BALANCE OF PAYMENTS
Practice Problems

BoP Formula: CA + K/FA + OR = 0

Short Answer

1. What action must a central bank take when the current account balance and the financial account balance are not the same? How might this action be different in a fixed exchange rate regime versus a freely floating exchange rate regime?

2. When the US exports grain to the eurozone, assuming all else is equal, what impact will have on the respective currencies?

3. What effect does the purchase of US government bonds by China have on both the real interest rate in the US and the value of the USD?

4. What's the difference between balance of trade and balance of payments? What's the formula to determine the balance of trade?

5. While the US consistently realizes current account deficits, Japan continuously experiences current account surpluses. Explain the potential causes for this persistent divergence. Which is preferable – current account surpluses or current account deficits? Why?

6. Think through the impacts of borrowing to finance unfavorable balances on a country's current account. Is such a strategy more or less dangerous for developed countries compared to developing or, perhaps more accurately, "less-developed" countries? What are the likely impacts to the less-developed country as it adjusts to a long-term current account deficit? Explain.

7. What might prompt a country to face a shortfall in its foreign exchange reserves? How can the International Monetary Fund (IMF) stabilize a country's currency in times of crisis?

Quantitative

8. A country exports $350 billion of goods and services while it imports $500 billion worth of goods and services. IFDI is $200 billion while OFDI is $120 billion. All other accounts are negligible. What is the net change in official reserves?

9. Using the data of Table 1, answer the question below. Show your work.

Table 1. *International Investment Position of the United States*

U.S. assets abroad	
U.S. government assets	$800 billion
U.S. private assets	$200 billion
Foreign assets in the U.S.	
Foreign official assets	$600 billion
Foreign private assets	$300 billion

Consider Table 1. The U.S. balance of international indebtedness suggests that the United States is a net:

a. Debtor
b. Creditor
c. Spender
d. Exporter

10. Consider Table 2. Calculate both the current account balance and the capital account balance. Show your work.

Table 2.

Exports of goods and services	1000
Imports of goods and services	800
Net change in assets owned abroad	500
Net change in foreign owned assets at home	400
Unilateral transfers received	100
Unilateral transfers paid	200
Investment income paid to foreigners	300
Investment income received from foreigners	400