

## Double Entry Accounting of the Balance of Payments

- Transactions resulting in payment to foreigners are entered as debits.
- Transactions resulting in receipt from foreigners are entered as credits

### Examples:

- Russia's Gazprom sells oil to the U.S. The U.S. importer pays by check written on a Citibank account.

Russia's Accounts		U.S. Accounts	
Oil sale	Credit	Oil purchase	Debit
Increase in financial assets	Debit	Increase in financial liabilities	Credit

- A U.S. investor buys shares in VAZ, a Russian auto-maker, from a Russian bank in Moscow. The U.S. investor pays by a check written on a Citibank account.

Russia's Accounts		U.S Accounts	
Sale of shares	Credit	Purchase of shares	Debit
Increase in financial assets	Debit	Increase in financial liabilities	Credit

- Russian central bank sells Russian government bonds to a U.S. investor. Once again the U.S. investor pays by a check on a Citibank account.

Russia's Accounts		U.S Accounts	
Sale of bonds	Credit	Purchase of bonds	Debit
Increase in financial assets	Debit	Increase in financial liabilities	Credit

- Russian central bank obtains a loan from the IMF.

Russia's Accounts	
Use of IMF credit	Credit
Increase in reserve assets	Debit

### Balance of Payments Example:

- a) Russia's Gazprom sells \$100 worth of oil to the U.S.
- b) A U.S. investor buys \$50 worth of shares in VAZ, a Russian auto-maker.
- c) Russian central bank sells \$20 worth of Russian government bonds to a U.S. investor.
- d) Russian central bank obtains a \$10 loan from the IMF.
- e) Russian government pays \$5 interest to a U.S. investor on its debt.

Russian Balance of Payments:

	Credit	Debit
<b>1. Current account</b>		
<b>A. Goods and services</b>		
Goods	100a	
Services		
<b>B. Income</b>		5e
Investment income		
<b>2. Capital and financial account</b>		
<b>A. Capital account</b>		
<b>B. Financial account</b>		
Direct investment		
Portfolio investment	50b+20c	
Other investment		
Deposits		100a+50b
Use of IMF credit	10d	
Reserve assets		
Foreign exchange	5e	20c+10d

Memorandum items:

Trade balance	100
Current account(CA)	95
Nonreserve capital account (KA)	-80
Overall balance	15
Reserves and related items ( $-\Delta R$ )	-15

### Balance of Payments Example:

- a) Russia's Gazprom sells \$100 worth of oil to the U.S.
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Goods		
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Direct investment		
Portfolio investment		
Other investment		
Deposits		
Use of IMF credit		
Reserve assets		
Foreign exchange		

#### Memorandum items:

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

## **Points to remember:**

### **About double entry accounting:**

- Every transaction is recorded with two entries of equal values and opposite signs.
- Transactions resulting in payment to foreigners are entered as debits.
- Transactions resulting in receipt from foreigners are entered as credits
- Exports of goods and services are entered as credits.
- Increases in financial liabilities are entered as credits.
- Increases in financial assets are entered as debits.
- An increase in official reserves is recorded as debit.

### **About BoP components:**

- The current account records “real” transactions - goods, services and income.
- Capital and financial accounts record financial transactions.
- Transactions involving a central bank’s reserves are recorded as transactions in reserve assets.

### **About the concept of BoP balance:**

- The overall balance is the sum of current and capital accounts excluding transactions in reserve assets:

$$\text{overall balance} = CA + KA$$

### **About BoP analysis:**

- Credit items in the capital account are purchases of domestic assets by foreigners, while debit items are purchases of foreign assets by domestic residents.
- Net foreign investment(NFI) is equal to purchases of foreign assets by domestic residents minus purchases of domestic assets by foreigners.

- Current account is equal to net foreign investment:

$$CA = NFI$$

- A capital account deficit means that a country received less foreign capital than it invested abroad. It is indicated by a negative balance.
- Overall balance is equal to the change in the stock of reserves:

$$CA + KA = \Delta R$$

- Current account deficits must be financed by either nonreserve capital account surpluses or official reserve losses.