

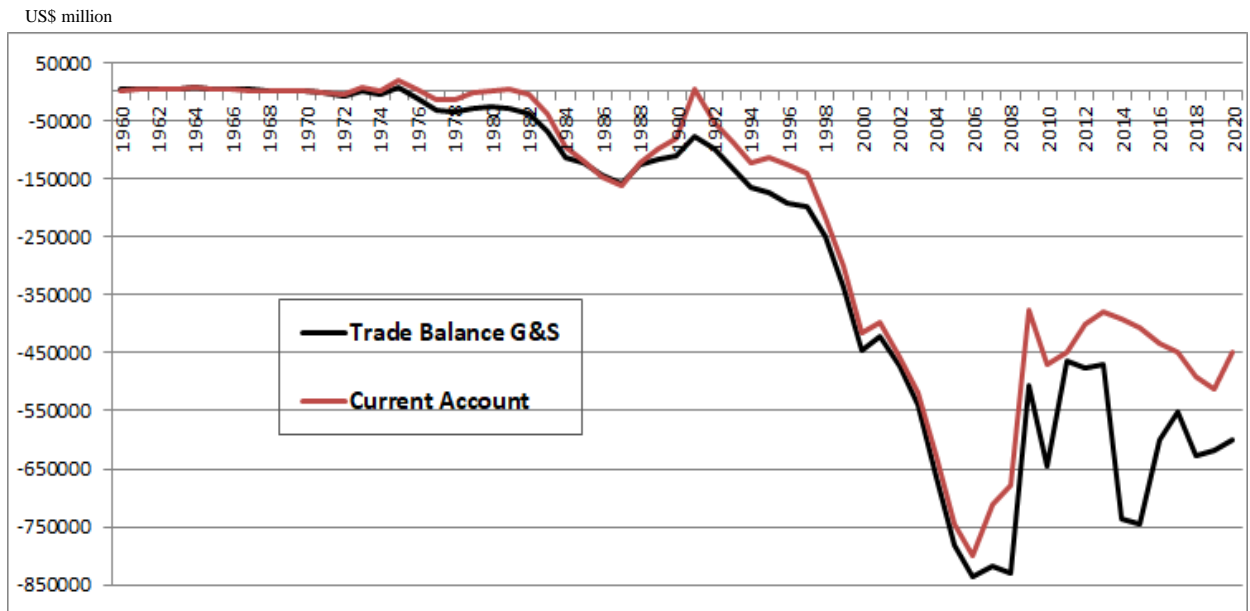
THE BALANCE OF PAYMENTS III CAPITAL ACCOUNT AND EXTERNAL FINANCING

CIFE SEMINAR NICE APRIL 2021
MICHEL-HENRY BOUCHET



1

US STRUCTURAL TWIN DEFICITS (1980-2020)

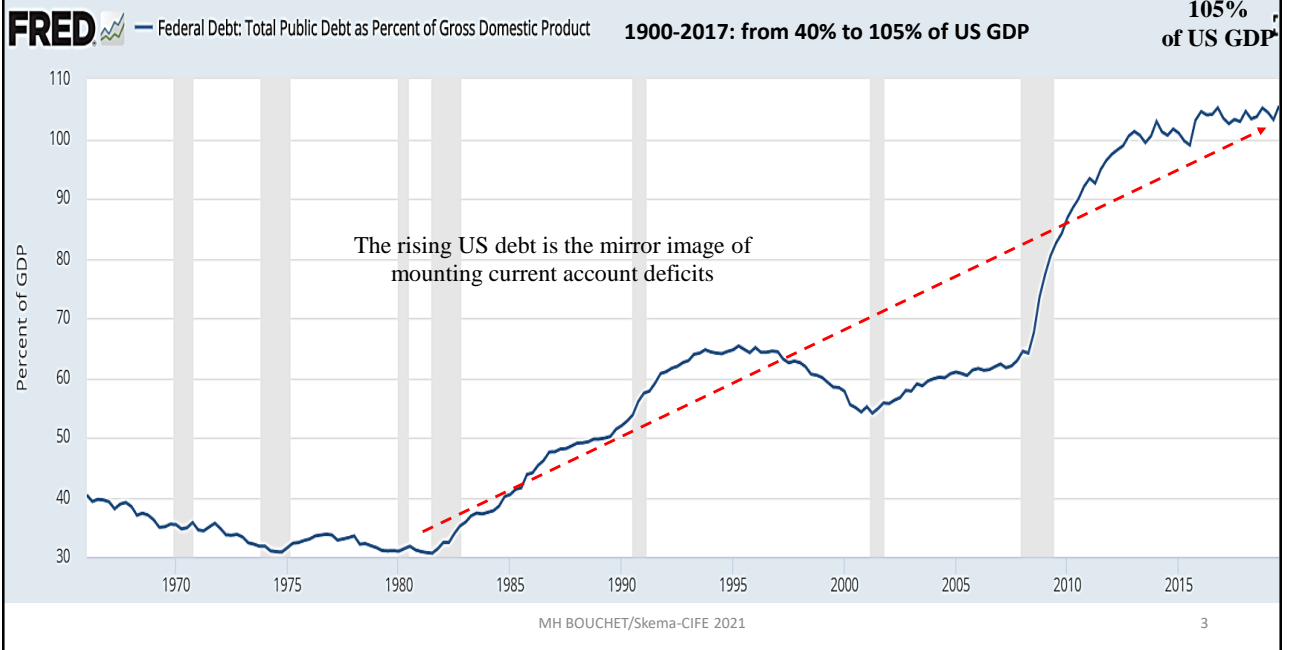


Source: US Treasury 2020/FED

MH BOUCHET/Skema-CIFE 2021

2

US DEFICIT ACCUMULATION AND DEBT GROWTH 1960-2020



► Capital 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...

CAPITAL ACCOUNT

The financial 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 2021

5

THE CAPITAL 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 2021

6



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

Let's go CIFE!

PH BOUCHET/Skema-CIFE 202



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

GOOD JOB CIFE!



TABLE OF USES AND SOURCES

USES (outflows)

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

SOURCES (inflows)

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

MH BOUCHET/Skema-CIFE 2021

11

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

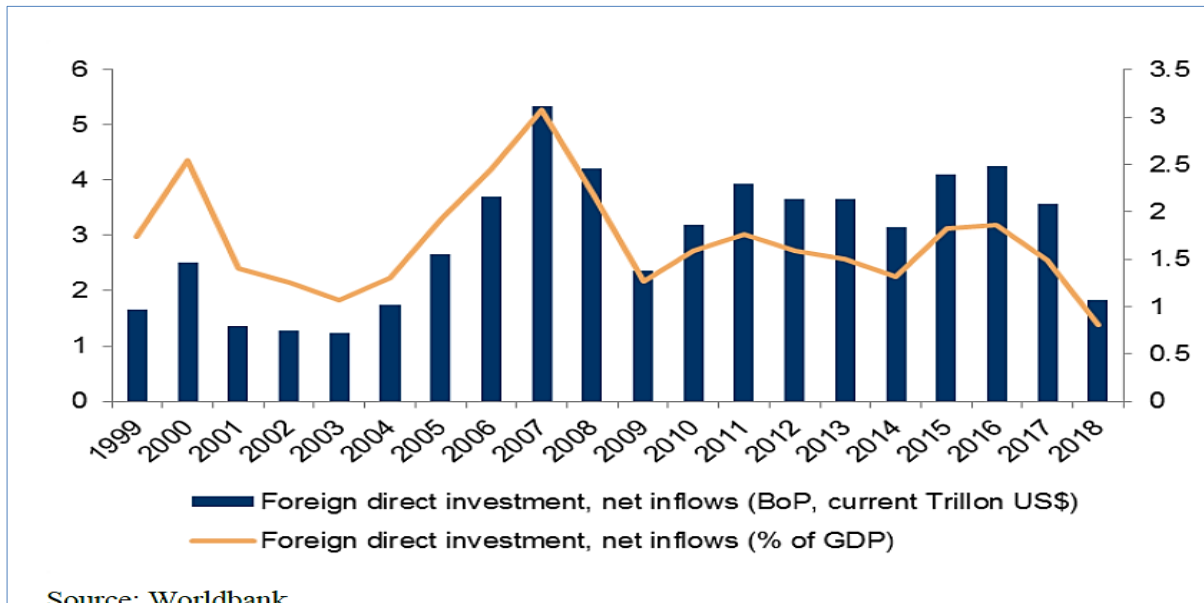
Private

- 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 2021

12

THE GLOBAL DECLINE IN FDI FLOWS



MH BOUCHET/Skema-CIFE 2021

13

Other capital is a residual 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 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 2021

14

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 2021

15

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.

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 2021

MH BOUCHET/Skema-CIFE 2021

16

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 2021

17

**FX RESERVES AS
BUFFER OF
LIQUIDITY CRISIS**

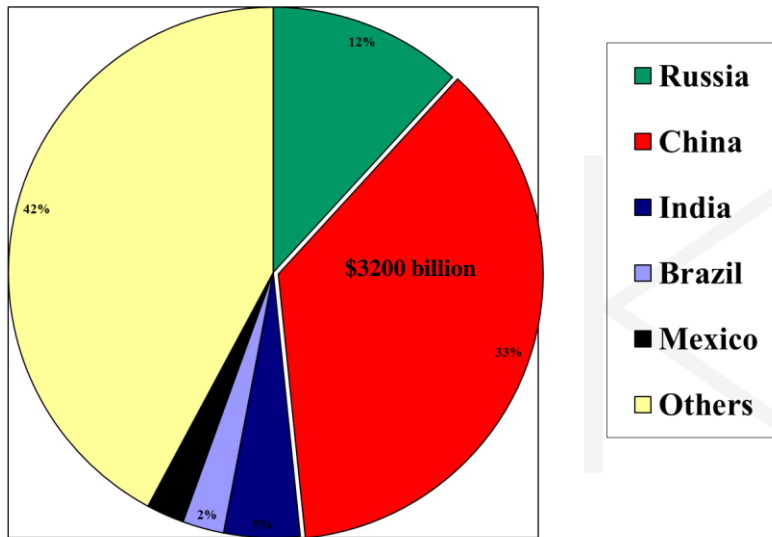
	FX Reserves as % of short term debt	FX reserves as % of GDP
India	427%	15%
China	399%	27%
Mexico	334%	16%
Korea	330%	26%
Taiwan	277%	82%
Switzerland	63%	96%
Japan	45%	23%
Canada	13%	5%
Italy	5%	2%
UK	2%	4%
Germany	2%	1%
France	2%	2%

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 2021

18

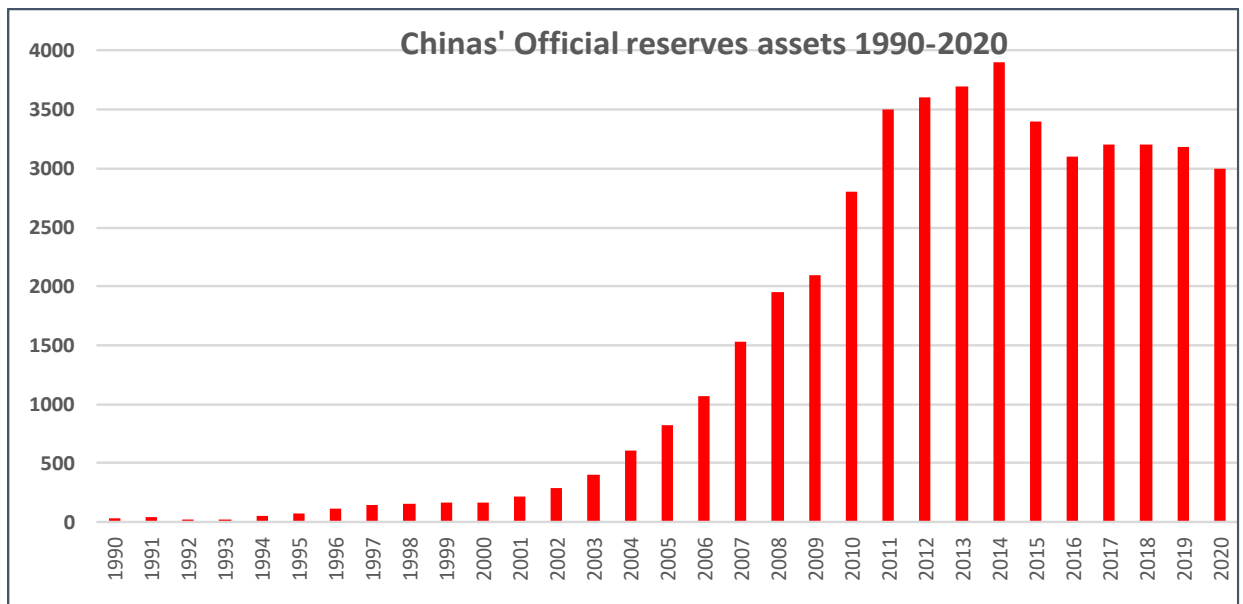


Σ world reserves =
\$11,500 billion

MH BOUCHET/Skema-CIFE 2021

19

THE RISE AND FALL OF CHINA'S RESERVE ASSETS

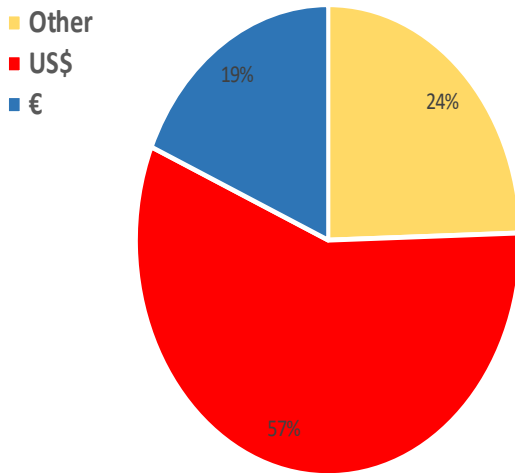


MH BOUCHET/Skema-CIFE 2021

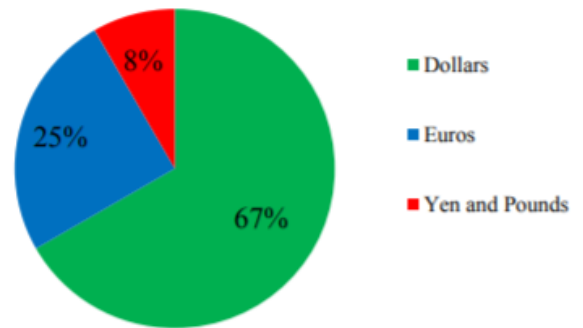
20

THE SHRINKING SHARE OF DOLLAR HOLDINGS ?

Currency shares in total reserve assets 2018

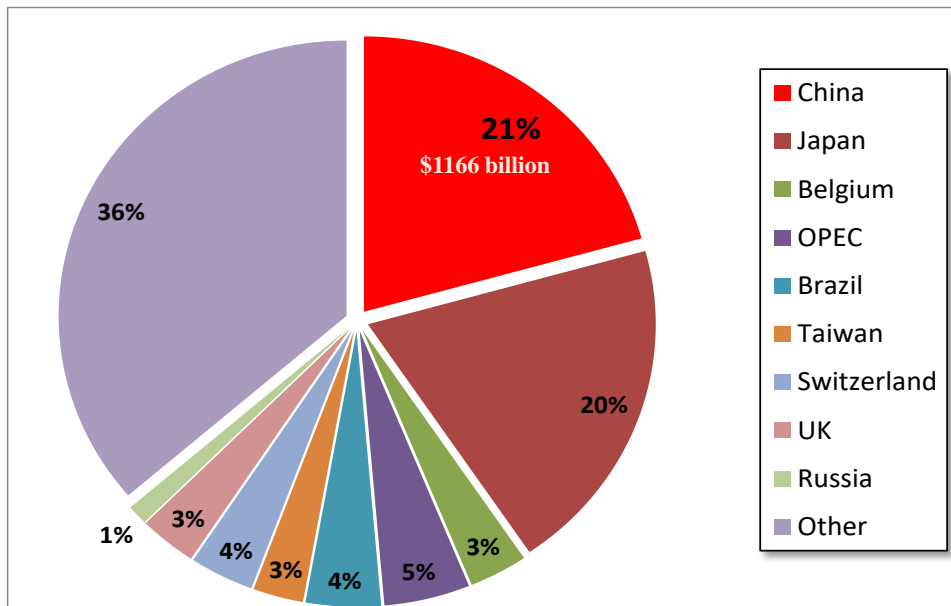


Currency Composition of Chinese FX reserves



MH BOUCHET/Skema-CIFE 2021

CHINA => 1/5 OF FOREIGN HOLDING OF US DEBT



US Treasury

MH BOUCHET/Skema-CIFE 2021

22

4. Net errors and omissions

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

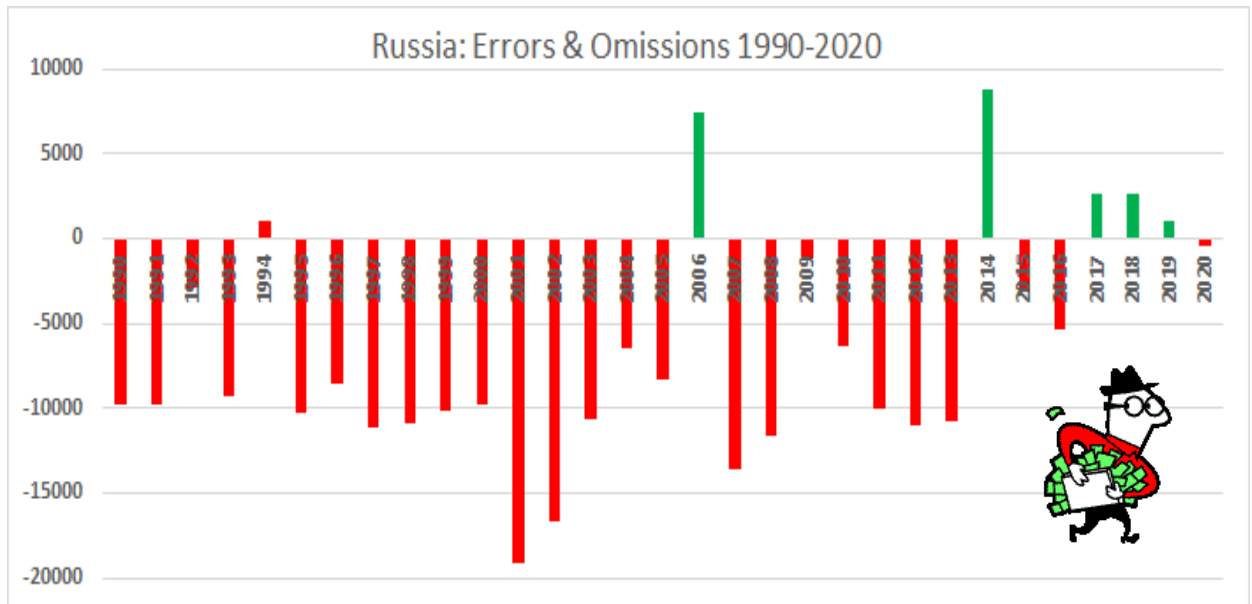
Other sources of E&Os:

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

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!

RUSSIA: NET ERRORS & OMISSIONS US\$ BILLION

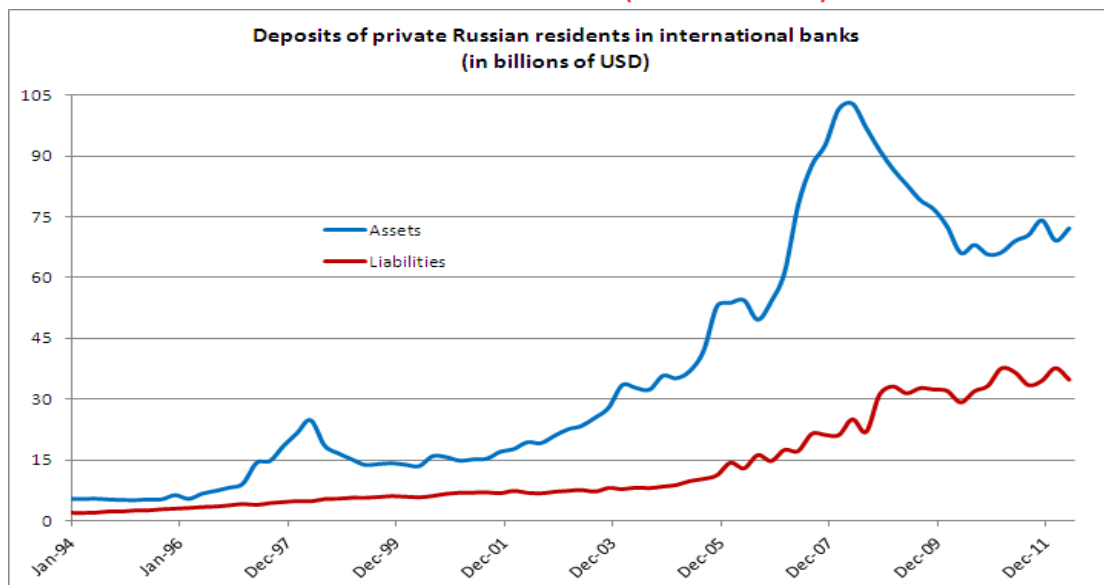


Source: IMF-IFS/IIF

MH BOUCHET/Skema-CIFE 2021

25

CAPITAL FLIGHT IN RUSSIA (1994-2012)

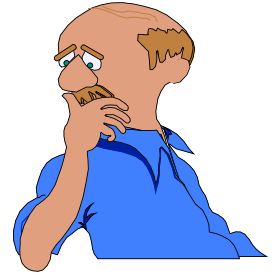


Source: BIS

MH BOUCHET/Skema-CIFE 2021

26

6. EXCEPTIONAL FINANCING



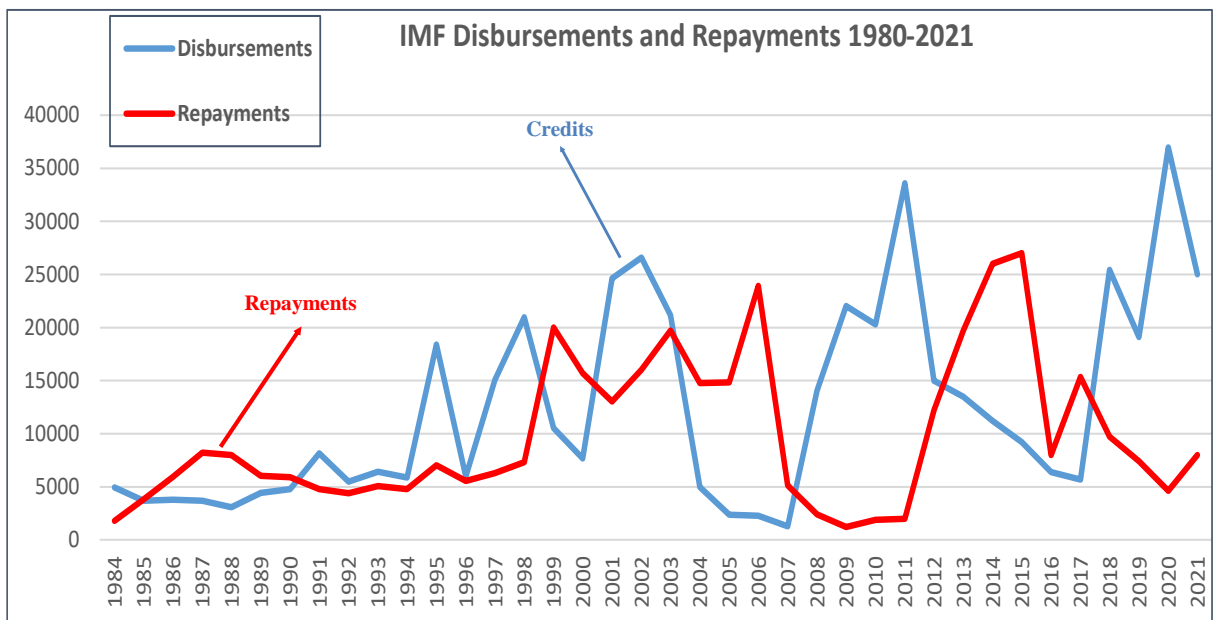
- IMF SDR Drawings
- World Bank's HIPC Initiative
- London Club debt reduction and restructuring workouts
- Paris Club debt relief
- Debt swap transactions

MH BOUCHET/Skema-CIFE 2021

27

IMF DISBURSEMENTS & REPAYMENTS

SDR million

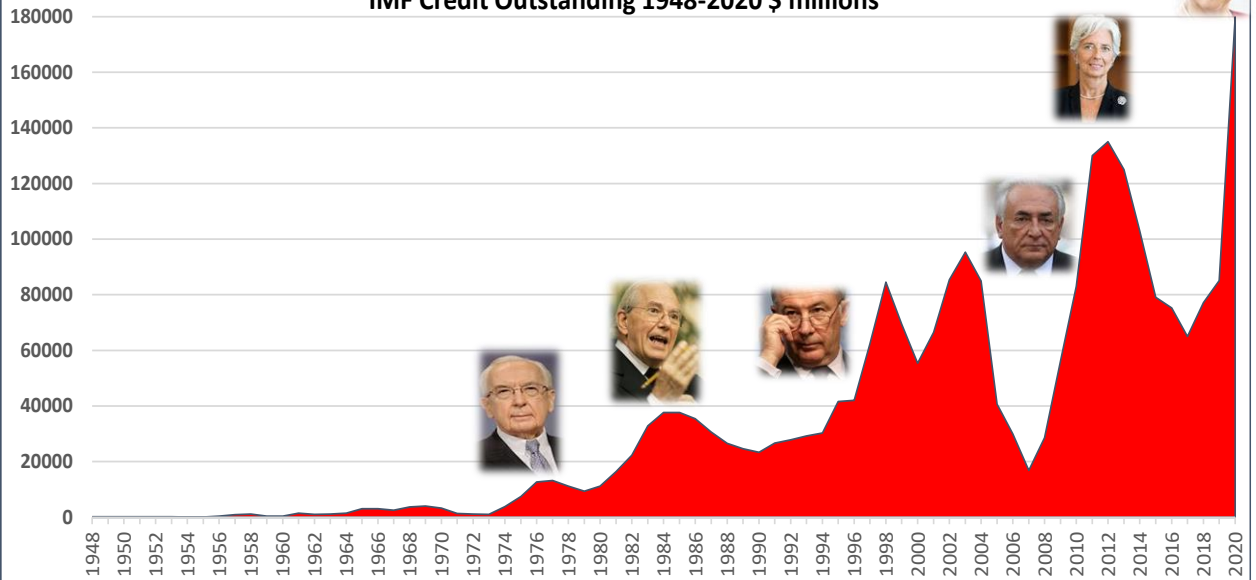


MH BOUCHET/Skema-CIFE 2021

28

IMF'S FIRE-FIGHTING ROLE IN TIMES OF CRISIS

IMF Credit Outstanding 1948-2020 \$ millions



MH.BOUICHET/Skema-CJEE 2021