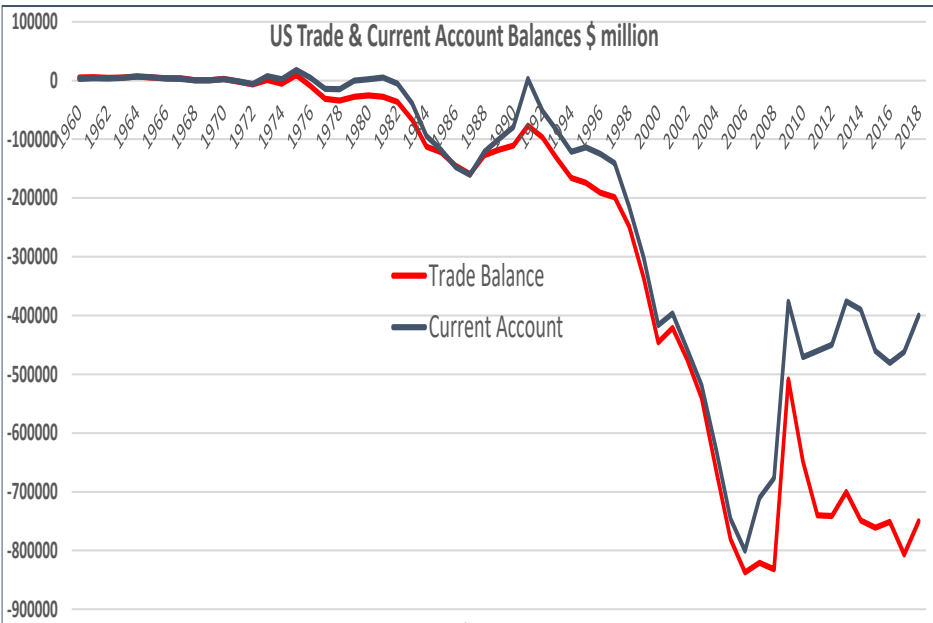


THE BALANCE OF PAYMENTS III CAPITAL ACCOUNT AND EXTERNAL FINANCING

CIFE SEMINAR NICE MAY 6-8, 2020
MICHEL-HENRY BOUCHET



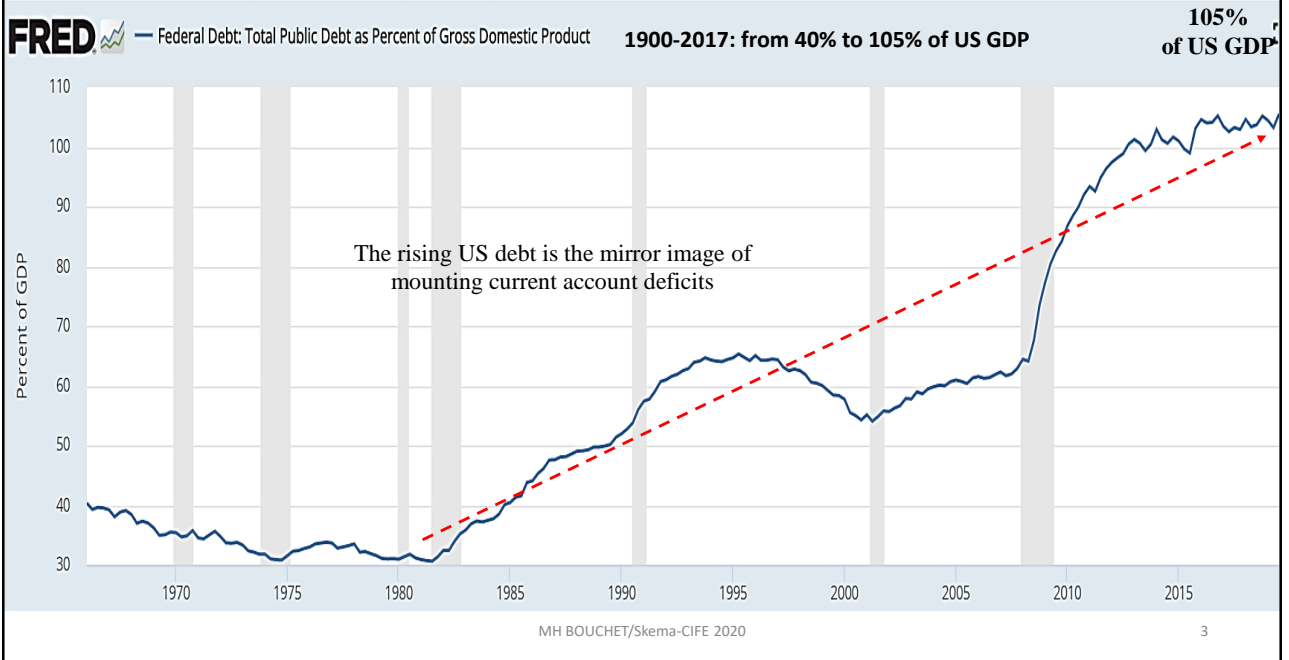
US STRUCTURAL TWIN DEFICITS (1980-2019)



Source: US Treasury 2018/FED

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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 the capital markets (Eurobonds, Eurocredits), official financing, ODA, 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, legal clauses...)

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!**



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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

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Let's go CIFE!



GOOD JOB CIFE!

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

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

SOURCES OF EXTERNAL FINANCING

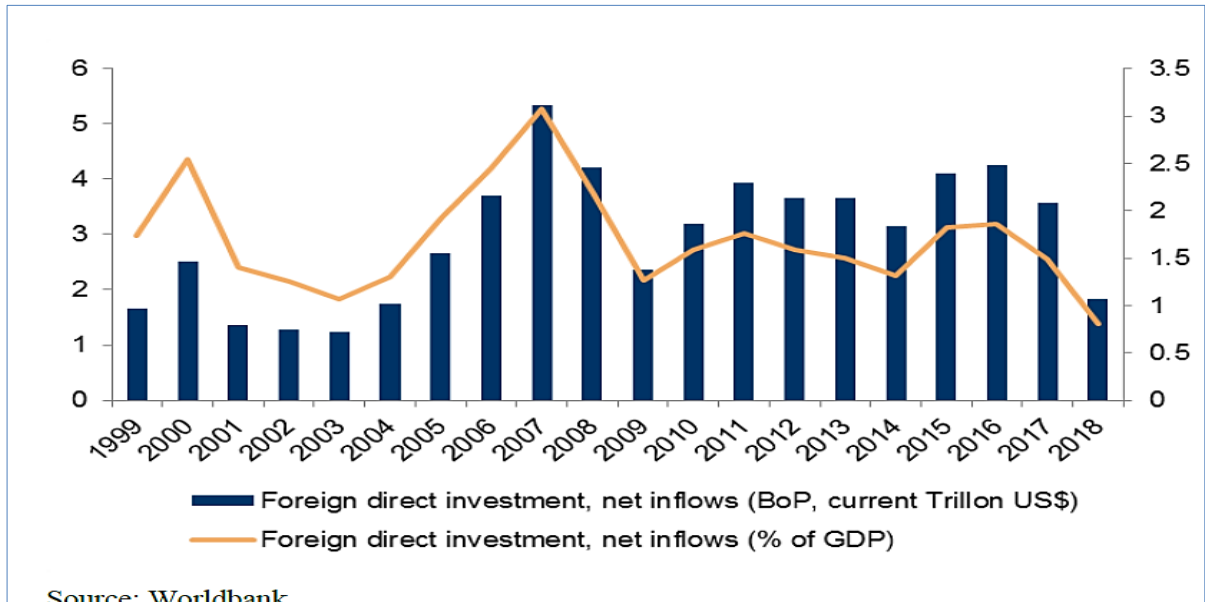
Official (bilateral + multilateral)

- 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

THE GLOBAL DECLINE IN FDI FLOWS



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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)

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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)

THE IMF QUOTAS

When a country joins the IMF, it is assigned an initial quota in the same range as the quotas of existing members of broadly comparable economic size and characteristics. The IMF uses a quota formula to help assess a member's relative position= weighted average of GDP (weight of 50 percent), openness (30 %), economic variability (15 %), and international reserves (5 %).

For this purpose, GDP is measured through a blend of GDP—based on market exchange rates (weight of 60 %) and on PPP exchange rates (40 %). The formula also includes a “compression factor” that reduces the dispersion in calculated quota shares across members.

Quotas are denominated in Special Drawing Rights (SDRs), the IMF's unit of account. The largest member of the IMF is the United States, with a quota of SDR83 billion (about US\$118 billion), and the smallest member is Tuvalu, with a quota of SDR2.5 million (about US\$3.5 million)

Source: IMF quotas 2019

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!

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17

**FX RESERVES AS
BUFFER OF
LIQUIDITY CRISIS**

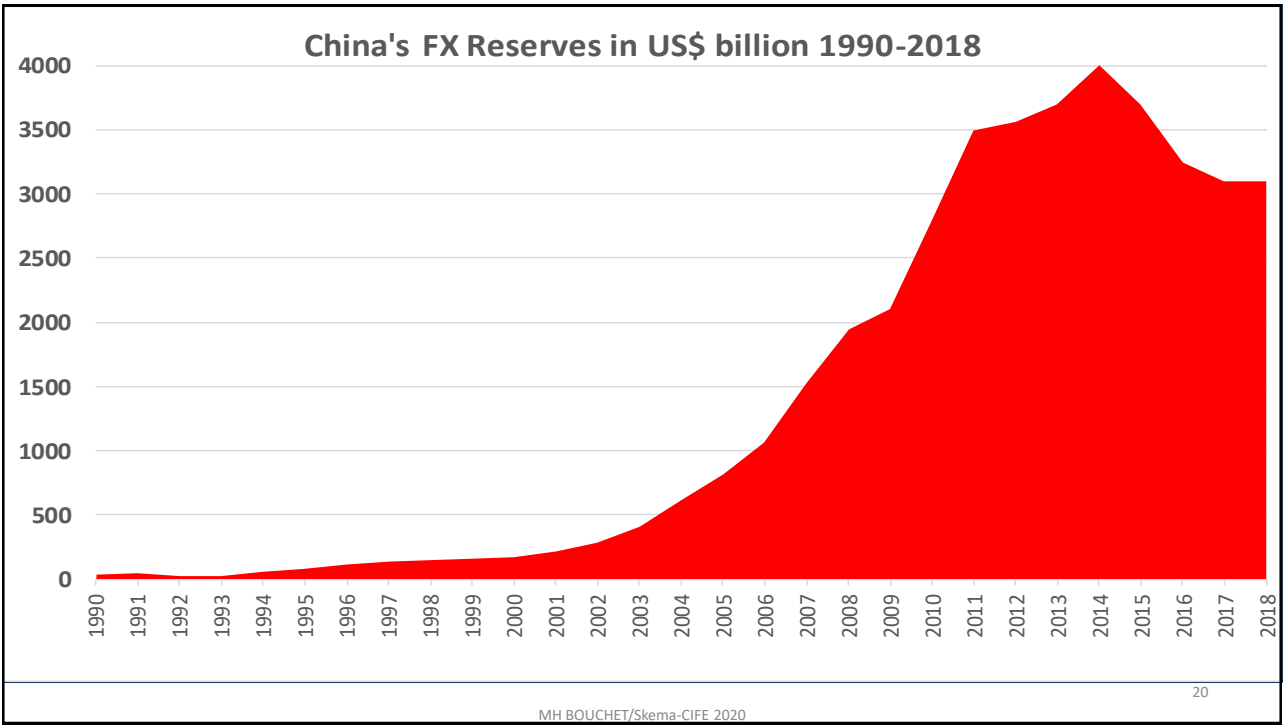
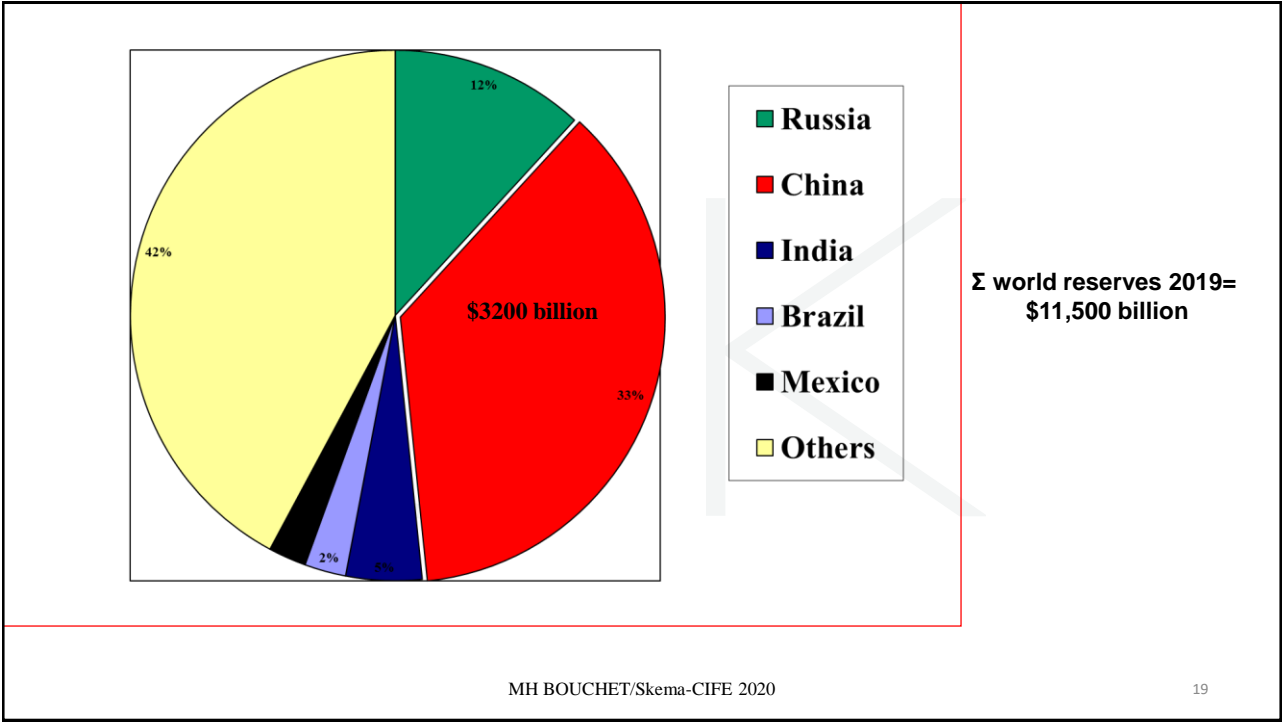
	FX Reserves as % of short term debt	FX reserves as % of GDP
India	427%	15%
China	399%	27%
Mexico	334%	16%
Korea	330%	26%
Taiwan	277%	82%
Switzerland	63%	96%
Japan	45%	23%
Canada	13%	5%
Italy	5%	2%
UK	2%	4%
Germany	2%	1%
France	2%	2%

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

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

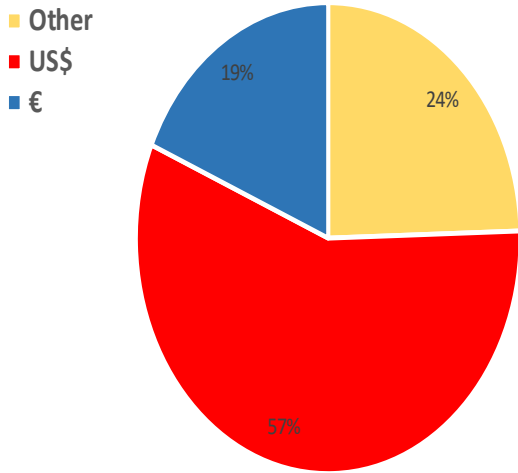
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18

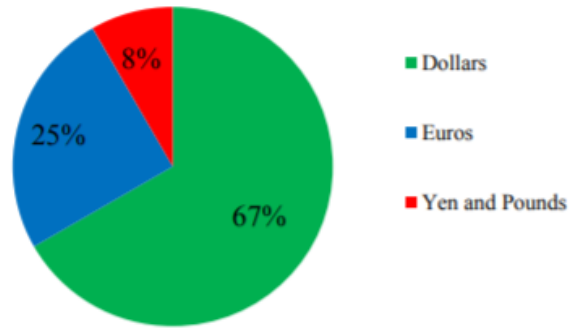


THE SHRINKING SHARE OF DOLLAR HOLDINGS ?

Currency shares in total reserve assets 2018

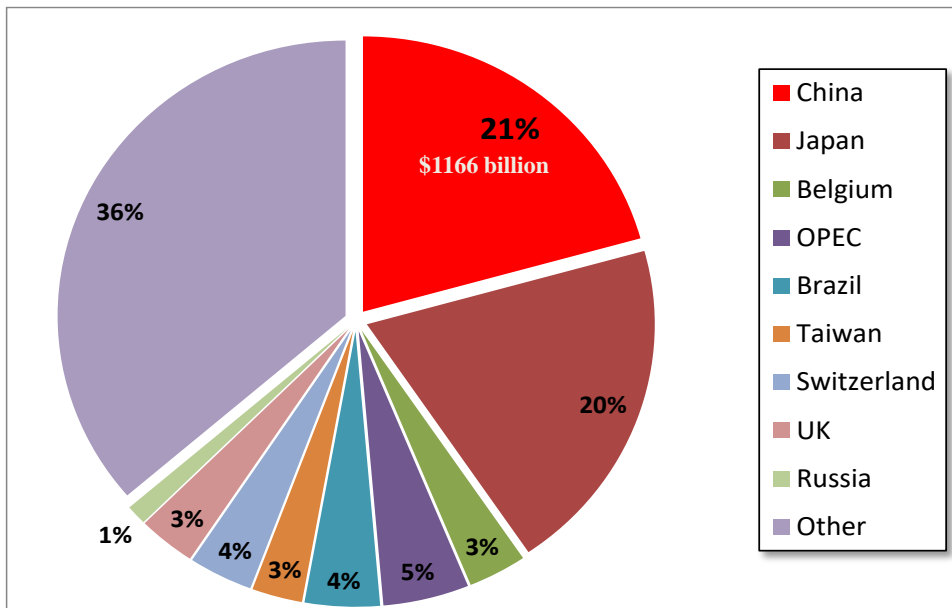


Currency Composition of Chinese FX reserves



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



US Treasury

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22

4. Net errors and omissions

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

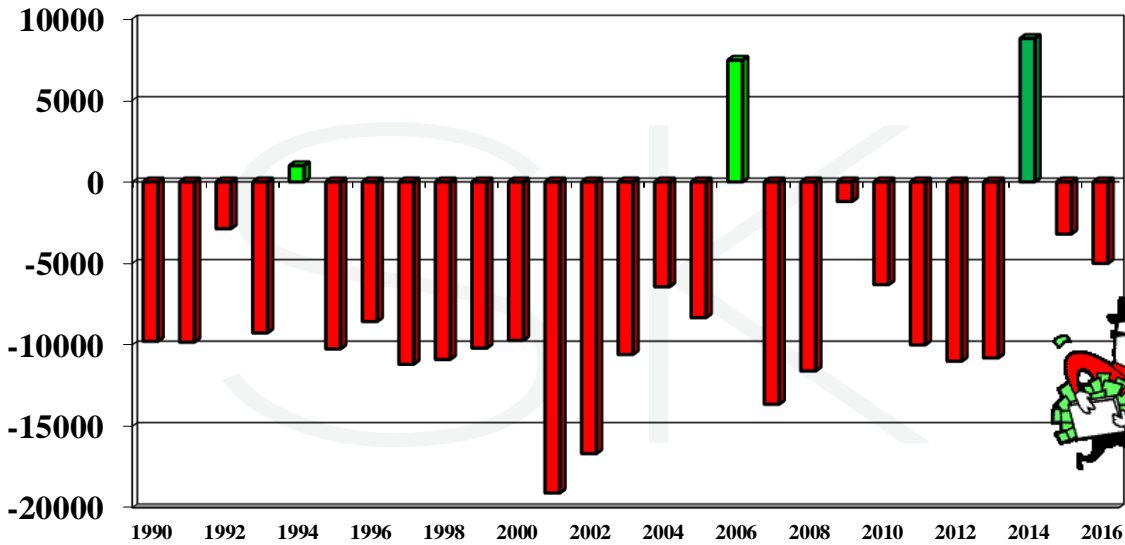
Other sources of E&Os:

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

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25

CAPITAL FLIGHT IN RUSSIA (1994-2012)

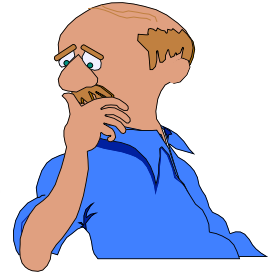


Source: BIS

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26

6. EXCEPTIONAL FINANCING

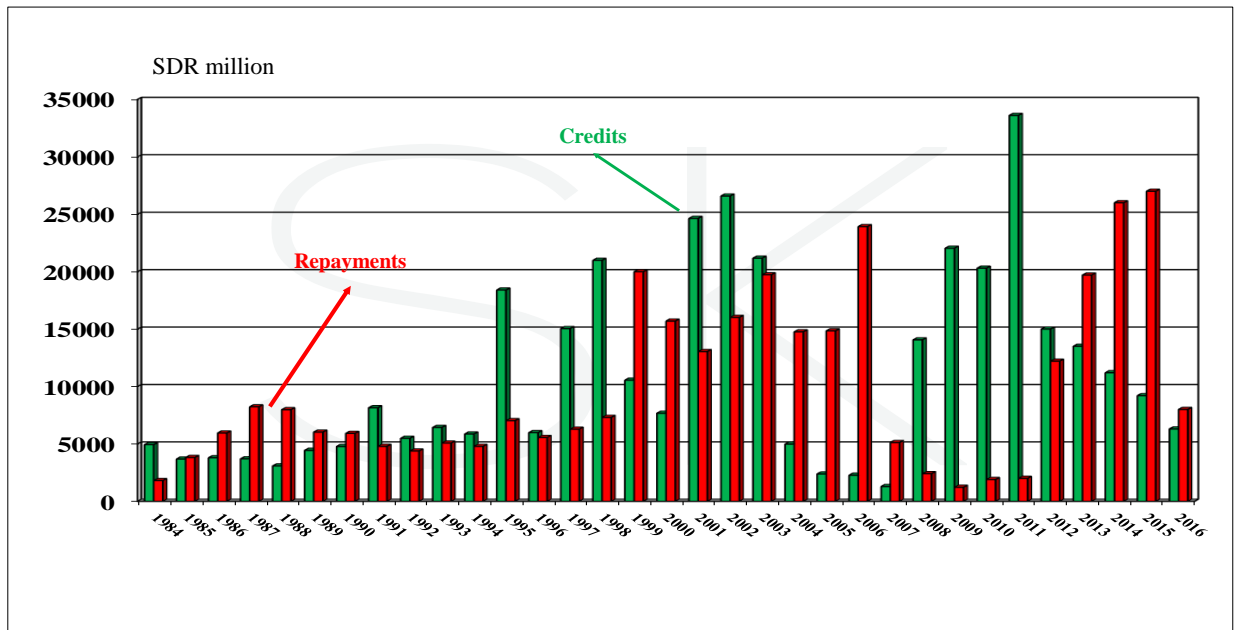


- IMF SDR Drawings
- World Bank's HIPC Initiative
- London Club debt reduction and restructuring workouts
- Paris Club debt relief
- Debt swap transactions

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27

IMF DISBURSEMENTS & REPAYMENTS



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28

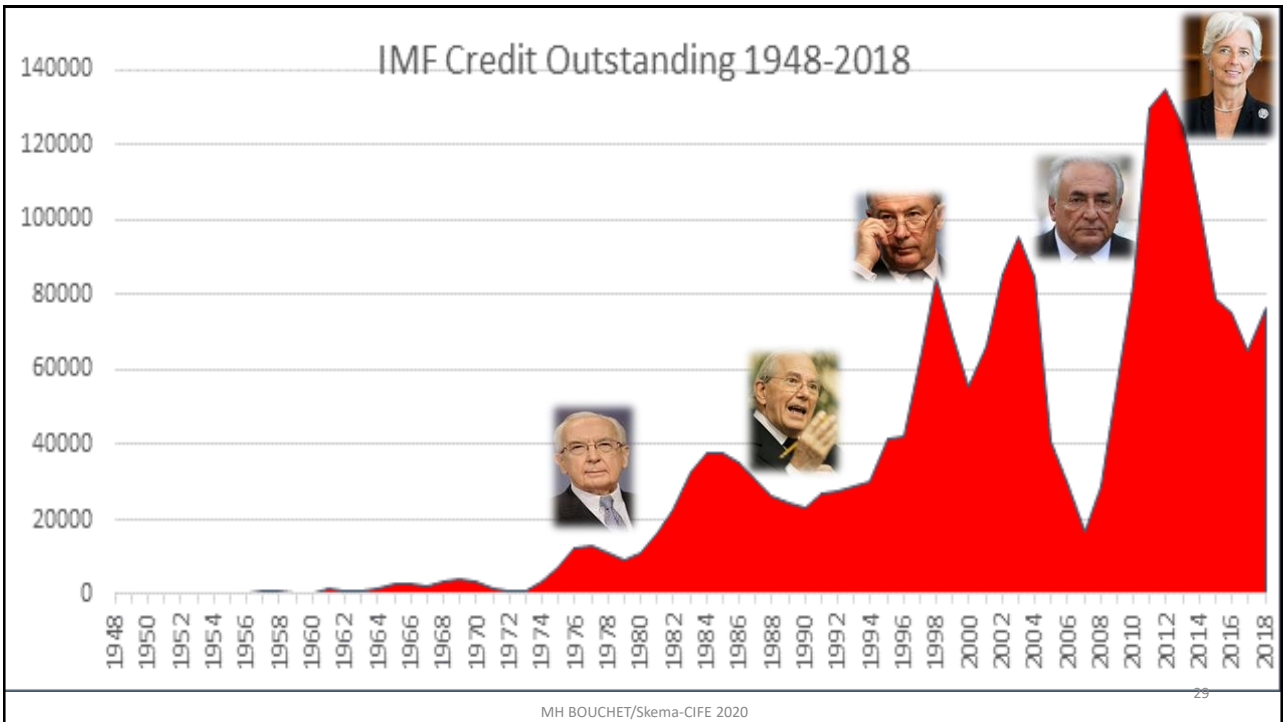


Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US\$)						Table1 Joint BIS-IMF-OECD-World Bank Statistics on External Debt (mill. US\$)					
Data are in millions						Data are in millions					
	2016Q2	2016Q3	2016Q4	2017Q1	2017Q2		2016Q2	2016Q3	2016Q4	2017Q1	2017Q2
A1. Loans and other credits (Debt of)						A1. Loans and other credits (Debt of)					
01_Cross-border loans, by BIS reporting banks	10,063	10,556	10,600	..	..	01_Cross-border loans, by BIS reporting banks	2,726	2,894	2,830	..	..
02_o/w to nonbanks	6,666	7,064	7,144	..	..	02_o/w to nonbanks	1,656	1,862	1,871	..	..
03_Official bilateral loans, total	..	..	..	..	..	03_Official bilateral loans, total	..	..	..	..	..
04_o/w aid loans	..	..	..	..	..	04_o/w aid loans	..	..	..	..	..
05_o/w other	..	..	..	..	..	05_o/w other	..	..	..	..	..
06_Multilateral loans, total	8,299	8,516	8,215	8,335	0	06_Multilateral loans, total	6,772	6,676	6,860	6,839	1,902
07_o/w IMF	0	0	0	0	0	07_o/w IMF	1,721	1,700	1,620	1,619	1,902
08_o/w other institutions	8,299	8,516	8,215	8,335	..	08_o/w other institutions	5,052	4,976	5,240	5,221	..
09_Insured export credit, Berne Union	7,200	7,272	6,599	..	..	09_Insured export credit, Berne Union	2,841	2,686	2,572	..	..
10_o/w short term	4,601	4,775	4,310	..	..	10_o/w short term	2,137	2,004	1,914	..	..
11_SDR allocations	785	784	755	762	781	11_SDR allocations	382	381	367	370	380
A2. Loans and other credits (Debt due within a year)						A2. Loans and other credits (Debt due within a year)					
12_Liabilities to BIS banks (cons.), short term	2,792	2,929	2,948	..	..	12_Liabilities to BIS banks (cons.), short term	528	585	584	..	..
13_Multilateral loans, IMF, short term	..	..	..	..	..	13_Multilateral loans, IMF, short term	149	231	328	448	531
B1. Debt securities (All maturities)						B1. Debt securities (All maturities)					
14_Debt securities held by nonresidents	5,761	..	..	..	..	14_Debt securities held by nonresidents	3,458	..	..	..	..
B2. Debt securities (short term, original maturity)						B2. Debt securities (short term, original maturity)					
15_Debt securities held by nonresidents	97	..	..	..	..	15_Debt securities held by nonresidents	24	..	..	..	..
C. Supplementary information on debt (liabilities)						C. Supplementary information on debt (liabilities)					
16_International debt securities, all maturities	8,029	8,044	8,197	8,234	..	16_International debt securities, all maturities	4,924	5,459	5,182	6,246	..
17_o/w issued by nonbanks	7,728	7,744	7,897	7,935	..	17_o/w issued by nonbanks	4,924	5,459	5,182	6,246	..
18_International debt securities, short term	555	558	527	535	..	18_International debt securities, short term	500	599	586	589	..
19_o/w issued by nonbanks	555	558	527	535	..	19_o/w issued by nonbanks	500	599	586	589	..
20_Paris Club claims (ODA)	..	..	4,479	..	..	20_Paris Club claims (ODA)	..	..	2,608	..	..
21_Paris Club claims (non ODA)	..	..	270	..	..	21_Paris Club claims (non ODA)	..	..	856	30	..
22_Liabilities to BIS banks, locational, total	13,990	14,548	12,089	..	..	22_Liabilities to BIS banks, locational, total	3,661	3,767	3,317	..	..