

Recap 19/1

1/

- Discuss how to analyze current and capital accounts.

- Current Account:

1. Deficit means "bad" ?

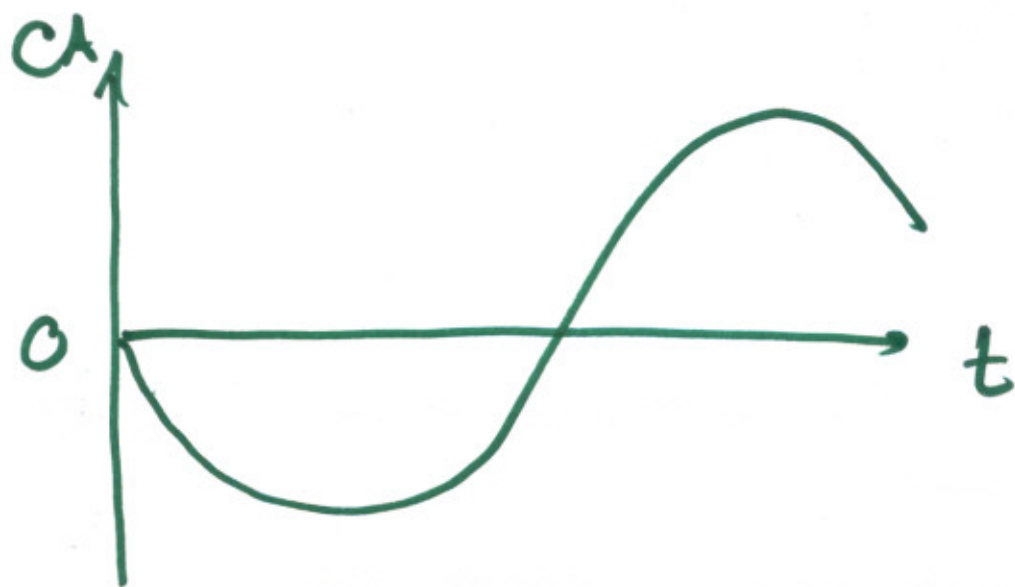
$$2. CA = S - I$$

$$[CA + ve \Rightarrow S > I]$$

Answer: Not necessarily

2. Firms might see market potential so they invest more than their own saving [Basic principle of resource allocation] etc.

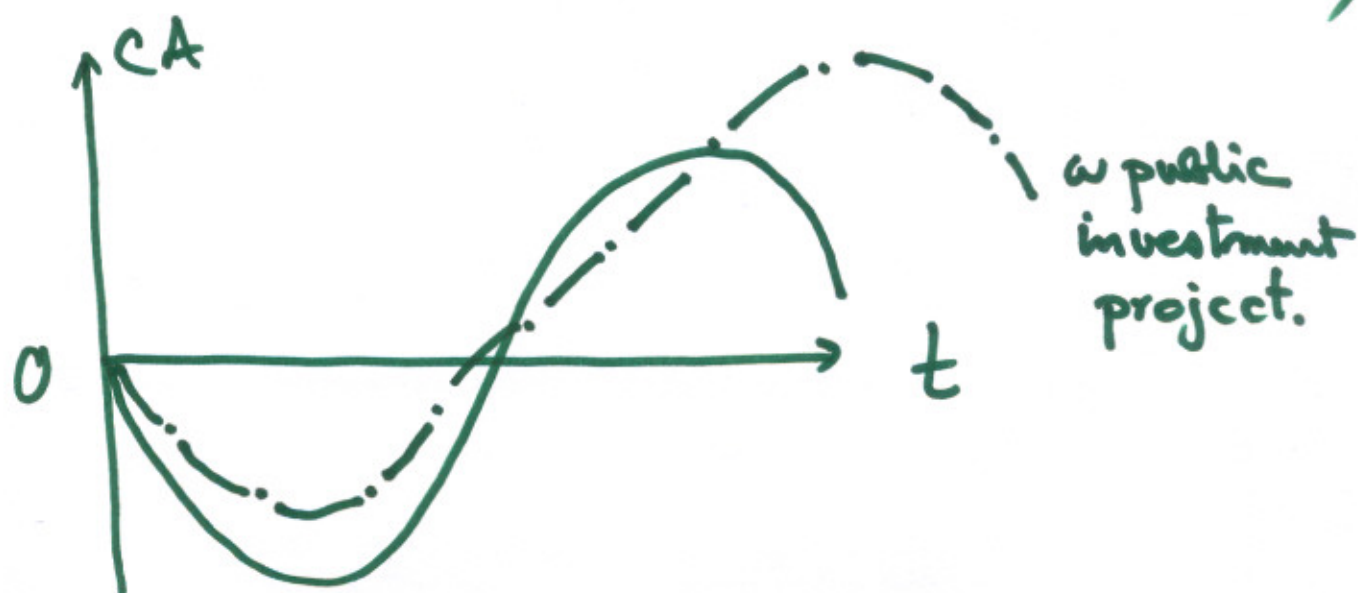
3. If their investment project is wise, we would expect temporary current account deficit



Punchline: Looking current account in any single period would be cautious.

4. ? Difference ? current account from private and public sectors.

- Not always economically feasible for public investment project in ~~private terms~~.
- It might generate positive externality



5. How to finance CA deficit?

1. Capital Flows (Borrow from abroad)

~~2. No Finance $\rightarrow$ BOP deficit~~

2. Δ Foreign exchange reserve.

3. Δ Exchange Rate

— Capital Account

1. What is the "hot" money?

$$CAP = FDI + Portfolio + F.Dem.$$

2. FDI → Setting up factories

→ Less volatile ~~Fast~~

OFCF → Banks lending, Stock Mkt Investⁿ

→ Short and Long Maturities.

→ Given their nature, they can enter a given country quickly and exit easily

→ Many countries impose control measures on OFCF

Dec 2006 :

All foreign transactions, except those related to trade in goods and services, repatriation of investment abroad by residents and FDI, are required to deposit 30% of foreign exchange with BCT..