Balance of Payments

Payments: track payments generated by transactions; get + if payments flow in; get – if payments flow out
Balance: Payments must balance

Balance of Payments 2013 (billions of dollars)

Current Account (CA):

Exports	+ $2,280	
Imports	- 2,756	
Net Exports		- $476
Factor Income received from ROW	+ $780	
Factor Income paid to ROW	- 580	
Net Factor Income		+ $199
Transfer Payments From ROW	+ $118	
Transfer Payments To ROW	- $242	
Net Transfer Payments		- $124
Current Account		**- $400**

Financial Account (FA):

Asset sales to ROW	+ $1,018	
Asset purchases from ROW	- 645	
Financial Account (FA)		**+ $373**
Statistical Discrepancy		**- $27**

Payments must balance: CA + FA = 0

Or, CA = - FA

Or, - CA = FA

Sweater example

So a country with a CA deficit will have to run a FA surplus, i.e., selling assets to ROW so that funds flow into the country

Or, to put the same thing the other way around, if the ROW wants to buy a country's assets, it must lead to a CA deficit in that country

Likewise, a country running a CA surplus will have to have a FA deficit, i.e., buying assets from ROW. This is how China accumulated US treasury bonds

Or, a country buying assets abroad necessarily has to have a CA surplus.

HOW this relationship between CA and FA comes about is the interesting part.

With flexible exchange rates, CA comes to equal –FA through movement of the exchange rate