

Econ 233 - Problem Set 5 - Answers
Balance of Payments Accounting

This problem set has two parts. In the first part you will practice recording international transactions into the balance of payments. In the second part you will analyze the external balance of “your” country.

Part I:

1. Record the following transactions in the Polish balance of payments.
 - a) Poland buys \$200 worth of computers from the U.S.
 - b) American tourists spend \$5 on restaurant meals in Warsaw.
 - c) A U.S. investor buys a Polish chemical factory for \$100.
 - d) The Polish central bank pays \$20 in interest on its debt to a U.S. investor.
 - e) The Polish central bank repays a \$10 loan from the IMF.
 - f) The Polish central bank intervenes in the foreign exchange market by buying \$70 worth of zloty and selling its dollar reserves.

Polish Balance of Payments:

	Credit	Debit
1. Current account		
A. Goods and services		
Goods		200a
Services	5b	
B. Income		
Investment income		20d
2. Capital and financial account		
A. Capital account		
B. Financial account		
Direct investment	100c	
Portfolio investment		
Other investment		
Deposits	200a	5b+100c+70f
Use of IMF credit		10e
Reserve assets		
Foreign exchange	20d+10e+70f	

2. Calculate the following memorandum items:

Trade balance	-200
Current account(CA)	-215
Nonreserve capital account (KA)	125
Overall balance	-90
Reserves and related items ($-\Delta R$)	90

3. Did Poland run a current account deficit or surplus? *Yes, Poland ran current account deficit of -215.*
4. Did the Polish central bank gain or lose reserves? *The Polish central bank lost \$100 worth of reserves, \$90 to finance the overall balance and \$10 to repay IMF loan.*
5. Did Poland increase or decrease its foreign debt? *Poland increased its foreign debt by \$215 - its current account deficit. Recall that $CA = \Delta NFI$.*

Part II:

Using the data in the IFS, describe your country's external position in the most recent year. Answer the following questions:

1. Did your country run a current account deficit or surplus? How large was the surplus/deficit in terms of percent of GDP? How much of it was due to the trade balance and how much due to the trade in services? *Negative number on the current account indicates deficit.*
2. Was your country losing or gaining official reserves? *Since increases in assets are recorded as debits, a negative number in "Reserves and related items" indicates an increase in reserves.*
3. Did your country experience capital inflows or capital outflows? *If a country runs current account deficit, it increases its indebtedness with the rest of the world and experiences capital inflows.*
4. If the development in your country persists for a several years, what types of risks do you see in maintaining an external balance? Would this trend be sustainable? *This question gives you a chance to think about the data you just collected. A country can not increase its indebtedness as a share of GDP indefinitely. Sooner or late capital inflows will stop or a country will run out of reserves. This will require an adjustment in the current account.*