Balance of Payments
the Current Account

The current account summarizes a country's trade in currently produced goods and services.

- "Balance of trade". It measures that is the difference between a country's expenditures on imports and its income from exports of goods and services.
  - -The balance of trade in goods is known as "the visible balance"
  - -The balance of trade in services is known as "the invisible balance"

- Balance on the current account is found by adding all transactions (expenditures on imports plus income from exports) in the current account.

- If a country spends more on imports than it earns from exports, it is said to have a "current account deficit" or a "trade deficit".

- If a country earns more from its exports than it spends on imports, it is said to have a "current account surplus" or a "trade surplus".

For example: US expenditures on laptop computers made in Taiwan count towards a deficit in the US current account. The export revenue for Taiwan moves its current account towards surplus.

Taiwan's expenditures on airplanes made in the US count towards a deficit in Taiwan's current account. The export revenue earned by the US moves its current account towards surplus

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Balance of Payments

Balance of Trade

BoP Case Study: *Examine the table below. Calculate US's balance of trade with each of its top 15 trading partners.*

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Source: http://www.censusbureau.biz/foreign-trade/balance/c5700.html

Total Trade (Goods)

Rank	Country	Exports (Year-to-Date)	Imports (Year-to-Date)	Total Trade (Year-to-Date)	Percent of Total Trade
---	**Total, All Countries**	**1,163.3**	**1,953.6**	**3,117.0**	**100.0%**
---	**Total, Top 15 Countries**	**820.4**	**1,442.6**	**2,263.0**	**72.6%**
1	Canada	248.9	313.1	562.0	18.0%
2	China	65.2	321.5	386.7	12.4%
3	Mexico	136.5	210.8	347.3	11.1%
4	Japan	62.7	145.5	208.1	6.7%
5	Federal Republic of Germany	49.7	94.4	144.0	4.6%
6	United Kingdom	50.3	56.9	107.2	3.4%
7	Korea, South	34.7	47.6	82.3	2.6%
8	France	27.4	41.6	69.0	2.2%
9	Taiwan	26.4	38.3	64.7	2.1%
10	Netherlands	33.0	18.4	51.4	1.6%
11	Brazil	24.6	25.6	50.3	1.6%
12	Venezuela	10.2	39.9	50.1	1.6%
13	Italy	14.1	35.0	49.2	1.6%
14	Saudi Arabia	10.4	35.6	46.0	1.5%
15	Singapore	26.3	18.4	44.7	1.4%

Balance of Payments

Consequences of current and capital account imbalances

Consequences of a current account deficit:

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- Foreign ownership of domestic assets: such as property, businesses, stocks and bonds. Threatens economic sovereignty, national security. If foreigners lose faith in economy and sell off assets, will lead to massive depreciation of country's currency, destabilizing economy further.

- Foreign indebtedness: Current account deficits must be offset by capital account surpluses. To attract financial investment in the economy central banks must keep interest rates high, discouraging domestic investment, which threatens to further increase current account deficits in the future.

Example: *China uses some of its US$ reserves to buy US gov't bonds, financing US budget deficits. Since it can borrow from China, the US gov't can keep taxes low, meaning higher levels of disposable income and consumption for Americans. Since much of US consumption is made up of imports from China, low taxes mean strong demand for Chinese output.* Indirectly, China's purchase of US gov't bonds is financing America's trade deficit with China.

Balance of Payments

Consequences of current and capital account imbalances

In 2007 the US current account deficit was about $800 billion.

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Causes of the trade deficit

- From 1992 till 2007 the U.S. economy grew more rapidly than the economies of several major trading nations.
- This growth of income has boosted U.S. purchases of foreign goods.
- In contrast, Japan, some European nations, and Canada suffered recessions or slow income growth during this period.
- Also, a declining savings rate in the U.S. has contributed to U.S. trade deficits and an increase in foreign investment in U.S.

Implications of U.S. trade deficits

- A trade deficit means that the U.S. is receiving more goods and services as imports from abroad than it is sending out as exports. This gain in present consumption may come at the expense of reduced future consumption.
- A trade deficit is considered "unfavorable" because it must be financed by borrowing from the rest of the world, selling off assets or dipping into foreign currency reserves.
- *In 2004, foreigners owned $2.5 billion more assets in U.S. than Americans owned in foreign assets*. Therefore, the current consumption gains delivered by U.S. trade deficits mean permanent debt, permanent foreign ownership, or large sacrifices of future consumption.
- But it could also mean higher economic growth as foreign investment expands our capital base