

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.

“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.

COURSE OUTLINE EXPLANATION

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 & Applications

Evaluation

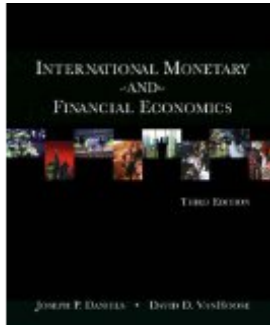
- Midterm Exam 30%
- Final Exam 50%
- Group Report/Presentation 20%

Texts

- *Pugel, T. A. (2012, 2016) *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](#) .

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Description: xlv, 980, 21 p. : ill. (some col.).

ISBN: 0716792834; 9780716792833.

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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.

Primary Income, Secondary Income, Unilateral Transfers

- Primary Income
 - earnings arising from the provision of a factor of production: labor, financial assets, land, and natural resources
- Secondary Income
 - redistribution of income through current transfers (e.g., by governments or charitable organizations)
- Unilateral Transfers
 - Items in the current account of the balance of payments of a country's accounting books that correspond to gifts from foreigners or pension payments to foreign residents who once worked in the particular country.

BOT Definition

- Primary Income comprises compensation of employees (wages, salary, and benefit both in cash and in kind) and investment income (direct investment income, income on portfolio investment, and other investment earnings).
- Secondary Income refers to donation or grant paid to or received from nonresidents, which results in transfers of ownership over real or financial resources.

BOT Definition

- Capital Account encompasses receipts and payments pertaining to: (1) transfers in cash or in kind (for instance, investment grant, transfer of ownership of fixed asset, and debt forgiveness), and (2) acquisition and disposal of non-produced, non-financial assets (tangible assets such as land, and intangibles such as patents, trademarks, etc.).
 - Exception applies to the case of land purchase/sale by the embassy. This results in increase/decrease of economic territory, hence recorded in the capital account. On the contrary, purchase/sale of land by nonresidents other than embassies merely provides them with a financial claim over land purchased, thus recorded as direct investment as described in Financial Account.

BOT Definition

- Financial Account refers to net flows of financial transactions between residents and nonresidents, reflecting changes of ownership over financial assets and liabilities, which may be categorized as direct investment, portfolio investment, financial derivatives, and other investment.

IMF

- In recent years, many countries have adopted the narrower meaning of capital account used by the International Monetary Fund (IMF). It splits the capital account into two top-level divisions: the *financial account* and *capital account*. The capital and financial accounts measure net flows of financial claims, i.e., changes in asset position.

Financial Account (Textbook)

- 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.

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.

Balance of Payments 2010-2017p

Bank of Thailand EC_XT_047 : Balance of Payments (Summary) (US\$) (Unit : Millions of US Dollars)								
	2010	2011	2012	2013	2014	2015	2016	2017 p
1 Exports (f.o.b.)	192,902.97	221,399.03	227,655.21	227,455.34	226,623.63	214,045.84	214,250.83	235,267.44
2 Imports (f.o.b.)	166,225.24	209,213.42	227,625.14	227,415.75	209,422.25	187,247.53	177,711.42	201,106.81
3 Trade balance	26,677.73	12,185.61	30.07	39.59	17,201.38	26,798.31	36,539.42	34,160.64
4 Net services, primary income and secondary income	-15,191.65	-2,758.76	-1,728.44	-4,900.72	-1,977.43	5,313.05	11,668.43	16,050.57
5 Current account balance	11,486.08	9,426.85	-1,698.37	-4,861.13	15,223.96	32,111.36	48,207.85	50,211.20
6 Capital account	244.59	-40.87	234.43	281.23	100.33	0.08	12.72	-140.94
7 Financial account	23,572.85	-8,269.15	12,789.99	-2,487.99	-15,954.70	-16,799.24	-20,839.74	-12,429.49
8 Central Bank	2,718.52	-89.58	1,038.54	-4,562.79	-2,956.03	-1,405.09	1,061.91	3,151.49
9 General government	3,615.75	3,438.01	6,513.43	4,579.07	1,426.90	-1,720.77	950.49	3,161.75
10 Other depository corporations	8,249.34	-8,244.03	16,350.78	3,187.35	-5,472.08	-12,819.43	-691.03	4,219.59
11 Other sectors	8,989.23	-3,373.54	-11,112.77	-5,691.62	-8,953.50	-853.95	-22,161.11	-22,962.31
12 Other financial corporations	-967.70	-937.82	-10,942.29	-12.85	-9,575.35	-281.16	-11,919.53	-11,034.41
13 Nonfinancial corporations, households, and NPISHs	9,956.92	-2,435.72	-170.48	-5,678.77	621.86	-572.79	-10,241.58	-11,927.91
14 Net errors & omissions	-3,979.12	96.77	-6,061.35	2,018.79	-579.78	-9,453.29	-14,536.33	-11,684.07
15 Overall balance	31,324.40	1,213.60	5,264.70	-5,049.10	-1,210.20	5,858.90	12,844.50	25,956.70

Source: www.bot.or.th as of 15 January 2018

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>-61</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 (official and private) 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).

$$S = I_d + I_f, \text{ so that}$$

$$CA = S - I_d$$

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

= Net foreign investment

= The difference between national saving and domestic investment

= The difference between domestic product and national expenditure

CA

$$= I_f$$

$$= S - I_d$$

$$= Y - E$$

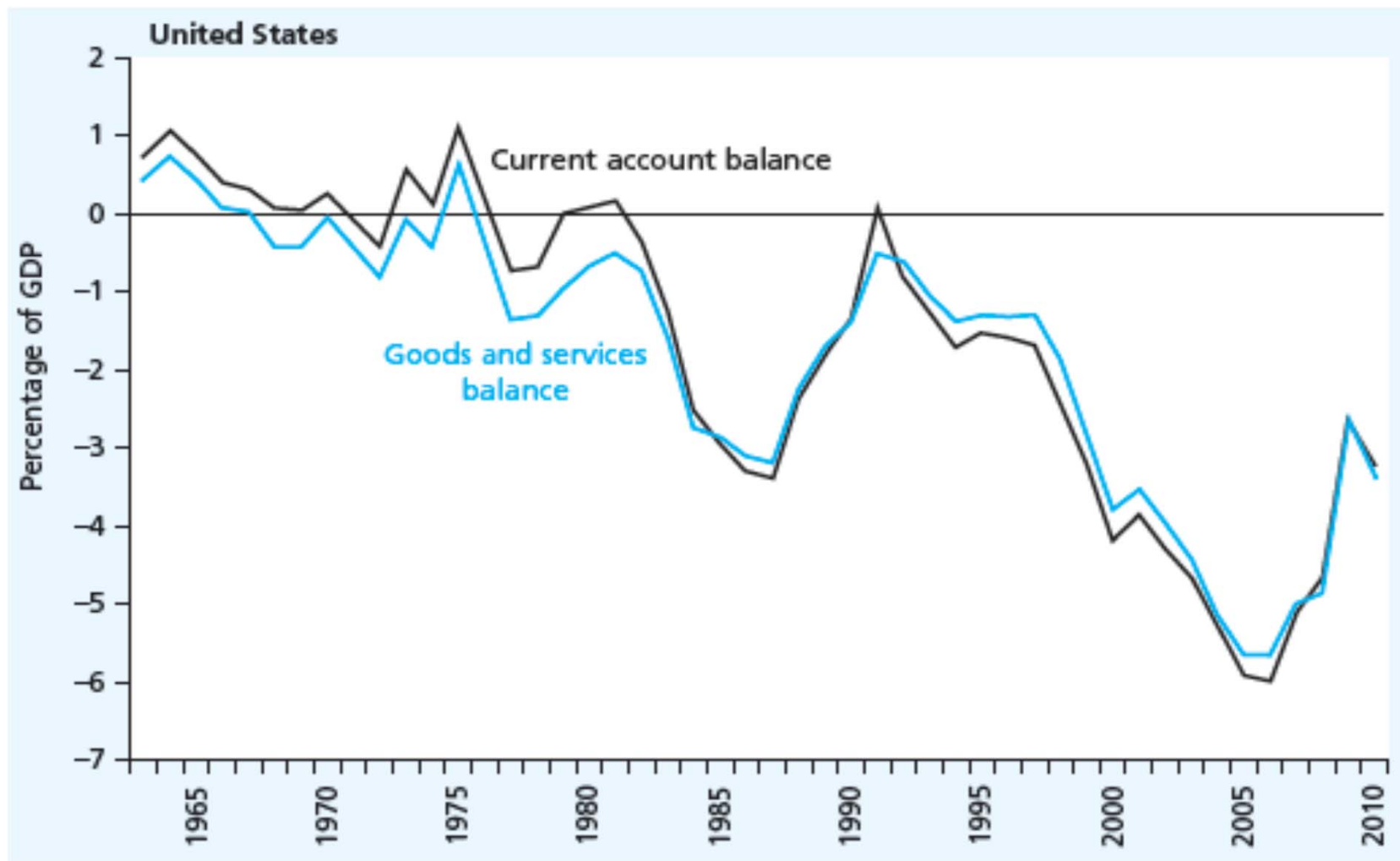
Application on Thailand's Current Account

- Suppose in 20XX, 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.

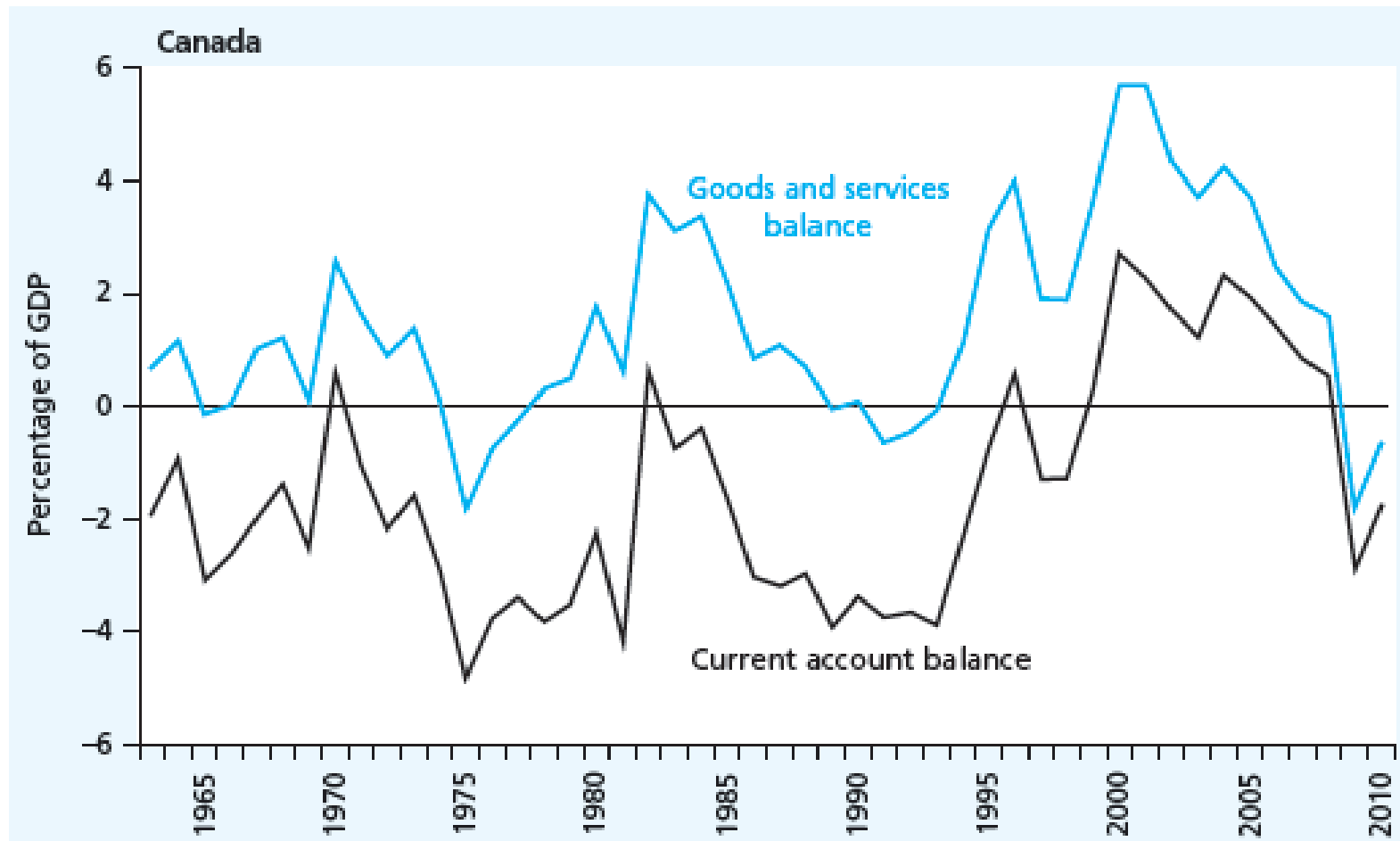
Policy Implications on US CA Deficit

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

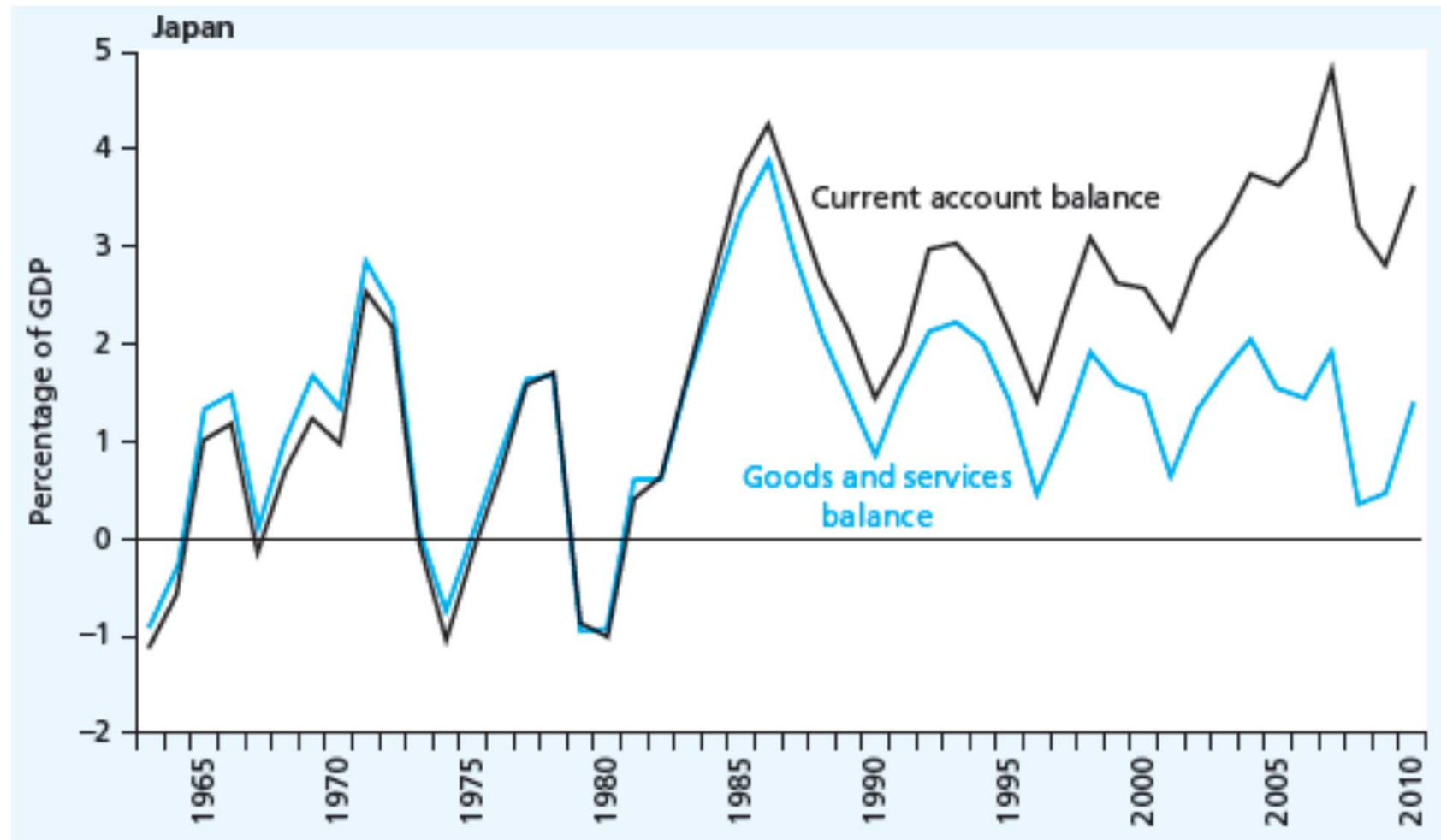
Current Account Balances for the U.S., 1963-2010



Current Account Balances for Canada, 1963-2010

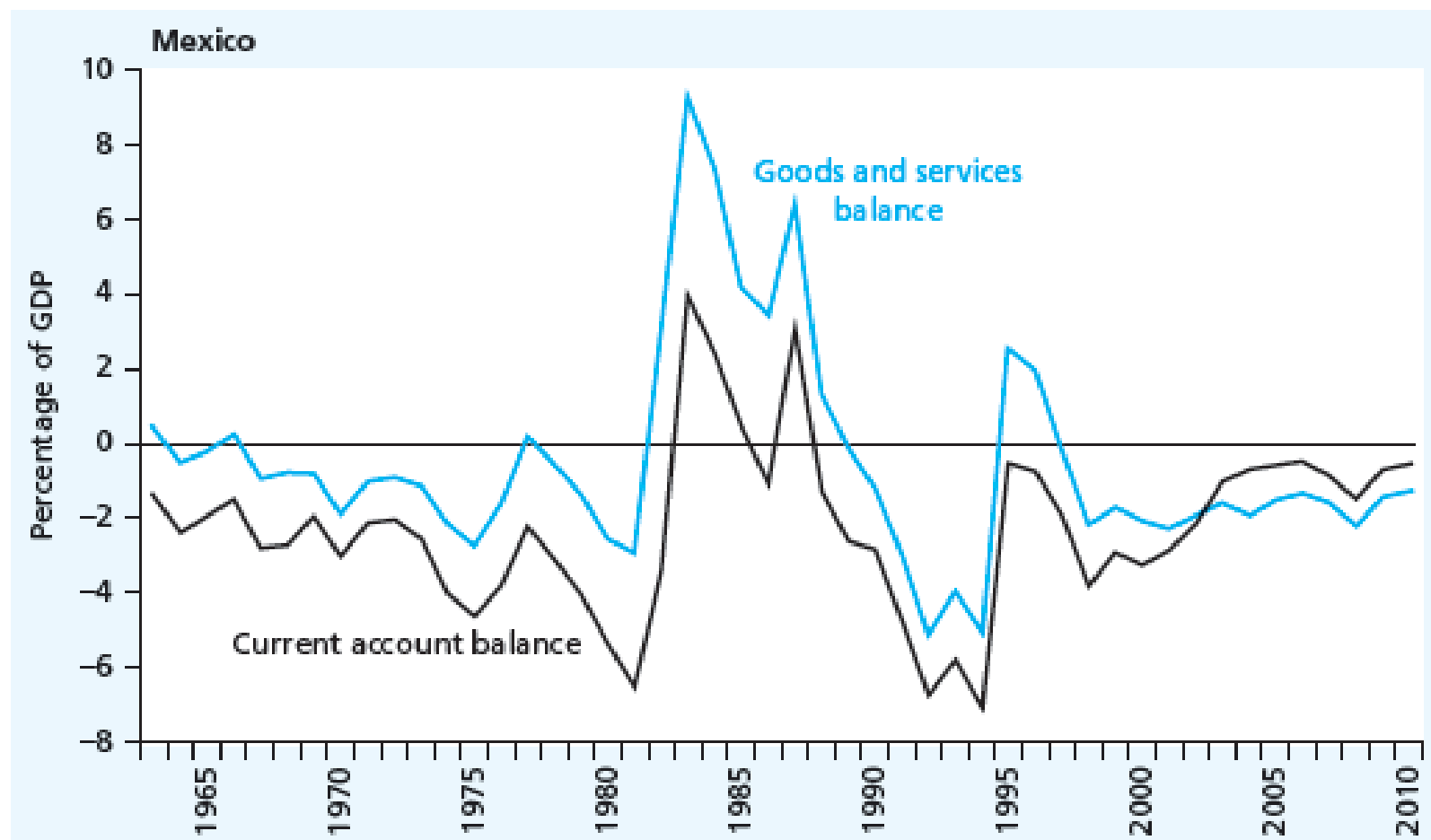


Current Account Balances for Japan, 1963-2010



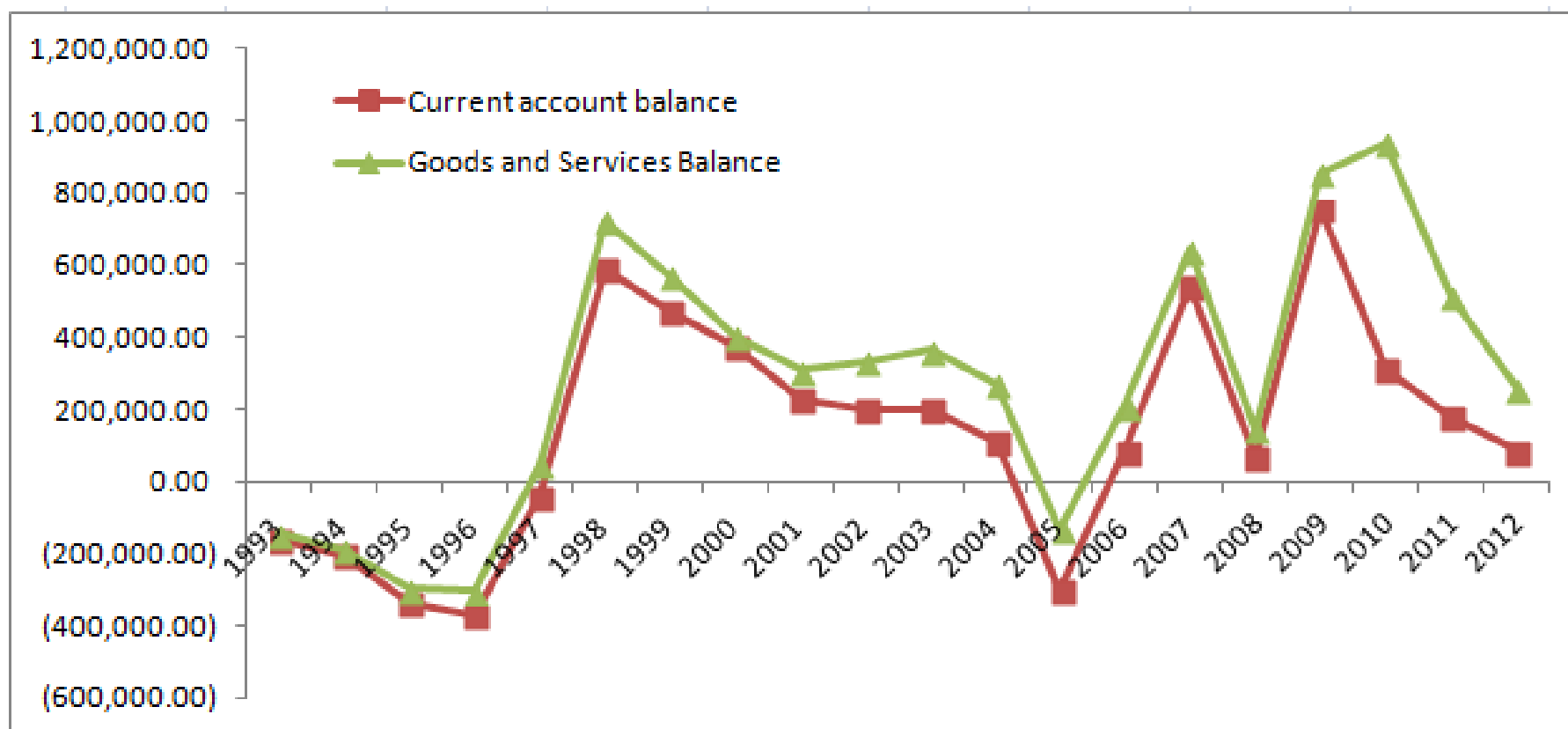
Source: Pugel (2012), p. 390

Current Account Balances for Mexico, 1963-2010



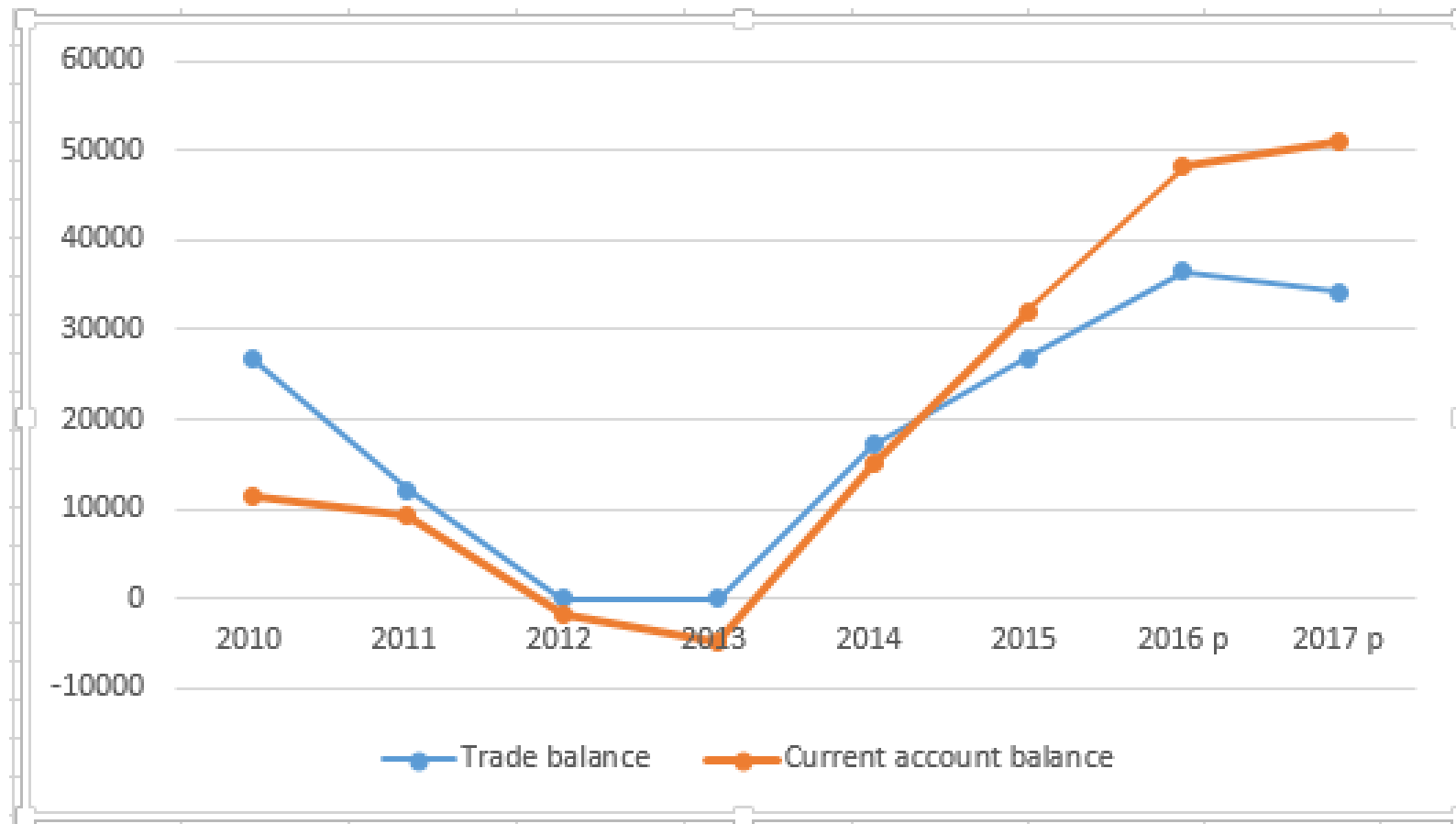
Source: Pugel (2012), p. 390

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



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

Current Account Balances for Thailand, 2010-2017p (in million US\$)



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

Bank of Thailand EC_XT_033_S2 : Thailand's International Investment P (Unit : Millions of US Dollars)									
Last Updated :									
Retrieved date :									
		2010	2011	2012	2013	2014	2015	2016	2017 p
1	Assets	263,128.94	283,897.51	316,956.90	320,607.66	329,441.03	338,958.65	382,435.67	458,390.84
42	Liabilities	304,997.58	325,009.71	398,030.39	390,252.84	426,719.84	381,775.05	414,791.86	499,987.05
75	Net International Investment Position	-41,868.64	-41,112.20	-81,073.49	-69,645.18	-97,278.81	-42,816.40	-32,356.18	-41,596.21
Source:									
Bank of Thailand									
Remark:									
1/ Composing of Commercial Banks including International Banking Institutions and Other Depository Special Financial Institutions.									
2/ Composing of Other financial corporations and Nonfinancial corpls.									
3/ Since 2008, price valuation method has been changed from "chdard.									
4/ Includes SDR allocations									

Source: Bank of Thailand www.bot.or.th as of 15 Jan 2019

HOMEWORK

Homework

- Go to www.bot.or.th, search the data and information, and briefly describe Thailand's Balance of Payments during 2000-2017.
- (Not longer than 2-A4 pages.)
- Please write your full name and ID number on the top of your paper.
- Due Friday, 18 January 2019.