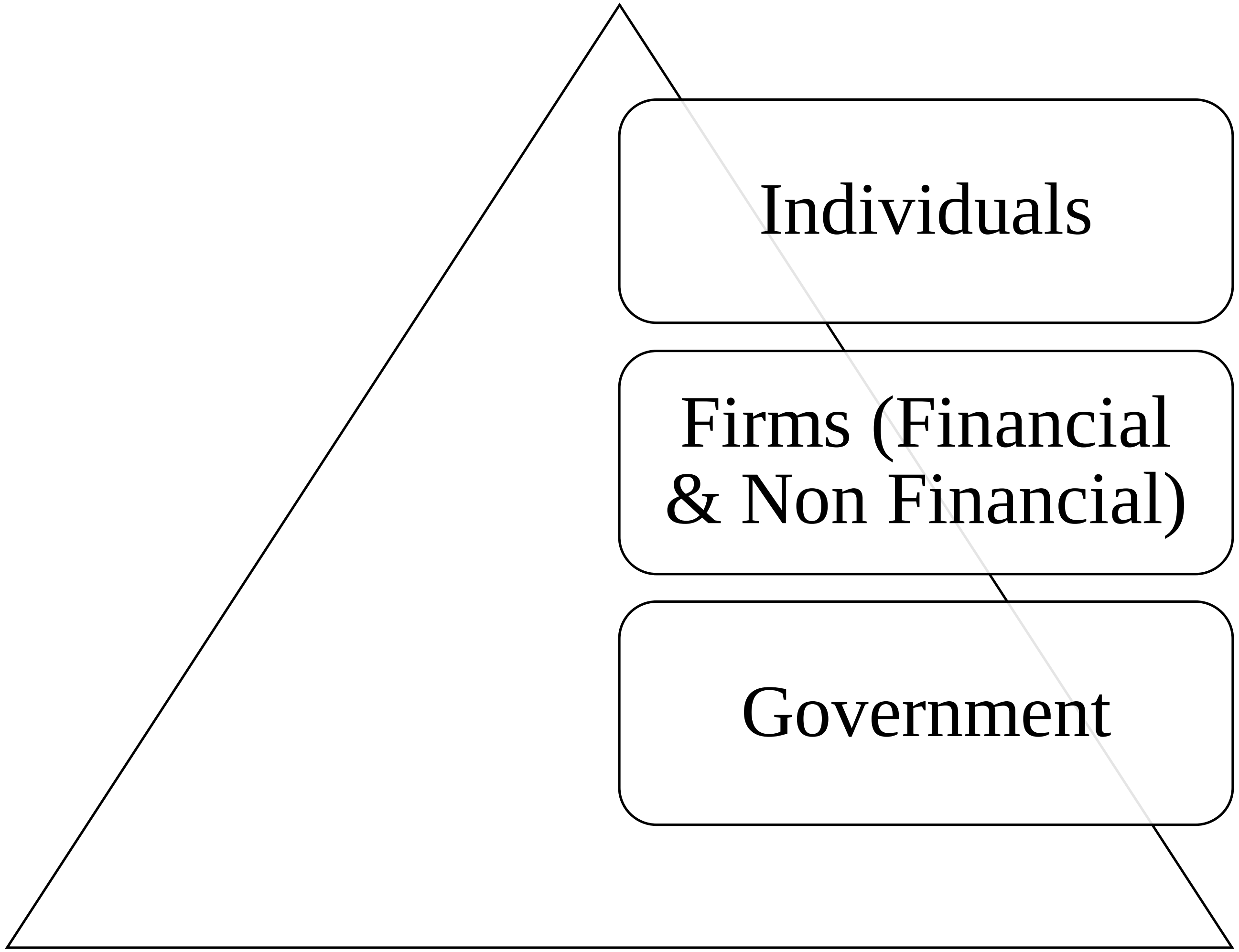


- The **balance of payment** (BOP) of a country is the record of all economic transactions between the residents of a country and the rest of the world in a particular period.

- The measure of **difference** between the **net inflow and the net outflow** of international financial liabilities.

	Party 1	Party 2		
	Mac D (USA)	Invest FDI and FII	Yes	
	Seema	Aparna	No	
	Seema	Foreign Trip	Yes	
	Eshika	Makeup from Aborad	Yes	
	Eshika	Makeup from RCITY	No	

Transactions Recorded in Balance of Payment



	Current			
	Ex-IM GOODS	Merchandise (BOT)	USA = 1.5% India = 8.5% 7.0%	
	Ex-IM Services	Invisibles		
	IM GOLD for Personal use	Non Monetary gold		

- Deficit = Payment > Receipts
- Imports > Exports
- Current Accounts Deficit= Payment > Receipts
- Imports > Exports
- 150 BN INR> 100 BN INR
- 150 BN INR> 100 BN INR
- Crude / GOLD

- Deficit = Payment > Receipts
- Imports > Exports
- Capital Accounts Deficit= Capital Out flow > Capital Inflow
- 150 BN INR> 100 BN INR
- 150 BN INR> 100 BN INR

Balance of Payment Structure

Current Account

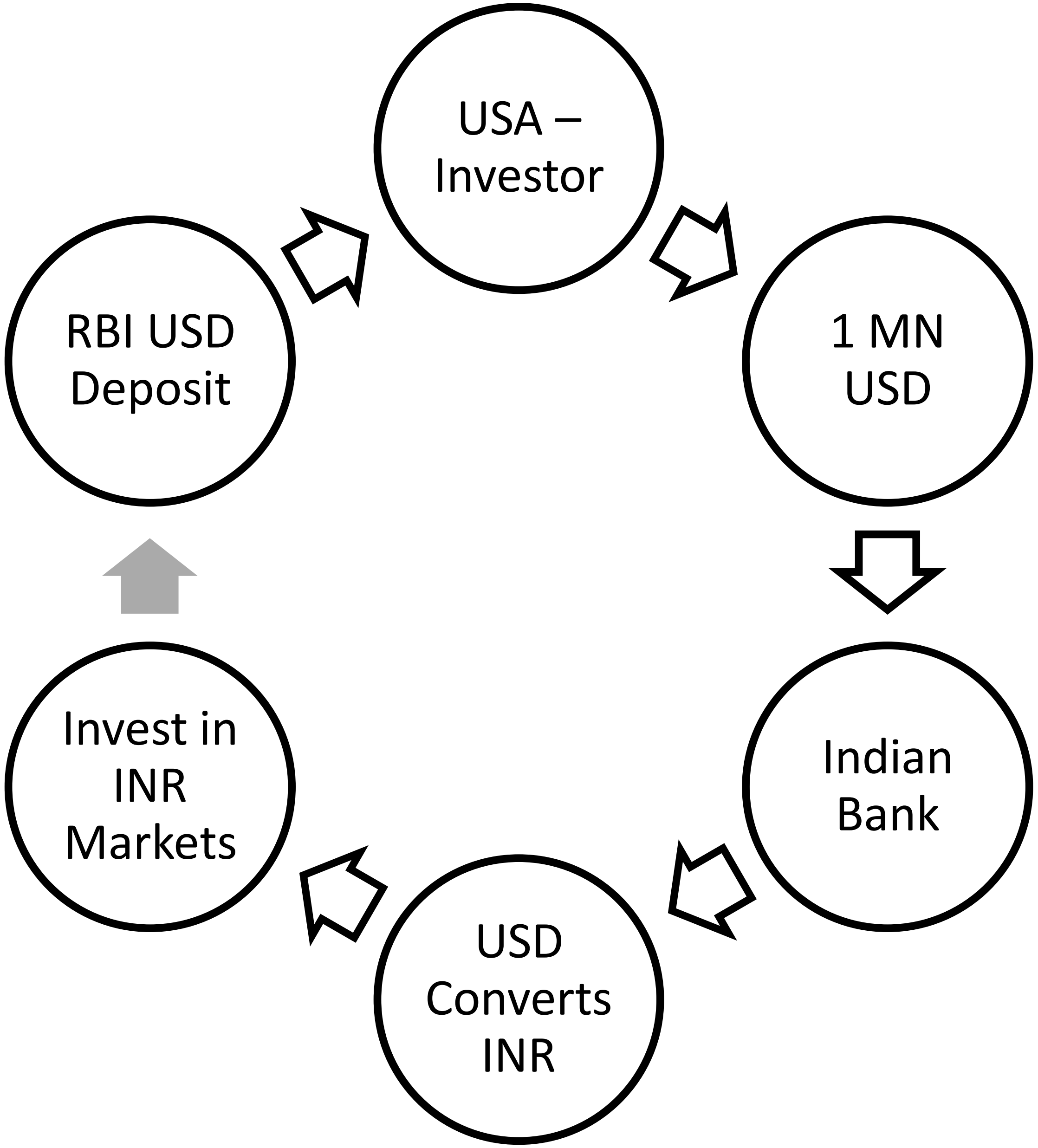
- Export and Import of Goods (Merchandise Transactions or Visible Trade) also called BOT Balance of Trade
- Export and Import of Services (Invisible Trade) travel, transportation, insurance, other misc services, transfer of interest, dividends profits, remittance (gifts)
- Non monetary Gold

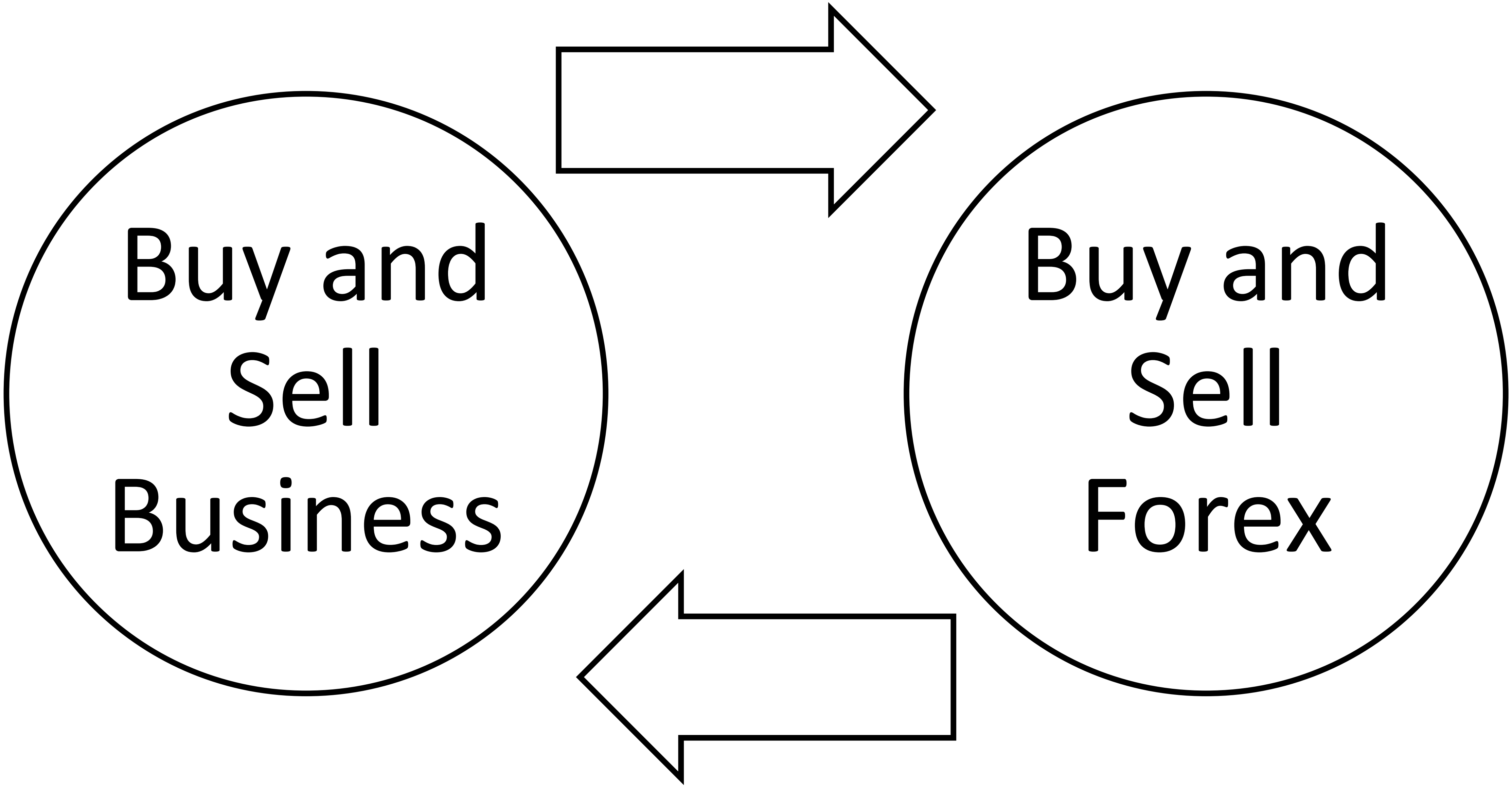
Capital Account

- Loans (borrowing & Lending)
- Investments (issue of equity, bonds, term loans, acquisition of assets)
- Private, Banking, Government

- Current Accounts Deficit= Payment > Receipts
- Imports > Exports
- 150 BN INR> 100 BN INR
- Crude / GOLD
- - 150 bN INR
- Deficit = Payment > Receipts
- Imports > Exports
- Capital Accounts Deficit= Capital Inflow > Capital Outflow
- 150 BN INR> 100 BN INR
- 150 BN INR> 100 BN INR
- + 50BN INR
- NET DEFECIT = 100 BN INR

				Net
	Current	Imports -150	Exports +100	(-50) Pay
	Capital	Outflow (-)400	Inflow (+)600	-200
	Resvs			


USA – Investor
1 MN USD
Indian Bank
USD Converts INR
Invest in INR Markets
RBI USD Deposit


Buy and Sell Business
Buy and Sell Forex

Third Component of BOP: Reserve A/c or Official Settlement Account

- An official settlement account is a special type of account used in international balance of payments (BoP) accounting to keep track of central banks' reserve asset transactions with one other.

- Stock of foreign currency denominated assets held by monetary authority of the country
- Includes Forex reserves of RBI
- Monetary Gold
- Contribution to IMF
- Special Drawing Rights by IMF

Third Component of BOP: Reserve A/c or Official Settlement Account

- The reserves with the RBI accumulate due to several factors.
- **First** is its income from three sources: interest on government bonds held for conducting open market operations; fees from government's market borrowing programme; and income from investment in foreign currency assets.
- **Second** source is earnings retained after giving dividends to government.
- **Third** source is revaluation of foreign assets and gold.

What is SDR?

- The SDR is an international reserve asset, created by the IMF in 1969 to supplement its member countries' official reserves.
- The SDR is neither a currency nor a claim on the IMF. Rather, it is a potential claim on the freely usable currencies of IMF members.
- SDRs can be exchanged for these currencies member countries' official reserves

SDR

- The SDR basket is reviewed every **five** years, or earlier if warranted, to ensure that the SDR reflects the relative importance of currencies in the world's trading and financial systems.
- The value of the SDR is based on a basket of five currencies—
  - U.S. dollar, 41.73%,
  - Euro, 30.93%
  - Chinese Renminbi, 10.92%,
  - Japanese Yen, 8.33%
  - British Pound Sterling. 8.09%

Criteria for inclusion in the SDR basket

- Export criterion: Issuer of currency is an IMF member or a monetary union, that includes IMF members, who is one of the top five exporters of the world.
- Freely usable : For a currency to be determined "freely usable" by the IMF, it has to be widely used to make payments for international transactions and widely traded in the principal exchange markets.

Transactions: BOP

- Autonomous Transaction/ transactions above the line. Undertaken in normal course of business, usually imbalanced. Current and Capital Account Transaction

- Accommodating Transaction/ transactions below the line, undertaken to balance BOP undertaken by government & RBI. Reserve Account Transaction

References:

- https://m.rbi.org.in/Scripts/Bs_sddsviewhtmldetails.aspx?pg=IMF290216.html
- https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR
- https://www.imf.org/en/About/Factsheets/Sheets/2016/08/01/14/51/Special-Drawing-Right-SDR
- https://economictimes.indiatimes.com/industry/banking/finance/banking/battle-over-reserves-heres-how-much-money-rbi-sits-on-can-part-with-and-how-it-builds-the-funds/articleshow/66625456.cms?from=mdr#:~:text=The%20reserves%20with%20the%20RBI,investment%20in%20foreign%20currency%20assets.
- https://www.investopedia.com/terms/o/official-settlement-account.asp

Thank You

If You Have Found This Lecture Useful ,

Kindly Subscribe To My YouTube Channel and Press the Bell Icon

To Receive Latest Updates About New Educational Lectures

Disclaimer: This E-content is developed for the benefit of undergraduate students and should not be constructed as professional advice in any manner

Email for comments, suggestions and copyright issues – sugandhi.vgupta@gmail.com

Quantitative easing (QE)

- '**Quantitative Easing**' is an unconventional monetary policy in which a central bank purchases government securities or other securities from the market in order to lower interest rates and increase the money supply
- Central banks are responsible for keeping inflation in check

Before the financial crisis

- Before the financial crisis of 2008-09 Central bank managed that (inflation) by adjusting the interest rate at which banks borrow overnight
- If firms were growing nervous about the future and scaling back on investment, the central bank would reduce the overnight rate
- That would reduce banks' funding costs and encourage them to make more loans, keeping the economy from falling into recession.

During Crisis

- When the crisis struck, big central banks like the Fed and the Bank of England slashed their overnight interest-rates to boost the economy.
- But even cutting the rate as far as it could go, to almost zero, failed to spark recovery.

- CB started using new tool for managing inflation called QE

How QE works

- To carry out QE central banks create money by buying securities, such as government bonds, from banks, with electronic cash that did not exist before.

- The new money swells the size of bank reserves in the economy by the quantity of assets purchased—hence "quantitative" easing.

- QE is supposed to stimulate the economy by encouraging banks to make more loans.

- Due to QE interest rates on everything from government bonds to mortgages to corporate debt are lower