

EE452 International Monetary Economics

1. Payments among Nations

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Outline of Topic 1

- ☞ Introduction: Overview of International Finance
- ☞ Course outline explanation
- ☞ Balance of payments
- ☞ Accounting principles
- ☞ Components of the Balance of Payments
- ☞ Current Account Balance
- ☞ Current Account Balance and Capital & Financial Account Balance
- ☞ Overall Balance
- ☞ International Investment Position

INTRODUCTION

International Economics

- International Trade
- International Monetary Economics, International Macroeconomics, International Finance

Some recent controversial issues in International Economics

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- US-China Controversy: the rise in imports of automobile tires from China during 2004-2008.
- Controversy over international immigration: complaints about immigrants in many major receiving countries.
- Controversy about exchange rate value of the Chinese Renmibi (Yuan): During mid-1990s-2005, 2008-2010; China maintained fixed exchange rate of the Yuan to US Dollar.
- Global financial and economic crisis: The sub-prime crisis began in the US, caused by a credit boom and a bubble and bust in the house prices, beginning in 2006.

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“China maintained fixed exchange rate”

- From mid-1990s to 2005, Chinese government maintained a fixed exchange rate of yuan to US dollar.
- China’s trade surplus increased, Chinese government buy dollars and sell yuan to keep exchange rate steady.
- US and EU increasingly complained.
- In 2005, the Chinese government allowed an appreciation of exchange rate.
- In 2008, in response to global crisis, China’s government reverted to fixed exchange rate.
- In mid-2010, China’s government again began to allow gradual appreciation of yuan.

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“Global financial and economic crisis”

- Began in the US during credit boom and bubble in house prices.
- As the bubble began to deflate in 2006, an increasing number of mortgages went into default.
- In Aug 2007, BNP Paribas signaled the losses on securities backed by bad mortgages. Financial institutions became reluctant to lend to each other because they worried that borrowing institutions may not be able to service their debts in the future.
- With the failure of Lehman Brothers in Sept 2008, short-term financial markets and lending among financial institutions froze and the crisis entered a much worse phase.
- This shows that problems in one sector (housing) in one country can spread to much of the rest of the world, through losses on their foreign investment and through declines in international trade in goods and services.

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COURSE OUTLINE EXPLANATION

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Objectives of EE452

1. To understand international monetary economic theory and its applications
2. To understand the effectiveness of fiscal and monetary policy under fixed and flexible exchange regimes
3. To understand the mechanism of financial crisis and its implications on future crises

All Topics in EE452

1. Balance of Payments
2. Foreign Exchange Market
3. Exchange Rate Determination
4. Government Policy toward Foreign Exchange Market
5. Macroeconomy, International Balance and External Balance under Fixed Exchange Regime
6. Floating Exchange Rates and Internal Balance
7. Financial Crises

Evaluation

- Midterm Exam 30%
- Final Exam 50%
- Homework/Quizzes 20%

Texts

- *Pugel, T. A. (2012) *International Economics*. 5th Edition, New York: McGraw-Hill

Alternatives:

- Daniels, J. P. and D. D. Van Hoose (2014) *International Monetary and Financial Economics*. New Jersey: Pearson Education
- Feenstra, R. and A. Taylor (2008), *International Economics*. 1st Edition, New York: Worth Publishers



International monetary and financial economics / Joseph P. Daniels, David D. VanHoose.

by Daniels, Joseph P ; VanHoose, David D

Call no.: HG3881 .D32 2005
Publication: Mason, Ohio : Thomson/South-Western, c2005
Edition: 3rd ed.
Description: xxi, 600 p. : ill., maps.
ISBN: 0324261608.

Subject(s): International finance

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International economics / Robert C. Feenstra, Alan M. Taylor.

by Feenstra, Robert C ; Taylor, Alan M

Call no.: HF1359 .F427
Publication: New York, N.Y. : Worth, 2008
Description: xiv, 980, 21 p. : ill. (some col.).
ISBN: 0716792834; 9780716792833.

Subject(s): International economic relations | International trade | International finance | Balance of payments

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PAYMENTS AMONG NATIONS

Balance of Payments

- a systematic record of all economic transactions during a unit period between the reporting country and residents of foreign countries.

COMPONENTS OF THE BALANCE OF PAYMENTS

Current Account Balance

The current account balance equals the net credits minus debits on the flows of goods, services, primary income, secondary income and unilateral transfers.

The trade balance (goods and services balance) equals the net exports of both goods and services.

Financial Account

- Direct Investment
- Portfolio Investment
- Financial Derivatives
- Other investments: Assets, Loans, Currencies and Deposits

Overall Balance

- The overall balance (or official settlements balance) equals the sum of the current account balance and the private financial account balance (plus the statistical discrepancy from mismeasuring items in the current account and financial account).

International Reserves Account Balance

- The international reserves account balance is the balance of the countries' official holdings of gold, foreign exchange assets and certain assets related to the IMF.

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Overall Balance and Reserve Assets

- If the overall balance is in surplus, it is counterbalanced by an increase in the country's official reserve holdings or a decrease in its official liabilities to other countries' monetary authorities.
- If the overall balance is in deficit, it is counterbalanced by a decrease in the country's official reserve assets or an increase in its official liabilities.

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Balance of Payments 2010-2012

Unit: Million Baht

	2010	2011	2012
Exports (f.o.b.) (ส่งออก เอฟ โอ บี)	6,060,184.02	6,675,068.11	7,029,411.88
Imports (f.o.b.) (นำเข้า เอฟ โอ บี)	5,122,934.60	6,160,220.42	6,768,697.69
Trade balance (ดุลการค้า)	937,249.42	514,847.70	260,714.19
Net services, primary income and secondary income	-624,305.43	-334,210.84	-175,181.95
Current account balance (ดุลบัญชีเดินสะพัด)	312,943.99	180,636.86	85,532.24
Capital account (บัญชีทุน)	7,718.63	-1,198.01	7,245.72
Financial account (เงินทุนเคลื่อนย้าย)	794,947.66	-162,567.13	357,971.38
Central Bank (ธนาคารกลาง)	84,139.53	-5,392.10	32,403.48
General government (รัฐบาล)	113,274.68	115,395.52	183,109.09
Other depository corporations (สถาบันการเงินที่รับฝากเงิน นอกจากธนาคารกลาง)	330,330.69	-268,804.89	425,029.45
Other sectors	267,202.76	-3,765.67	-282,570.64
Other financial corporations (สถาบันการเงินที่มิใช่รับฝากเงิน)	85,566.64	-38,498.43	-390,383.89
Nonfinancial corporations, households, and NPISHs (ธุรกิจที่ไม่ใช่สถาบัน)	181,636.12	34,732.76	107,813.25
Capital and Financial Account Balance (ดุลบัญชีทุนเคลื่อนย้าย)	802,666.29	-163,765.14	365,217.10
Net errors & omissions (ความคลาดเคลื่อนสุทธิ)	-128,984.66	18,198.28	-287,779.93
Overall balance (โดยรวม)	986,625.62	35,070.00	162,969.40
Reserve assets (สินทรัพย์เงินสำรองระหว่างประเทศ)	986,625.62	35,070.00	162,969.40
a. Reserve position in the Fund (ฐานะเงินสำรองในกองทุนการเงินระหว่างประเทศ)	692.72	9,959.28	892.77
b. Foreign exchange (เงินตราต่างประเทศ)	965,789.92	-57,982.41	162,064.20
c. Monetary gold (ทองคำ)	20,102.23	83,038.33	0.00
d. SDRs (สิทธิพิเศษถอนเงิน)	40.75	54.80	12.43

Source: www.bot.or.th

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Balance of Payments 2005-2015p

	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015p
Exports (f.o.b.) (ส่งออก เอฟ โอ บี)	4,486,672.11	4,838,241.73	5,212,209.04	5,321,089.79	5,857,644.02	6,080,984.02	6,675,068.11	7,029,411.88	7,361,545.16	7,733,398.3	7,733,398.3
Imports (f.o.b.) (นำเข้า เอฟ โอ บี)	4,264,437.62	4,324,904.07	4,295,410.53	5,295,944.93	4,626,589.52	5,122,934.60	6,160,220.42	6,710,232.34	6,809,002.30	6,440,702.7	6,440,702.7
Trade balance (ดุลการค้า)	222,234.49	513,337.66	916,798.51	1,025,144.86	1,231,054.50	958,049.42	514,847.70	319,179.54	552,542.86	1,292,695.6	1,292,695.6
Net services, primary income and secondary income	-444,728.43	-429,583.82	-377,090.39	-509,800.35	-365,718.20	-424,305.43	-327,927.49	-233,837.55	-290,603.50	-47,428.73	-179,263.13
Current account balance (ดุลบัญชีเดินสะพัด)	-302,493.94	84,553.84	539,708.12	515,344.51	865,336.30	533,743.99	186,920.21	85,342.00	261,939.36	1,245,266.9	1,113,432.47
Capital account (บัญชีทุน)	n.a.	n.a.	n.a.	n.a.	2,263.94	7,718.63	-1,198.01	7,245.72	8,744.44	3,248.71	2,57
Financial account (เงินทุนเคลื่อนย้าย)	282,766.78	207,920.82	-50,817.83	414,836.26	-83,834.07	794,947.66	-235,751.81	426,709.19	-10,586.76	-524,492.91	-597,994
Central Bank (ธนาคารกลาง)	5,298.69	16,200.07	-21,482.93	1,096.66	50,005.16	84,139.53	-5,392.10	32,403.48	-14,874.16	-95,562.94	-47,719.97
General government (รัฐบาล)	-38,103.79	-20,651.71	-77,645.54	-15,461.62	19,448.00	113,274.68	115,395.52	203,076.68	194,732.63	45,112.13	-609,056
Other depository corporations (สถาบันการเงินที่รับฝากเงิน)	8,072.23	-297,166.13	-305,720.05	27,485.89	277,628.96	330,330.69	-275,269.34	505,683.76	-11,536.11	-181,683.70	-448,089.7
Other sectors	303,576.70	609,538.59	346,020.70	401,714.82	-440,936.21	267,202.76	-57,919.19	-314,454.73	29,960.88	-296,468.44	-486,523.83
Other financial corporations (สถาบันการเงินที่มิใช่รับฝากเงิน)	-182,687.95	685,606.01	-314,177.63	-581,914.58	-871,550.56	85,566.64	-149,640.81	-358,089.21	85,287.39	-336,855.59	-11960.2
(ธุรกิจที่ไม่ใช่สถาบันการเงิน ครัวเรือน และองค์กรที่ไม่ใช่สถาบันการเงิน)	486,254.55	-60,667.43	1,80,208.31	983,629.40	430,634.25	181,636.12	34,732.62	43,634.48	55,435.91	19,637.95	-363,632.63
Capital and Financial Account Balance (ดุลบัญชีทุนเคลื่อนย้าย)	100,682.92	452,920.92	-91,570.13	415,920.21	2,263.94	7,718.63	-1,198.01	7,245.72	8,744.44	3,248.71	2,57
Net errors & omissions (ความคลาดเคลื่อนสุทธิ)	241,172.02	85,050.74	105,532.22	329,652.01	360,834.02	128,984.66	-4,900.39	-225,935.09	-97,179.32	-7,898.27	-395,532.48
Overall balance (โดยรวม)	224,168.07	477,524.83	588,418.54	811,848.77	1,231,054.50	986,625.62	35,070.00	162,969.40	-32,239.95	1,287,868.63	1,113,432.47
Reserve assets (สินทรัพย์เงินสำรองระหว่างประเทศ)	224,168.07	477,524.83	588,418.54	811,848.77	1,231,054.50	986,625.62	35,070.00	162,969.40	-32,239.95	1,287,868.63	1,113,432.47
a. Reserve position in the Fund (ฐานะเงินสำรองในกองทุนการเงินระหว่างประเทศ)	1498.13	1,990.94	1,320.54	3,017.37	4,871.63	692.72	9,959.28	892.77	2,460.76	N/A	N/A
b. Foreign exchange (เงินตราต่างประเทศ)	219,962.28	479,630.77	587,420.29	804,827.62	1,227,224.84	965,789.92	-57,982.41	162,064.20	-165,804.04	1,274,867.91	1,274,867.91
c. Monetary gold (ทองคำ)	0.00	-201.07	893.66	0.00	0.00	20,102.23	83,038.33	0.00	0.00	N/A	N/A
d. SDRs (สิทธิพิเศษถอนเงิน)	2,072,094.88	2,349,228.44	2,889,743.28	3,210,012.75	4,456,734.91	4,994,538.80	5,027,322.03	5,240,462.80	5,219,590.16	N/A	N/A

Source: www.bot.or.th as of 17 January 2017

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U.S. Balance of Payments, 2010 (\$ billions)

Current Account	
Exports of goods and services	1,834
Imports of goods and services	-2,330
Income received from foreigners	662
Income paid to foreigners	-499
Unilateral transfers, net	-137
<i>Current account balance</i>	<u>-470</u>
Financial Account (excluding official international reserves)	
Changes in U.S. direct investments abroad	-346
Changes in foreign direct investments in the U.S.	194
Changes in U.S. holdings of foreign stocks and bonds	-167
Changes in foreign holdings of U.S. stocks and bonds	482
Changes in U.S. loans to foreigners and other investments	-510
Changes in foreign loans to the U.S. and other investments	286
<i>Financial account balance</i>	<u>-67</u>
Official International Reserves	
Changes in U.S. official holdings of foreign assets	-2
Changes in foreign official holdings of U.S. assets	298
<i>Changes in official international reserves, net</i>	<u>296</u>
Statistical Discrepancy^a	
	235
Other important balances:	
<i>Goods and services balance</i>	-496
<i>Overall balance^b</i>	<u>-296</u>

Source: Pugel (2012), p. 383

MACROECONOMIC MEANINGS OF CURRENT ACCOUNT

The Macro Meaning of the Current Account (CA) Balance (1)

- Since all items in the BOP must add to zero (because it is double-entry bookkeeping), the *country's CA must equal net foreign investment (I_f)*.
- I_f is the increase in the country's foreign financial assets minus the increase in the country's foreign financial liabilities.

The Macro Meaning of the Current Account (CA) Balance (1)

- If the country has a CA surplus, then its *foreign assets are growing faster than its foreign liabilities*.
- If the country has a CA deficit, then its *foreign liabilities are growing faster than its foreign assets*.
- Compare the case of Thailand and US.

The Macro Meaning of the Current Account (CA) Balance (2)

- A country's CA balance is also linked to its national saving and domestic real investment
- Two things can be done with the national saving (S):
 - Invest at home in domestic capital formation, which is domestic real investment (I_d)
 - Invest abroad in net foreign investment (I_f)
- $S = I_d + I_f$, $I_f = S - I_d$
- That is, $CA = S - I_d$
- CA surplus means national saving is high relative to domestic real investment.
- CA deficit means national saving is low relative to domestic real investment.

The Macro Meaning of the Current Account (CA) Balance (3)

- CA balance is also linked to domestic production, income and expenditure.
- A country's CA is the difference between its domestic production of goods and services and its total expenditures on goods and services.

The Macro Meaning of the Current Account (CA) Balance (3)

- Recall: $Y = C + I_d + G + X - M$
- Total expenditure on goods and services:
 $E = C + I_d + G$
- $Y = E + (X - M)$
- $CA \cong X - M = Y - E$
- CA surplus means that households, businesses and government are buying less goods and services than they are producing.
- CA deficit means that these economic units are buying more goods and services than they are producing.

Summarizing the three major macro meanings of the CA Balance

1. Financing and international financial flows: Net foreign investment (I_f).
 $CA = I_f$
2. National saving (S) versus domestic investment (I_d).
 $S = I_d + I_f$ so that
 $CA = S - I_d$
3. Domestic production (Y) versus national expenditure (E). $Y = C + I_d + G + (X - M)$, $E = C + I_d + G$, and $CA = (X - M)$ approximately, so that
 $CA = Y - E$

Current Account Balance	CA
= Net foreign investment	= I_f
= The difference between national saving and domestic investment	= $S - I_d$
= The difference between domestic product and national expenditure	= $Y - E$

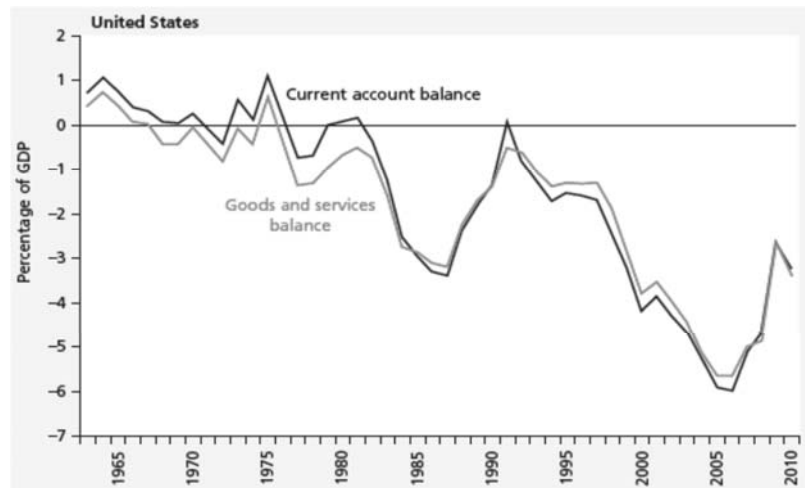
Application on Thailand's Current Account in 2012

- In 2012, CA surplus in Thailand has the following macroeconomic implications:
 1. Thailand has positive net foreign investment
 2. Thailand has higher saving growth rate compared to domestic real investment growth rate.
 3. Thailand can produce (and, hence, generate revenue) higher than the total expenditure on goods and services.

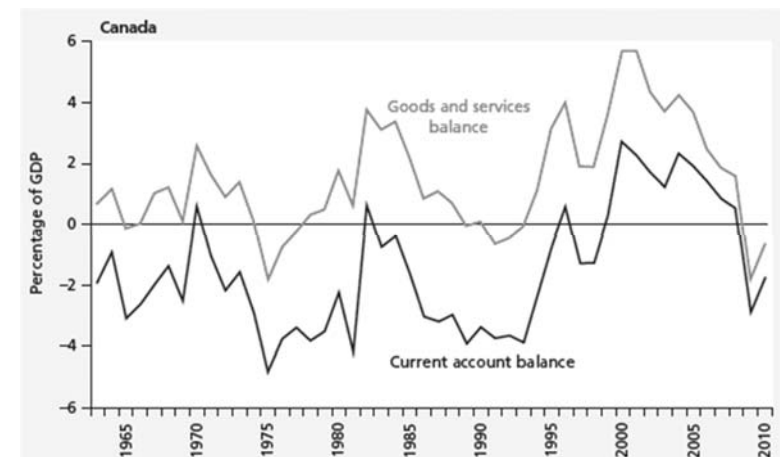
Policy Implications on US CA Deficit

- Increase domestic production (Y)
- Reduce national expenditure (E) to decrease import (M) and increase exports domestic production (X)

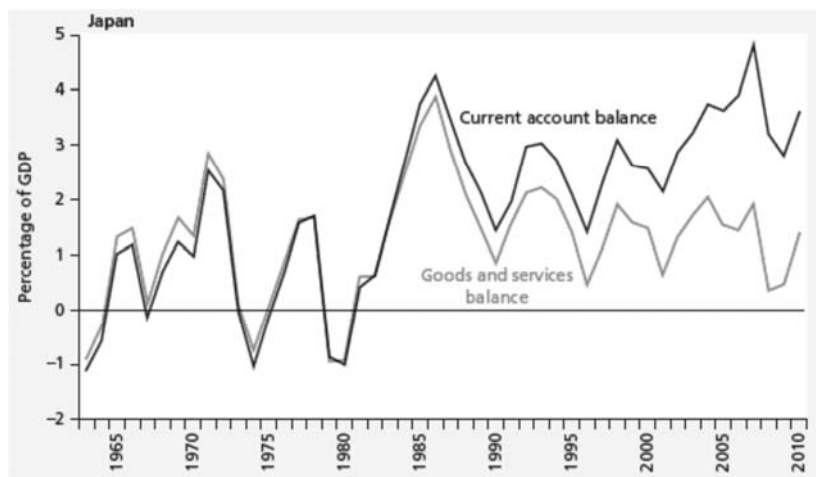
Current Account Balances for the U.S., 1963-2010



Current Account Balances for Canada, 1963-2010

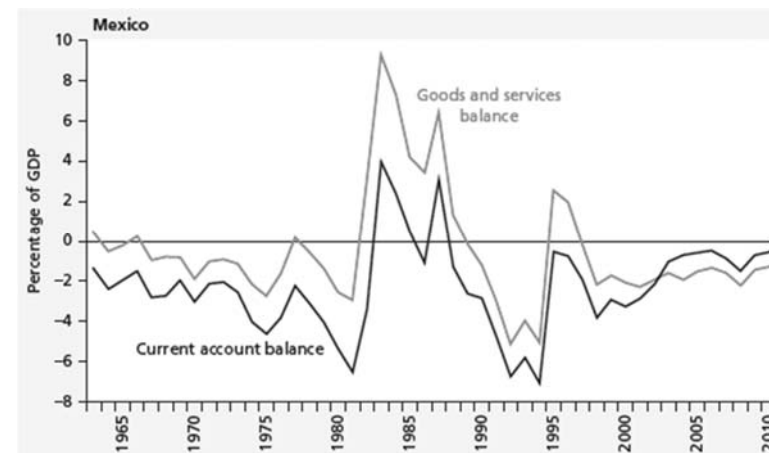


Current Account Balances for Japan, 1963-2010



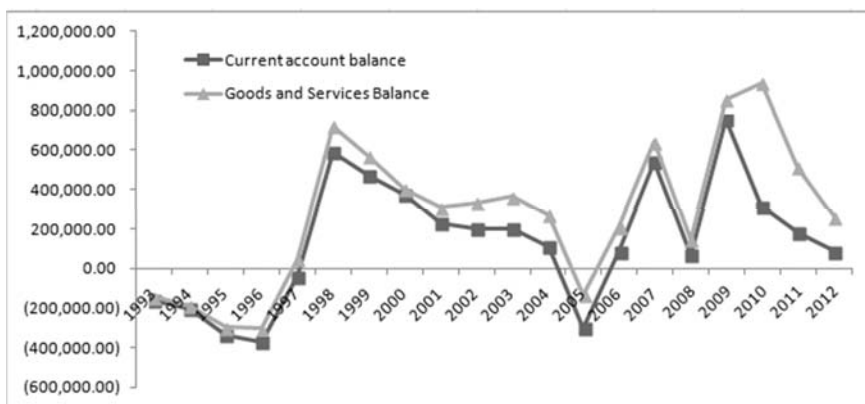
Source: Pugel (2012), p. 390

Current Account Balances for Mexico, 1963-2010



Source: Pugel (2012), p. 390

Current Account Balances for Thailand, 1963-2010 (in million Baht)



Source: Bank of Thailand www.bot.or.th

MACRO MEANING OF OVERALL BALANCE

The Macro Meaning of Overall Balance

- It can be divided to two components: (1) the private FA and the net flows of official reserve assets (OR).
- The overall balance (official settlements balance), B, measures the sum of the current account (CA) plus the (nonofficial) financial account (FA) balance: $B = CA + FA$.
- Because of double entry book-keeping:
- $\rightarrow B + OR = 0$.

The Macro Meaning of Overall Balance

- If B is in surplus, it equals an accumulation of official reserve assets by the country or a decrease in foreign official reserve holdings of the country's assets (debit in official reserves account).
- If B is in deficit, it equals a decrease in the country's holdings of official reserve assets or an accumulation of foreign official reserve holdings of the country's assets (credit in official reserves account)

The Macro Meaning of Overall Balance

- The official settlements balance (B) measures the net flows of all private transactions in goods, services, income, transfers, and (nonofficial) financial assets.
- It is the counterbalancing items – the changes in OR that show the macroeconomic meaning of B.

INTERNATIONAL INVESTMENT POSITION (IIP)

International Investment Position

- Shows the nation's stocks of international assets and liabilities at a moment in time.
- These stocks are changed each year by the flows of private and official assets measured in the balance of payments.

International Investment Position

Unit: Million US Dollar

	2005	2006	2007	2008	2009	2010	2011 p
Net International Investment Position 1/	-53,834.87	-56,117.04	-55,068.93	-13,417.18	-4,678.48	-41,868.64	-31,959.73
General government	-4,467.88	-3,860.92	-1,747.65	-1,884.36	-2,435.62	-6,250.36	-9,653.70
Central Bank	51,538.57	65,941.37	87,224.05	110,518.94	136,421.16	167,299.79	170,588.32
Other depository corporations 2/	-8,525.27	-1,077.67	-3,831.90	-7,334.78	-23,052.89	-41,153.02	-35,657.08
Other sectors 3/	-92,380.29	-117,119.82	-136,713.43	-114,716.98	-115,611.13	-161,765.05	-157,237.27
Foreign Assets	93,658.69	123,165.71	163,361.01	178,500.47	217,922.21	263,128.94	283,814.01
General government	50.77	279.34	522.99	987.79	1,447.38	1,532.55	1,354.67
Central Bank	52,112.66	67,034.09	87,752.41	111,061.64	138,468.96	172,179.37	175,766.63
Other depository corporations 2/	16,546.91	26,299.95	29,365.51	21,574.02	17,067.60	19,028.84	30,155.16
Other sectors 3/	24,948.35	29,552.33	45,720.10	44,877.02	60,938.27	70,388.18	76,537.55
Foreign Liabilities	147,493.56	179,282.75	218,429.94	191,917.65	222,600.69	304,997.58	315,773.74
General government	4,518.65	4,140.26	2,270.64	2,872.15	3,883.00	7,782.91	11,008.37
Central Bank	574.09	1,092.72	528.36	542.70	2,047.80	4,879.58	5,178.31
Other depository corporations 2/	25,072.18	27,377.62	33,197.41	28,908.80	40,120.49	60,181.86	65,812.24
Other sectors 3/	117,328.64	146,672.15	182,433.53	159,594.00	176,549.40	232,153.23	233,774.82

Source: Bank of Thailand www.bot.or.th

HOMEWORK

Homework

- Go to www.bot.or.th, search the data and information, and briefly describe Thailand's Balance of Payments during 2000-2016.
- (Not longer than 2-A4 pages.)
- Please write your full name and ID number on the top of your paper.
- Due Friday, 18 August 2017.