


CIFE Centre international de formation européenne
BIE BERLIN BRUXELLES ROTTERDAM

COUNTRY RISK AND THE BALANCE OF PAYMENTS
THE CURRENT ACCOUNT




CIFE SEMINAR NICE
MICHEL-HENRY BOUCHET

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► **Country risk assessment starts with the Balance of Payments!**

1. Inflation and trade deficits
2. Currency volatility
3. Exchange rates and competitiveness
4. External financing flows
5. Capital flight
6. Liquidity or solvency problems?
7. Debt crisis!

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BALANCE OF PAYMENTS

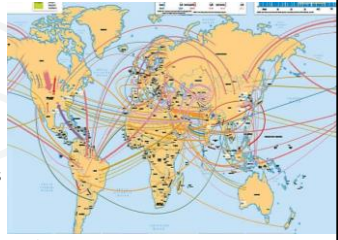
Accounting framework and statistical record of all economic and financial flows between residents of the reporting country and the rest of the world

The time period itself is arbitrary:
monthly, quarterly and yearly basis

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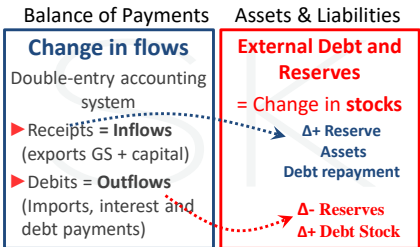
BALANCE OF PAYMENTS RECORDING OF TRADE AND FINANCIAL FLOWS

- Exports
- Imports
- Services (tourism)
- Interest Payments
- Transfers (remittances)
 - FDI
 - Portfolio
- Capital inflows and outflows
 - Reserve Change
 - Arrears



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BALANCE OF PAYMENTS AND EXTERNAL DEBT



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THE BALANCE IS ALWAYS BALANCED!



Changes in the stock of reserve assets, emergency financing, payment arrears... or debt default, will balance the national accounts

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Residents? = Government, households, individuals, NGOs & private non-profit entities, and firms.

- MNCs are by definition resident in more than one country. The MNC's subsidiaries are treated as resident in the country in which they are located even if their shares are actually owned by foreign residents.
- IFIs are always foreign residents (IMF...)
- Tourists and CIFE students are foreign residents if they stay in the reporting country < 1 year

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BALANCE OF PAYMENTS ACCURACY ?



- Data collection and methodological errors
- Inconsistencies in the time of recording and valuation of the corresponding debit and credit entries
- Undercoverage (over-invoicing/under-invoicing of trade transactions)
- Data revisions policy
- Use of sample surveys rather than complete enumeration
- Trade-off between accuracy and timeliness!
- Customs deficiency!

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INTERPRETING THE BALANCE OF PAYMENTS

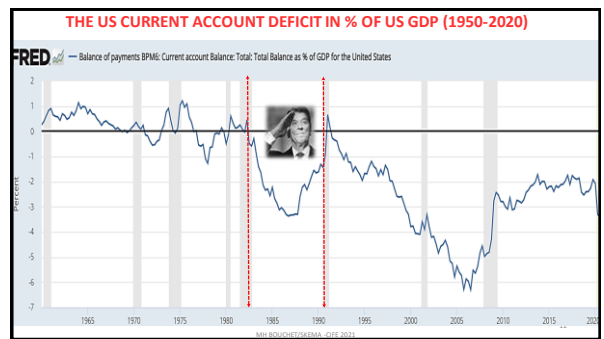
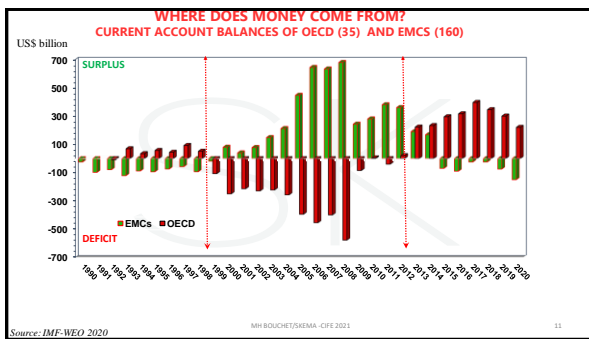
Different accounts in the balance of payments make it possible to see whether or not a country lives
"beyond its means"

Merchandise exports or imports can be broken down by product and by market source and destination (incompressible imports or volatile exports!)

Useful for determining how a country's balance of payments and overall economic performance will react to different situations (elasticities, exchange rate adjustment, domestic absorption, terms of trade, trade barriers, deflation...)

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INTERPRETING THE BALANCE OF PAYMENTS

- Living beyond its means?
- Current account balance = saving - domestic spending
- A country that **saves > it invests** at home sends its surplus abroad to purchase foreign assets
- One that **saves < it invests** finances the shortfall by issuing liabilities to foreign investors = Δ debt!
- The accumulated history of current account surpluses or deficits, along with capital gains and losses on past investments, determines a country's **net international investment position**.

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NATIONAL INCOME IDENTITY

Y = National income
 C = Domestic Consumption
 I = Investment
 G = Government expenses
 T = Taxes & Government revenues
 X = Exports
 M = Imports
 S = Domestic Savings (income > consumption)

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DOMESTIC AND EXTERNAL FINANCIAL EQUILIBRIUM

What is disposable income?

Y = gross income - imports & taxation

$$Y = C + I + G + X - M - T + (KM - K \text{ flight})$$

Savings = $Y - C$

$$\underbrace{(S - I)}_{\text{Savings}} + \underbrace{(T - G)}_{\text{Fiscal balance}} = \underbrace{(X - M)}_{\text{Trade balance}} + \underbrace{(KM - K \text{ flight})}_{\text{Net capital inflows}}$$

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BOOSTING SAVINGS TO FINANCE INVESTMENT WITHOUT EXTERNAL DEFICIT?

if $S > I \Rightarrow X > M$

If $S < I \Rightarrow M > X$

- ▶ a trade imbalance is always rooted in low savings and excessive domestic spending (absorption)
- ▶ It requires macroeconomic correction (interest rate hike, devaluation, \uparrow taxation, credit reduction, \uparrow reserve requirements...)

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Two principal sub-accounts

1. **current account** plays a role similar to a private company's income statement= country's **economic performance** vis-à-vis the rest of the world.

2. **capital account** shows how the country's economic growth gets **financed**

The **basic balance** draws the line under "other long-term capital" to emphasize the role of economic performance and stable long-term financing. Another presentation is the **Table of Uses & Sources**

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BALANCE OF PAYMENTS: CURRENT & CAPITAL ACCOUNTS

1. **Balance of trade** = Exports of merchandise – Imports

2. **Balance of services** ("invisible")

= freight, insurance, shipping, banking, tourism, interest and dividend payments (i.e. services of capital)

3. **Unilateral transfers**

= **CURRENT ACCOUNT**



► A deficit in the current account must be financed by a surplus in the capital account!

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THE CURRENT ACCOUNT OF THE BALANCE OF PAYMENTS

+ Export of goods f.o.b.
- Imports of goods f.o.b.

= **Trade balance**

+ Exports of non-financial services
- Imports of non-financial services
+ Investment income (credit)

- **Interest payments**

+ Private unrequited transfers
+ Official unrequited transfers

= **Current account balance**

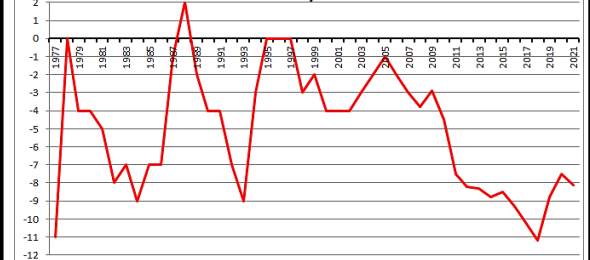
From less liquid items
toward more liquid items!



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Tunisia: Current Account/GDP % 1977-2021



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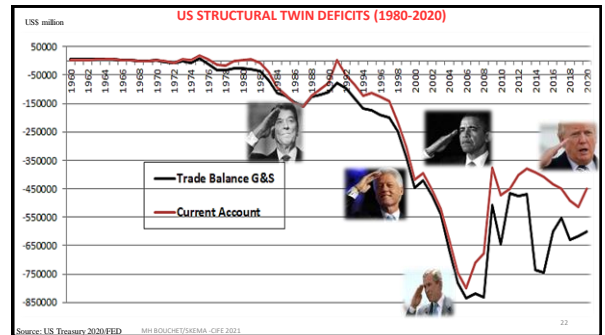
1. The trade balance comprises



1. **Merchandise exports:** all movable goods such as equipment, cars, trucks, textile, appliances, oil etc.
2. **Imports are recorded "free on board" (f.o.b.):** services (freight, insurance, shipping and handling performed on goods up to the customs frontier of the economy from which the goods are exported), are **not** included in the trade balance.

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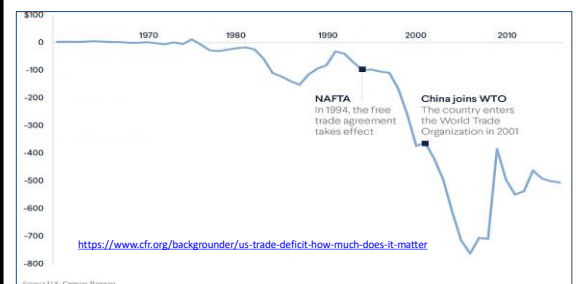
THE US TRADE BALANCE

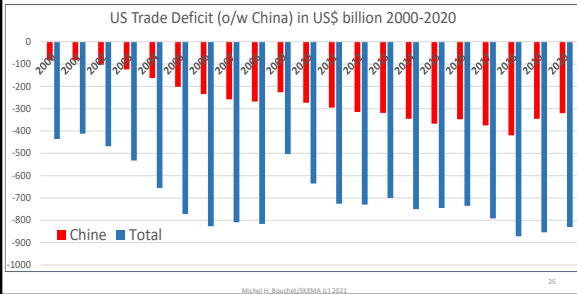
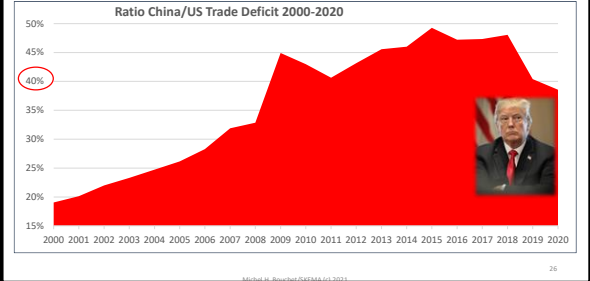
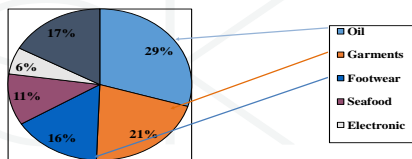
- ▶ In 2020 the United States exported \$1500 trillion in goods while it imported \$2500 trillion, hence a **\$850 billion deficit**.
- ▶ Major goods exported = aircraft, medical equipment, refined petroleum, and agricultural commodities.
- ▶ Major imports are dominated by capital goods, such as computers and telecom equipment; consumer goods, such as apparel, electronic devices, and automobiles; and crude oil.
- ▶ Services, such as tourism, intellectual property, and finance, make up roughly one-third of exports.
- ▶ The deficit in goods, at **\$850 billion**, is higher than the overall deficit, since a portion of the goods deficit is offset by the surplus in services trade.

Michaël H. Bouchet/S&P/IMA (c) 2021

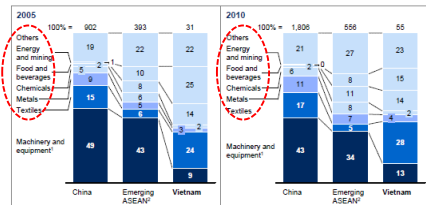
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BLAMING FREE TRADE, CHINA AND EMCS? THE US TRADE DEFICIT OVER TIME

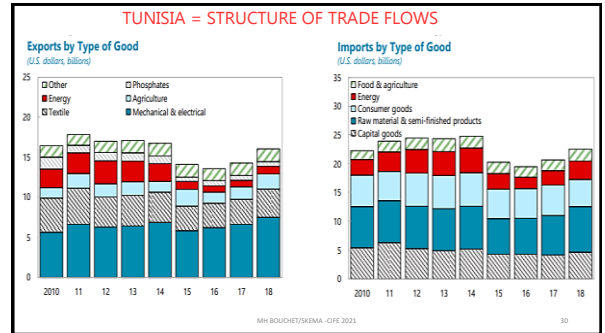
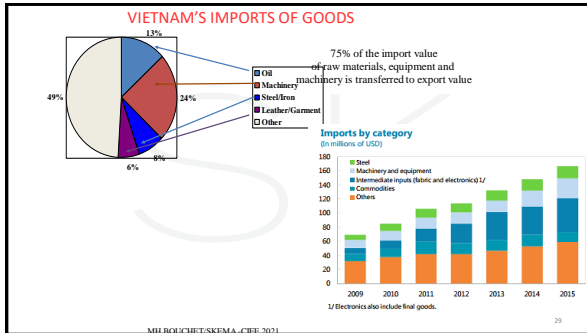


BLAMING CHINA?**BLAMING CHINA??****VIETNAM'S KEY EXPORTS OF GOODS**

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Vietnam's exports are concentrated in low-value-added products compared with ASEAN countriesExport breakdown by subsector
%, \$ billion

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2. Non-financial services =

Freight, insurance, passenger services, tourism, and travel!

The transportation of persons represents the largest component of passenger services.

Tourism earnings: Cuba, Morocco, Tunisia?, Vietnam, Thailand, Spain, France...

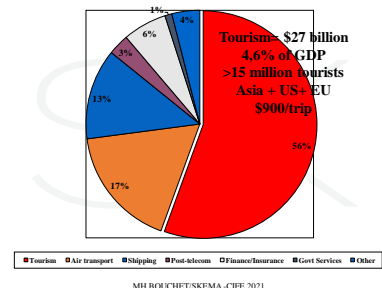
Freight refers mainly to the carriage or transport of goods between national economies (Malta, Cyprus, Liberia, Panama...)

Insurance comprises insurance on movable goods during the course of shipment between economies as well as insurance on the carriers and other types of insurance such as life insurance.

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SERVICE EXPORTS OF VIETNAM



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3. Financial services: = Investment income and interest payments

Investment income covers income derived from the ownership of foreign financial assets (interest and dividends for portfolio investment + non-distributed earnings of incorporated enterprises)

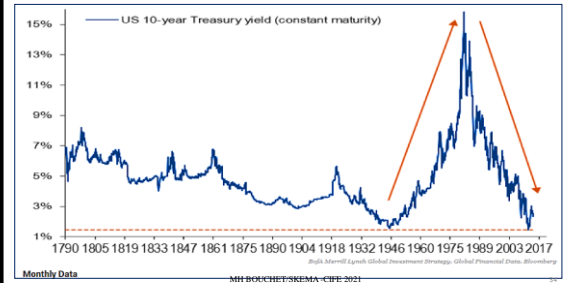
Distinction between portfolio investment and direct investment revolves around the investor's intentions concerning the foreign company.

Investment debits = **interest payments** on foreign liabilities
(interest on debt!)

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THE RISE AND FALL OF US 10-YEAR TREASURY YIELDS 1790-2020



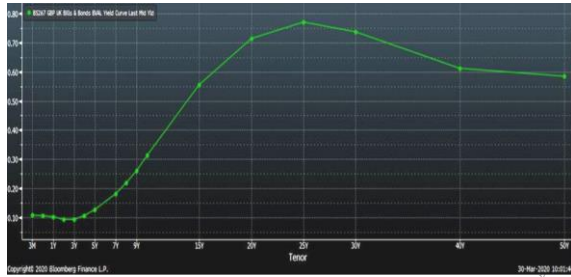
10 YEAR-TREASURY RATE 1960-2020



1 YEAR LIBOR RATE 1980-2020

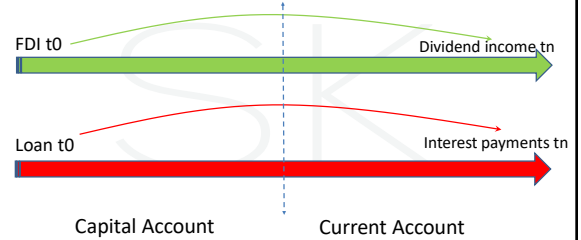


A WORLD OF NEGATIVE/ULTRA LOW INTEREST RATES UK'S YIELD CURVE 3-MONTHS/50 YEARS Q2-2020

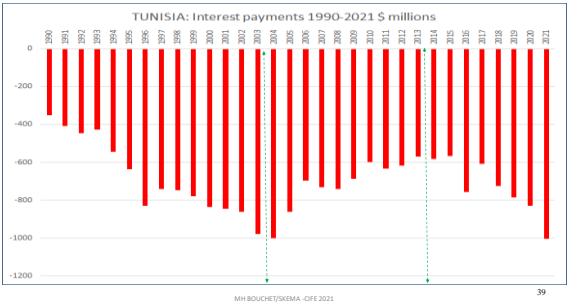


INTEREST INCOME AND INTEREST PAYMENTS

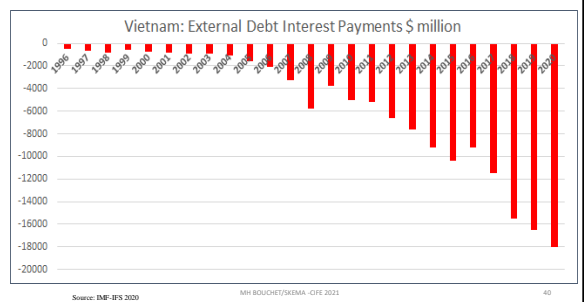
FLows VERSUS STOCKS!



TUNISIA: RISING INTEREST BILL IN A WORLD OF ULTRA-LOW RATES



EXTERNAL DEBT SERVICING BURDEN 1996-2020



4. Private and official unrequited transfers

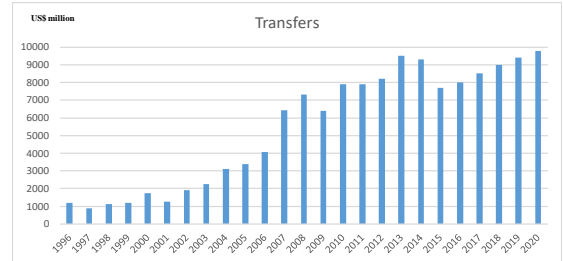
Private unrequited transfers refer mainly to immigrant workers' remittances to their country of origin as well as gifts, inheritances, prizes, charitable contributions, etc.: Morocco, Mexico, Algeria, Tunisia, India, Pakistan...

Official unrequited transfers include grants, subsidies, military aid, voluntary debt cancellation, contributions to international organizations, indemnities imposed under peace treaties, technical assistance, etc. : Large inflows for most HIPC-eligible countries (Benin, Tanzania, Haiti...)

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VIETNAM'S TRANSFERS REVENUES 1996-2020

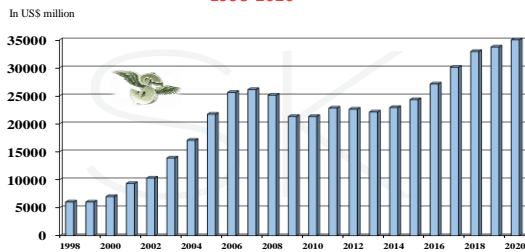


Source: IMF 2020

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MEXICO'S NET CURRENT TRANSFERS INFLOWS (REMITTANCES) 1998-2020



Source: IMF-IFS/IFP 2020

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REMITTANCES BETWEEN LATIN AMERICA AND THE US UNDER TRUMP??

- ▶ = Migrant worker's earnings sent back from the country of employment to the country of origin
- ▶ Key for Morocco, Tunisia, Indonesia, Vietnam, Philippines, Mexico...
- ▶ What linkages between remittance flows to Latin America and the U.S. business cycle?

All of the evidence suggests that remittance flows are relatively **insensitive** to fluctuations in the U.S. cycle, underlining their role as a stable source of external financing... until the 2008-09 global financial crisis!

Source: IMF Working Paper, 12/2007 = <http://www.imf.org/external/pubs/ft/wp/2007/wp07273.pdf>

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TUNISIA: POST-VIRUS BALANCE OF PAYMENTS

Table 3. Tunisia: Balance of Payments, 2017–25 1/
(In millions of U.S. dollars, unless otherwise indicated)

	2017	2018	2019	2020	2021	2022	2023	2024	2025
	Annual	Annual	Annual	Annual	Annual	Proj.	Proj.	Proj.	Proj.
Current account balance	-4,080	-4,443	-3,413	-2,751	-2,910	-2,949	-2,792	-2,558	-2,282
Trade balance	-5,308	-5,949	-5,427	-3,439	-4,760	-5,483	-5,637	-5,601	-5,920
Exports	14,231	15,485	14,945	11,939	13,586	14,832	15,963	17,340	18,723
Energy	846	880	824	547	533	629	732	848	940
Non-energy	13,384	14,606	14,121	11,392	13,053	14,203	15,231	16,493	17,783
of which: non-food	11,844	12,542	12,516	9,949	11,526	12,408	13,564	14,744	16,142
Imports	-19,538	-21,435	-20,372	-15,378	-18,346	-20,115	-21,600	-22,942	-24,643
Energy	-2,513	-3,214	-3,467	-2,457	-2,165	-2,308	-2,410	-2,480	-2,553
Non-energy	-17,025	-18,220	-16,905	-12,922	-16,182	-17,807	-19,190	-20,462	-22,089
of which: non-food	-15,100	-16,195	-14,979	-10,889	-14,188	-15,801	-17,151	-18,381	-19,960
Services and transfers (net)	1,228	1,506	2,015	688	1,850	2,534	2,845	3,044	3,628
Services	305	717	1,209	-107	1,350	1,736	1,935	2,150	2,296
of which: tourism exports	1,170	1,565	1,915	535	1,687	2,004	2,126	2,251	2,330
Transfers (net)	923	789	805	795	500	797	910	894	1,332
of which: workers' remittances	1,861	1,875	1,948	1,613	1,774	1,928	2,038	2,149	2,279
of which: interest payments on external debt	-607	-725	-787	-829	-1,003	-1,061	-1,167	-1,185	-954

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