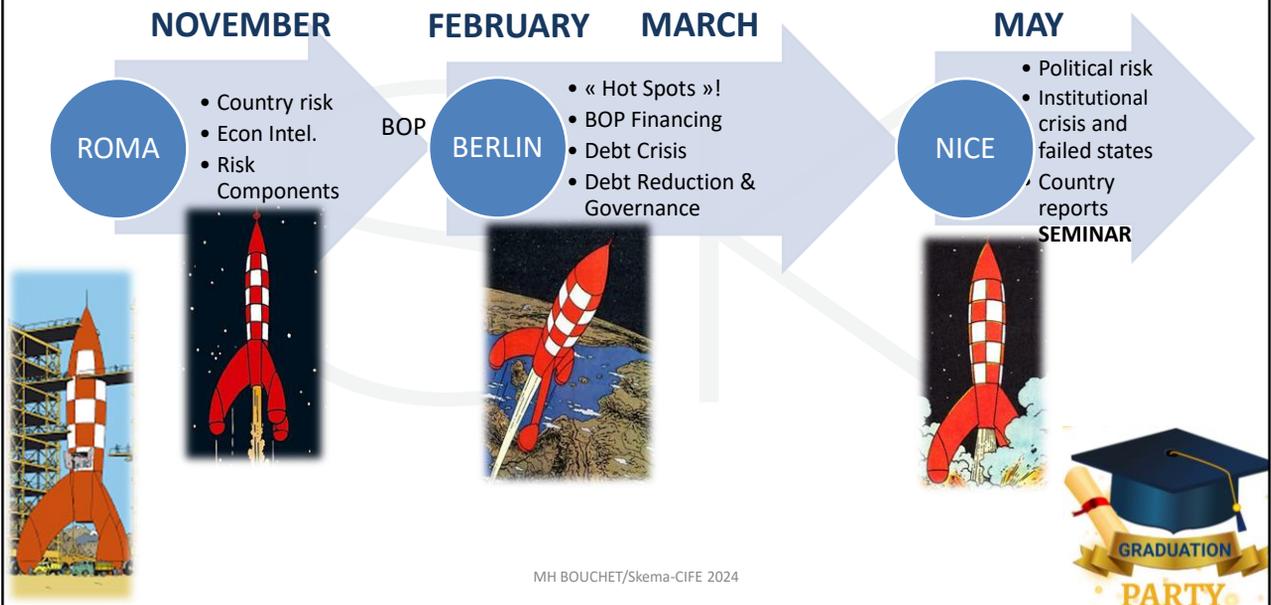


THE BALANCE OF PAYMENTS III FINANCIAL ACCOUNT AND EXTERNAL FINANCING

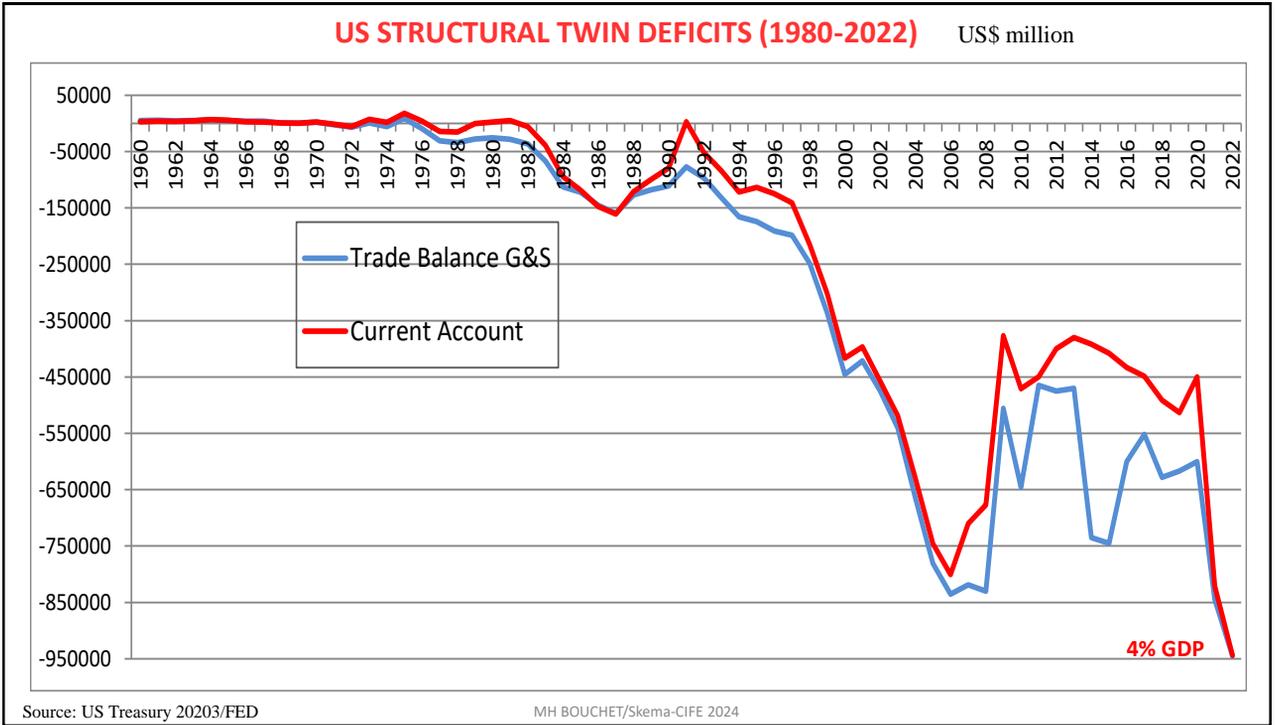


CIFE SEMINAR ROMA-BERLIN-NICE 2024
MICHEL-HENRY BOUCHET

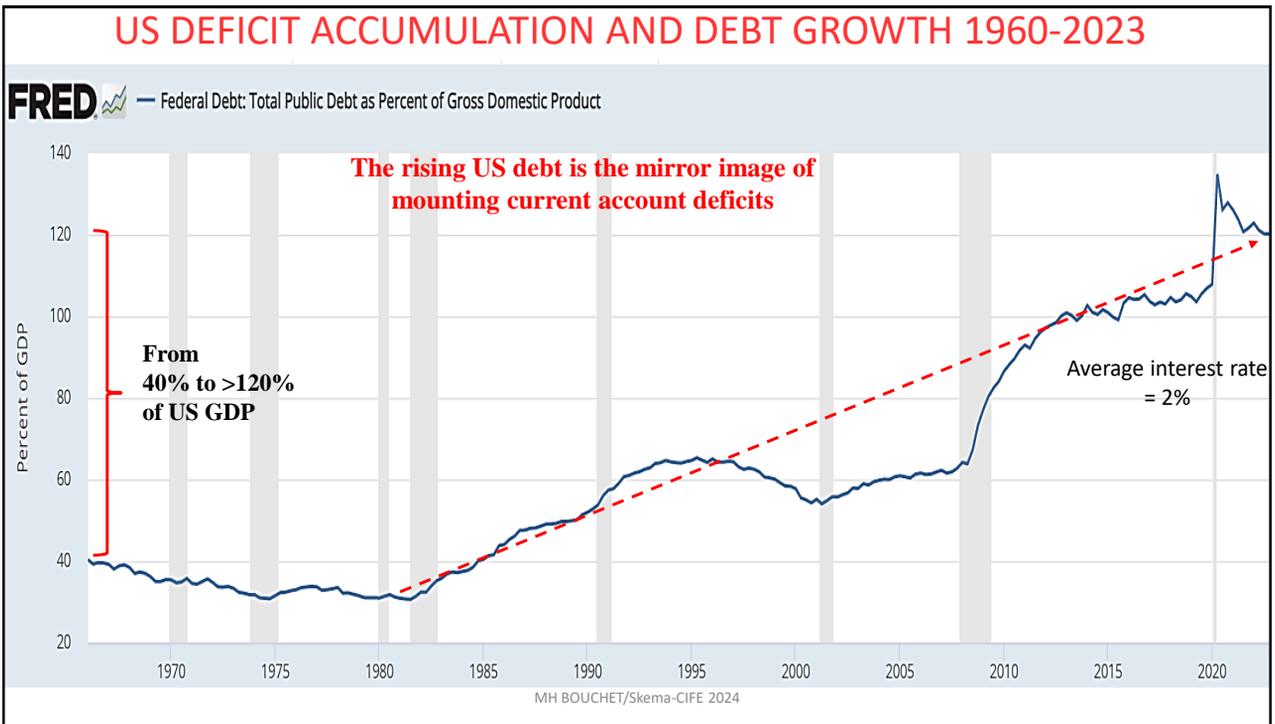
1



2

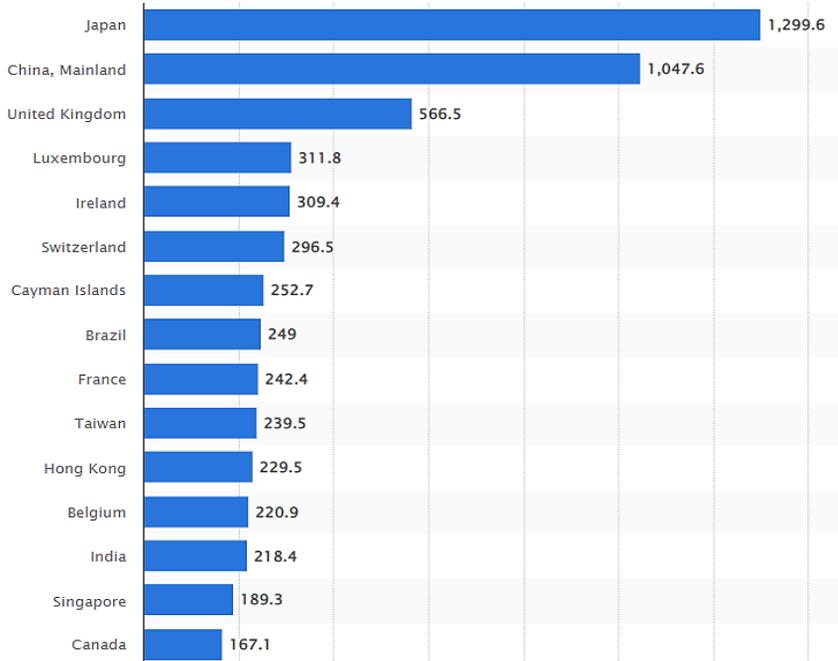


3



4

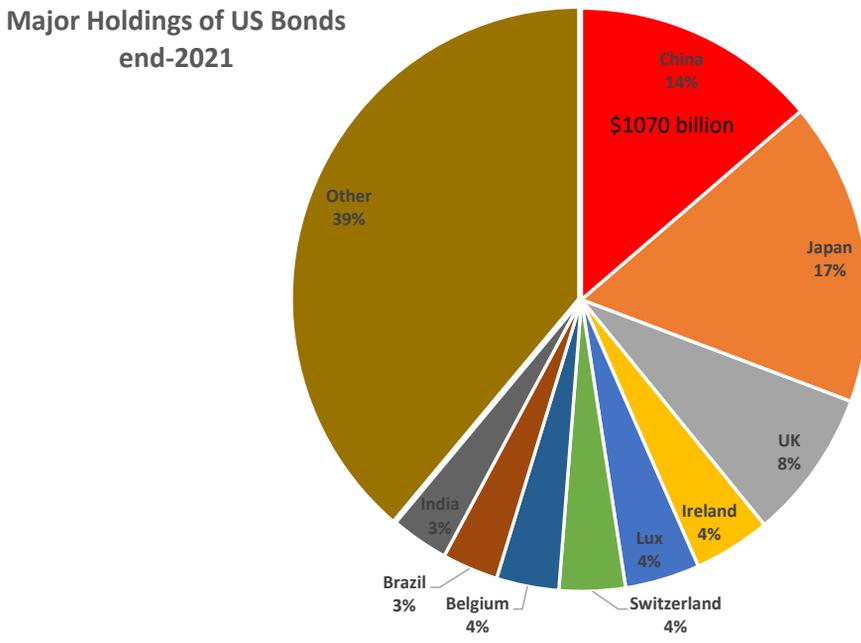
MAJOR HOLDERS OF US BONDS AS OF END-2023



MH BOUCHET/Skema-CIFE 2024

5

CHINA => 14% OF FOREIGN HOLDING OF US DEBT



US Treasury 2022

MH BOUCHET/Skema-CIFE 2024

6

CAPITAL AND FINANCIAL ACCOUNTS?

The **capital account (minor account!)** measures **financial transactions that don't affect income, production, or savings** (debt forgiveness, patents, trademarks, and copyrights).

The **financial account measures increases or decreases in international ownership of assets** (individuals, businesses, government, or central bank). The assets include direct investments, securities like stocks and bonds, and commodities such as gold and hard currency.

MH BOUCHET/Skema-CIFE 2024

7

► Financial account

- Reflects changes in country's ownership of assets
- Leads to increase/decrease in official reserve assets
- Reflects international market access
- Financing **flows** lead to changes in external **debt stock**, and to future debt servicing payment outflows
- Financing sources: LT debt, equity/FDI, international borrowing in capital markets (Eurobonds, Eurocredits), official financing, ODA, trade credits, short-term flows... arrears

MH BOUCHET/Skema-CIFE 2024

8

FINANCIAL ACCOUNT

The risk analyst must focus on :

- ▶ the **volume** of financing to match the financing requirements of the current account deficit
- ▶ the **nature** of financing sources (private/public) and
- ▶ the **sustainability** of the financing (short term/long term, volatility, currency mismatch, floating/fixed rates, repayment conditions, pledges, legal clauses...)

MH BOUCHET/Skema-CIFE 2024

9

THE FINANCIAL ACCOUNT



Capital account

- + (-) Direct investment (non debt creating flows)
- + (-) Portfolio investment (NDCF if equity)
- + (-) Other long-term capital (private + official)
- + (-) Other short-term capital (private + official)
- + (-) Net errors and omissions
- + (-) Counterpart items
- + (-) **Change in reserves**
- = Capital account balance
- + Exceptional Financing (or arrears)



**From less liquid items
to more liquid items!**

MH BOUCHET/Skema-CIFE 2024

10

TABLE OF USES AND SOURCES

USES (outflows)

1. Imports of goods
2. Imports of services
3. Interest payments
4. Principal debt repayments
5. ST capital outflows
6. E&Os
7. Capital flight

SOURCES (inflows)

1. Exports of goods
2. Exports of services
3. Transfers & Remittances
4. Dividends
5. FDI
6. Portfolio K inflows
7. ST K inflows
8. LT K inflows
9. Debt cancellation
10. Arrears
11. Reserve decrease

MH BOUCHET/Skema-CIFE 2024

11



MH BOUCHET/Skema-CIFE 2024

12



13

Exports	5000
Portfolio	150
LT K	1200
Transfers	285
Debt repayments	-1650
ST K	350
Current account	
FDI	325
Imports	-6500
Trade	
Services revenues	1200
Interest payments	-750
E&Os	-455
Counterpart items	100
Change in reserves	
CA/GDP%	
GDP	12500
R/M ratio (months)	
Reserve level 12/2017	4500



14

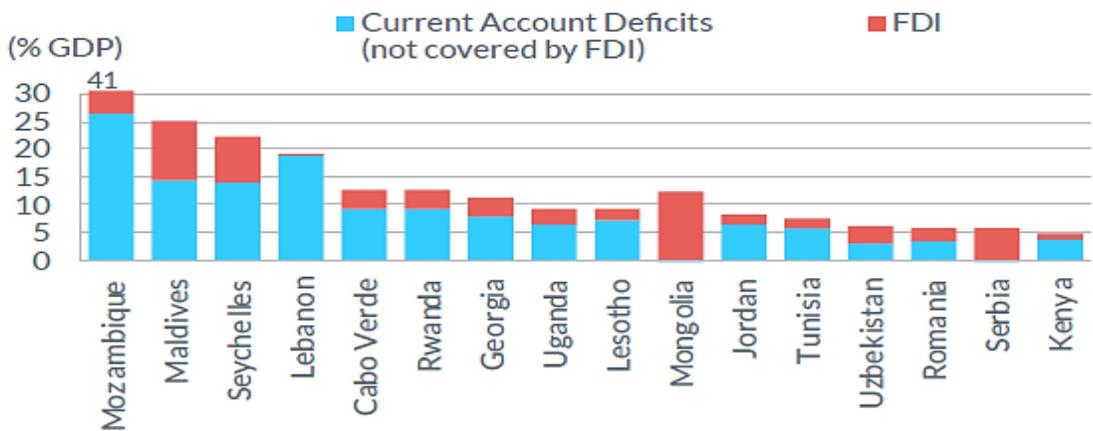
Exports	5000
Imports	-6500
Trade	-1500
Services revenues	1200
Interest payments	-750
Transfers	285
Current account	-765
FDI	325
Portfolio	150
LT K	1200
Debt repayments	-1650
ST K	350
E&Os	-455
Counterpart items	100
Change in reserves	745
CA/GDP%	-6,12%
GDP	12500
R/M ratio (months)	6,9
Reserve level 12/2017	4500



15

BEHIND CURRENT ACCOUNT DEFICITS, THERE RISING FOREIGN INDEBTEDNESS!

Largest Current Account Deficits, 2021



Source: Fitch Ratings

MH BOUCHET/Skema-CIFE 2024

16

UNCTAD: A KEY SOURCE OF FDI DATA!

[HTTPS://UNCTAD.ORG/SYSTEM/FILES/OFFICIAL-DOCUMENT/WIR2022_EN.PDF](https://unctad.org/system/files/official-document/wir2022_en.pdf)

Annex table 1. FDI flows, by region and economy, 2016–2021 (Millions of dollars)

Region/economy	FDI inflows						FDI outflows					
	2016	2017	2018	2019	2020	2021	2016	2017	2018	2019	2020	2021
World*	2 045 424	1 632 639	1 448 276	1 480 626	963 139	1 582 310	1 596 716	1 610 113	941 293	1 123 894	780 480	1 707 594
Developed economies	1 384 814	937 683	753 320	764 456	319 190	745 739	1 210 679	1 162 247	565 200	736 840	408 195	1 269 212
Europe	794 426	513 250	398 049	404 756	80 786	219 033	653 726	544 012	467 785	342 648	-20 572	551 598
European Union	342 615	274 904	366 347	401 677	209 509	137 541	495 406	347 293	293 339	368 335	66 412	397 637

Annex table 2. FDI stock, by region and economy, 2000, 2010 and 2021 (Millions of dollars)

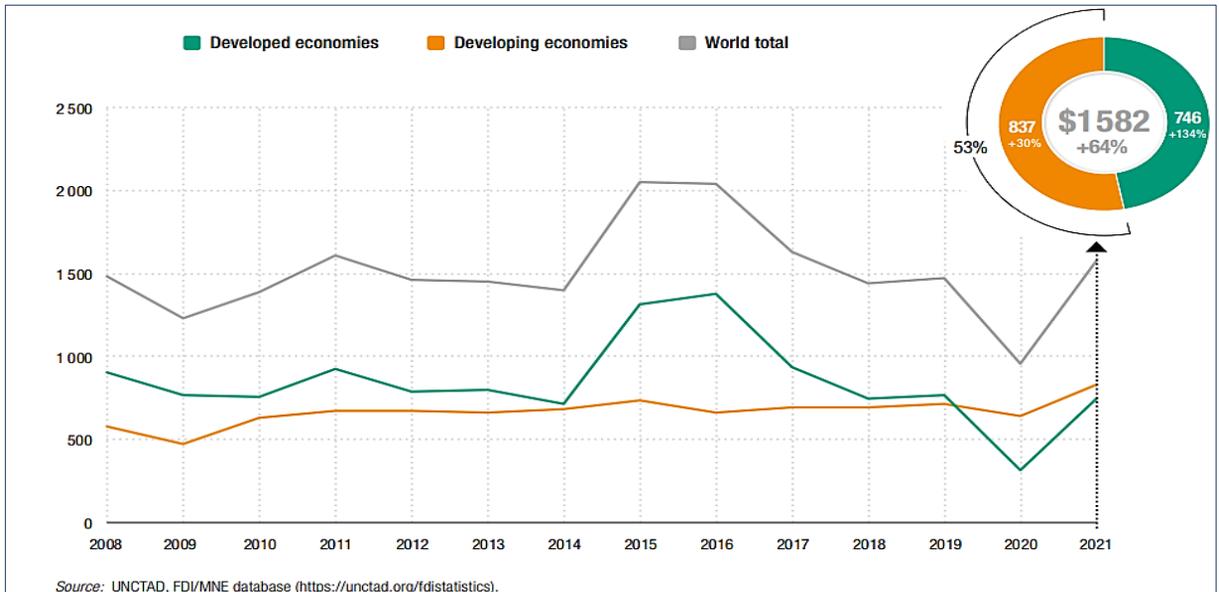
Region/economy	FDI inward stock			FDI outward stock		
	2000	2010	2021	2000	2010	2021
World*	7 377 201	19 907 143	45 448 812	7 408 902	20 471 257	41 798 485
Developed economies	5 860 038	13 846 108	33 119 269	6 740 421	17 568 316	33 008 670
Europe	2 491 244	8 439 157	16 441 775	3 193 644	10 264 456	17 619 059
European Union	1 882 785	5 960 396	11 590 104	1 967 112	6 988 784	13 263 759

MH BOUCHET/Skema-CIFE 2024

17

THE GLOBAL DECLINE IN FDI FLOWS (in \$ billions)

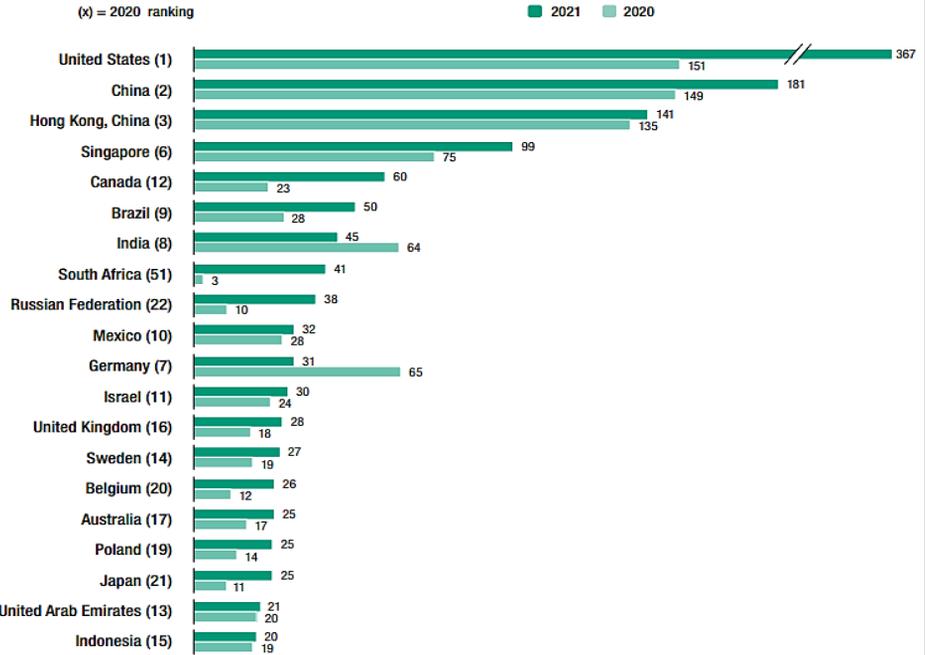
[HTTPS://UNCTAD.ORG/SYSTEM/FILES/OFFICIAL-DOCUMENT/WIR2022_EN.PDF](https://unctad.org/system/files/official-document/wir2022_en.pdf)



MH BOUCHET/Skema-CIFE 2024

18

FDI INFLOWS TOP 20 HOST ECONOMIES IN US\$ BILLIONS

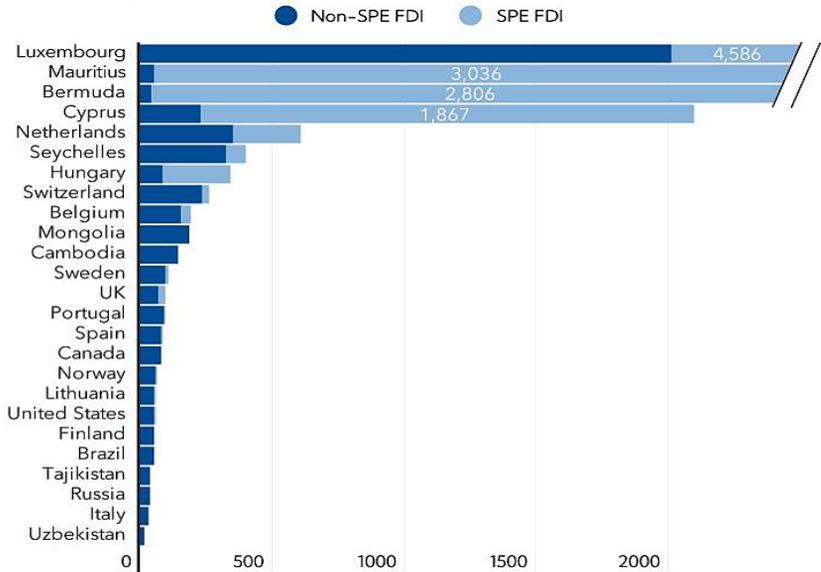


MH BOUCHET/Skema-CIFE 2024

Source: UNCTAD, FDI/MNE database (<https://unctad.org/fdistatistics>).

FDI FLOWS = SUPPOSEDLY LONG-TERM AND JOB-CREATING?

Special purpose entities are legal entities set up to obtain specific advantages from a host economy, in which they have little to no employment, physical presence, or production. Usually set up to benefit from low taxes or established for easier access to capital markets, financial services, and skilled workforces. Because they have little to no impact on the economy, these financial flows can **distort the true picture of economic activity provided by foreign direct investment numbers.**



Source: IMF staff calculations. Note: The figures for the UK do not include the Isle of Man, Channel Islands, or overseas territories.



SOURCES OF EXTERNAL FINANCING

Official (bilateral + multilateral)

- Paris Club (government to government credits)
- Export credit guarantees
 - IFIs (WB + IMF)
- Regional development banks
 - Debt rescheduling
 - Debt cancellation

Private

- FDI
- Portfolio Investment
- London Club (International bank loans)
 - Working capital lines
 - ST Trade credits
- Bonds & International debt securities
- Arrears and rescheduling

MH BOUCHET/Skema-CIFE 2024

21

Capital Flows is a BOP category that groups all the capital transactions that have not been included in direct investment and portfolio investment:

Two categories of capital inflows:

- ▶ **Long-term private & public capital**
- ▶ **Short-term capital ***

Non-negotiable instruments > 1 year or more such as London Club bank loans and mortgages, syndicated credits, euroloans...

* Financial assets < 1 year, such as currency, deposits and bills, interbank credit lines, trade credits... (Source: BIS)

MH BOUCHET/Skema-CIFE 2024

22

Change in reserves

Reserves include:

- ▶ Hard currency assets + Monetary gold (gold held by the authorities as a financial asset)
- ▶ Special drawing rights (SDRs): reserves created by the IMF and credited to the accounts of IMF member countries according to national quotas
<https://www.imf.org/external/np/sec/memdir/members.aspx>
- ▶ Reserve position in the Fund: (member's quota + other claims on the Fund)

MH BOUCHET/Skema-CIFE 2024

23

THE IMF QUOTAS



When a country joins the IMF, it is assigned an **initial quota** based on macroeconomic variables = weighted average of GDP (weight of 50 percent), trade openness (30 %), economic variability (15 %), and international reserves (5 %).

GDP is measured through a blend of GDP—based on market exchange rates (weight of 60 %) and on PPP exchange rates (40 %).

Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account
 March 2023: 1 SDR= \$1,35

Largest member = United States, with a quota of SDR83 billion (about US\$118 billion= 17,5%), and the smallest member is Tuvalu, with SDR2.5 million = US\$3.5 million)

Source: IMF quotas 2023

MH BOUCHET/Skema-CIFE 2024

24

Foreign Exchange Reserves

The largest component of total international liquidity.

It includes monetary authorities' claims on non-residents in the form of bank deposits, treasury bills, short-term and long-term government securities, and other claims usable in the event of balance of payments need, including non-marketable claims from inter-central bank and intergovernmental arrangements

A **+ sign** in the BOP means a financing flow in the capital account, i.e., a decrease in the stock of reserves!

MH BOUCHET/Skema-CIFE 2024

25

**FX RESERVES AS
BUFFER OF
LIQUIDITY CRISIS**

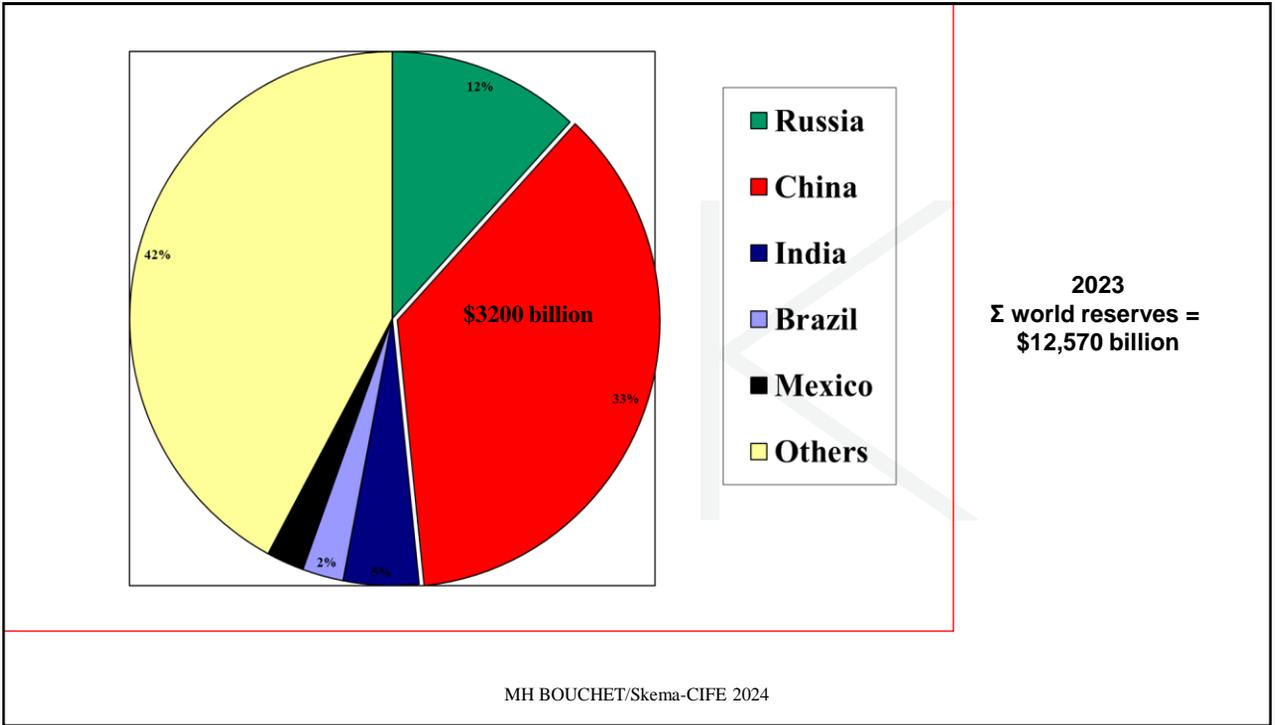
	FX Reserves as % of short term debt	FX reserves as % of GDP
India	427%	15%
China	399%	27%
Mexico	334%	16%
Korea	330%	26%
Taiwan	277%	82%
Switzerland	63%	96%
Japan	45%	23%
Canada	13%	5%
Italy	5%	2%
UK	2%	4%
Germany	2%	1%
France	2%	2%

Reserves and GDP for 2016, short-term debt as of 2016Q3

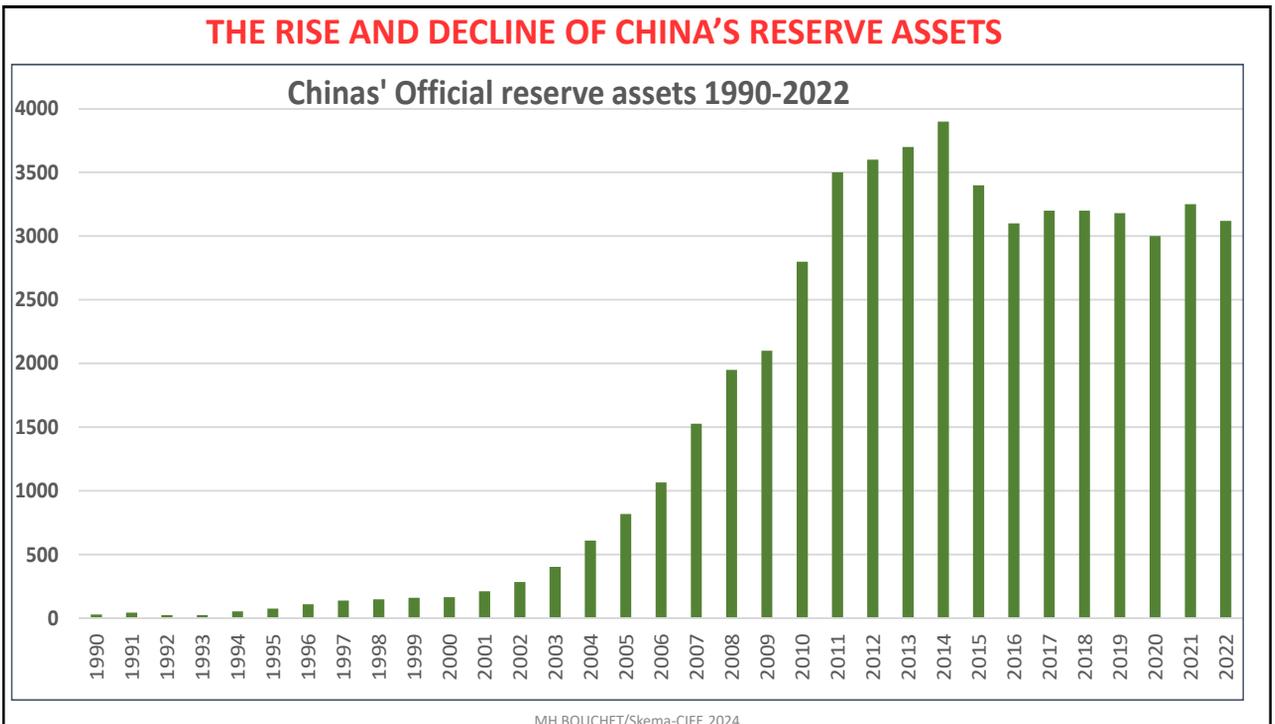
Sources: National Authorities; World Bank; International Monetary Fund; Haver Analytics

MH BOUCHET/Skema-CIFE 2024

26



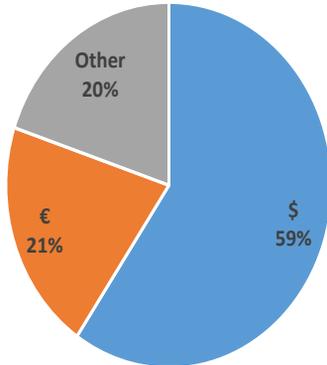
27



28

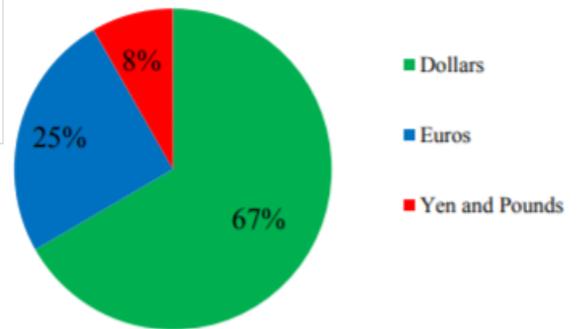
THE SHRINKING SHARE OF DOLLAR HOLDINGS ?

Currency composition of global official assets in 2021



Source: IMF Sept. 2021

Currency Composition of Chinese FX reserves



MH BOUCHET/Skema-CIFE 2024

29

4. Net errors and omissions

Statistical gaps involved in gathering balance of payments data (and capital flight!)

Other sources of E&Os:

1. leads and lags in trade flows
2. underinvoicing of exports
3. overinvoicing of imports
4. undeclared short-term capital movements...

MH BOUCHET/Skema-CIFE 2024

30

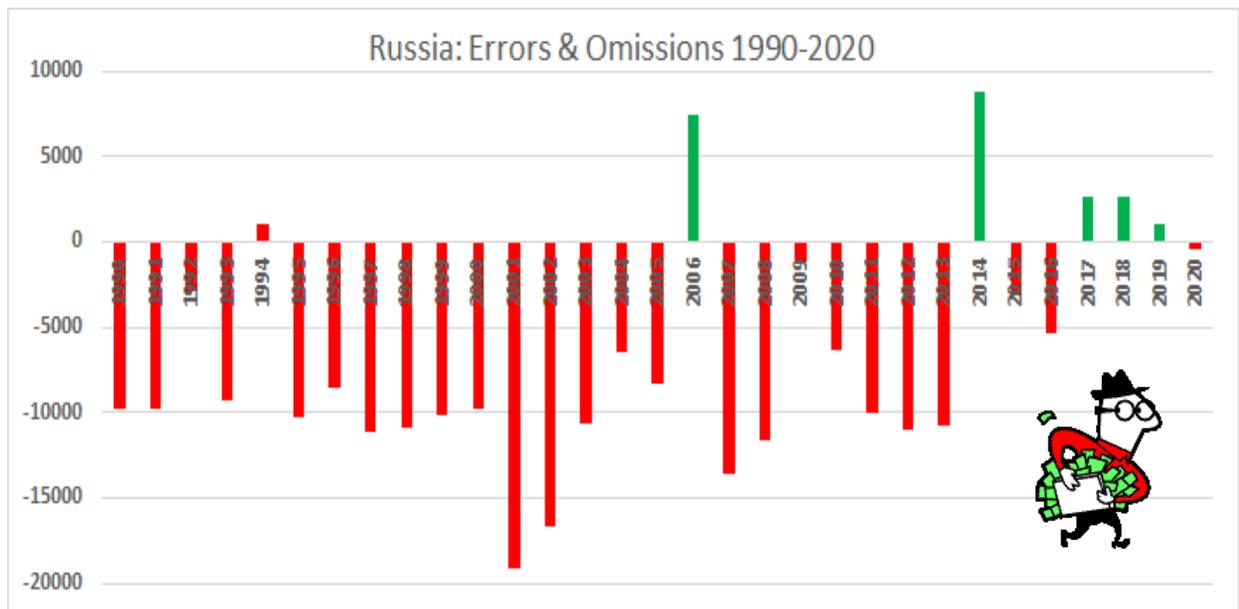
NET ERRORS AND OMISSIONS ?

- ▶ An examination of the size and direction of NE&Os may shed light on the accuracy of BoP estimates. The adoption of the double entry accounting system means that the net sum of all credit and debit entries should equal zero.
- ▶ In practice, any discrepancies are recorded in NE&Os, reflecting the net effect of differences in coverage, timing and valuation.
- ▶ An amount $> 5\%$ of the gross sum of merchandise exports and imports is a source of concern!

MH BOUCHET/Skema-CIFE 2024

31

RUSSIA: NET ERRORS & OMISSIONS US\$ BILLION

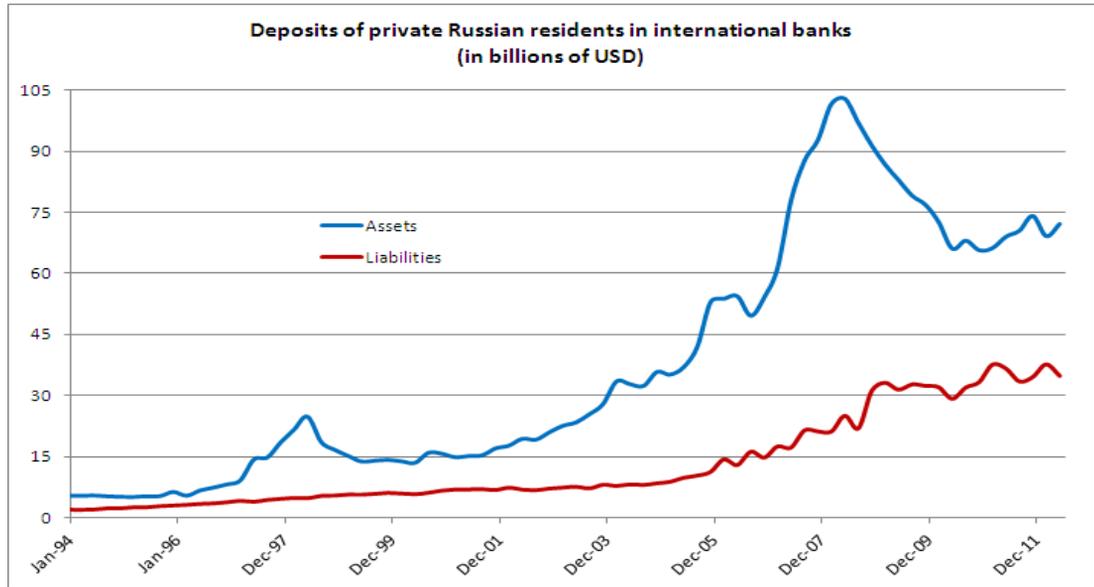


Source: IMF-IFS/IIF

MH BOUCHET/Skema-CIFE 2024

32

CAPITAL FLIGHT IN RUSSIA (1994-2012)

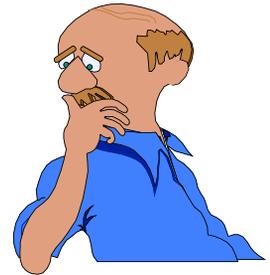


Source: BIS

MH BOUCHET/Skema-CIFE 2024

33

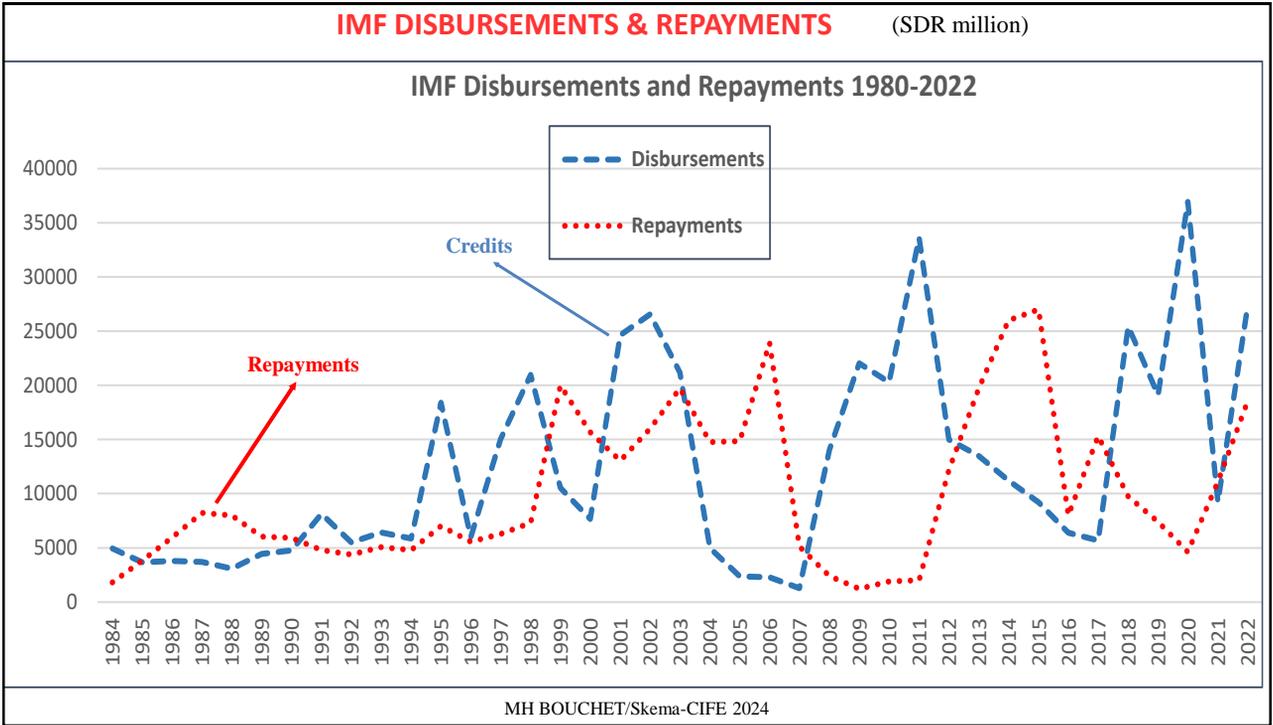
6. EXCEPTIONAL FINANCING



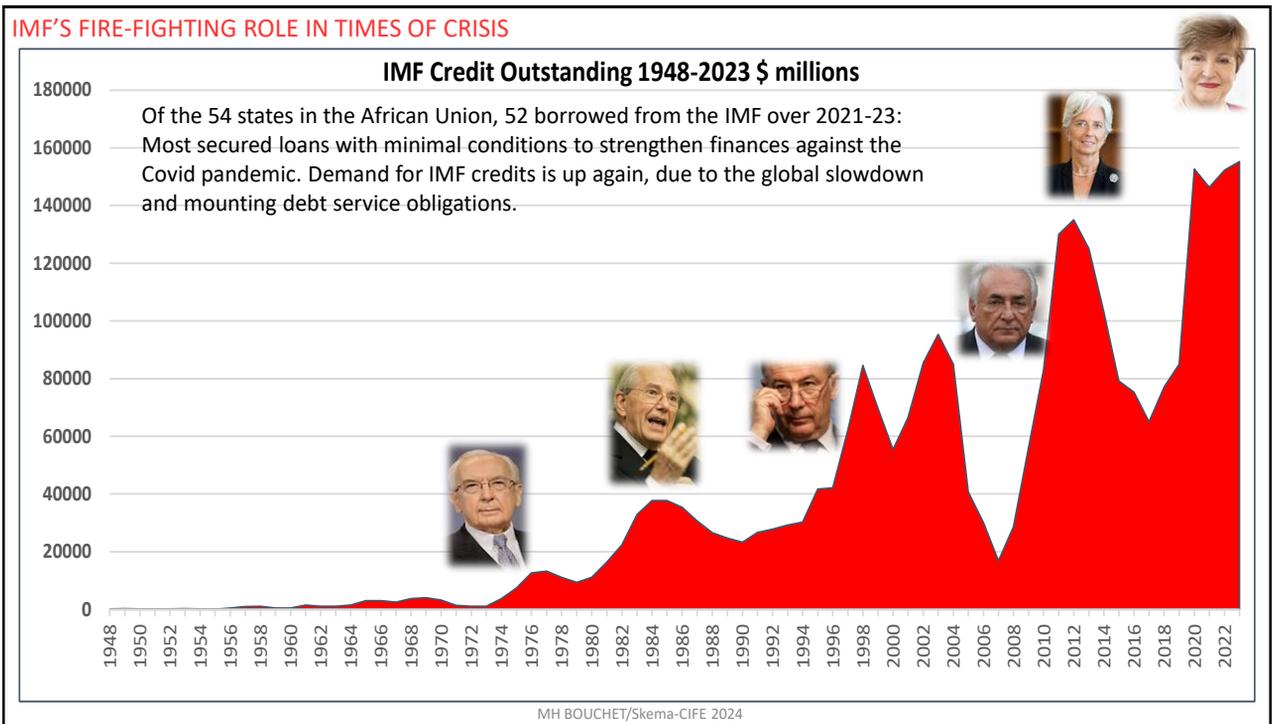
- IMF SDR Drawings
- World Bank's HIPC Initiative
- London Club debt reduction and restructuring workouts
- Paris Club debt relief
- Debt swap transactions

MH BOUCHET/Skema-CIFE 2024

34



35



36