OPEN – ECONOMY MACROECONOMICS

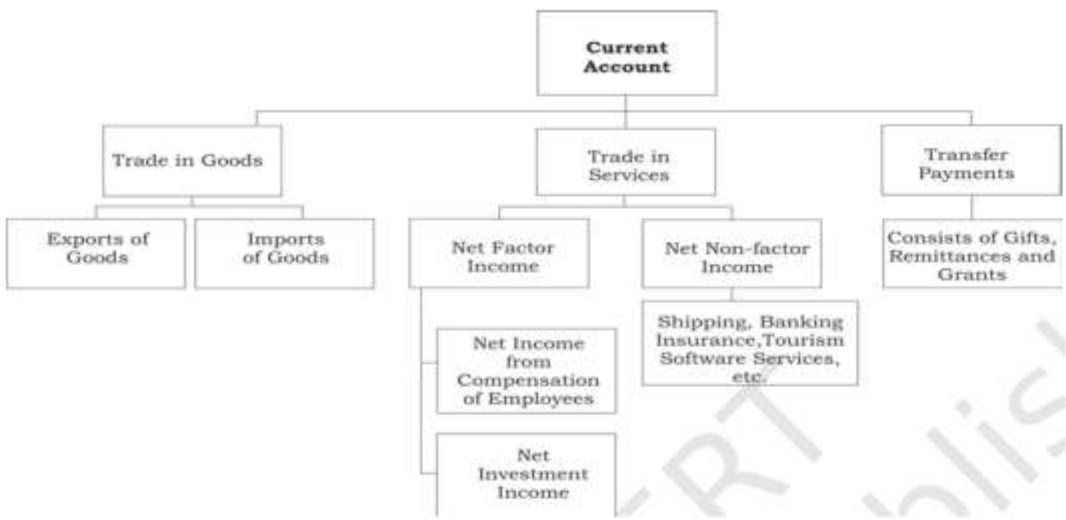
Current Account: It is the record of goods and services traded as well as transfer payments. It encompasses a country's most important activities, such as capital markets and services.

Two Components of the Current Account:

- **Balance of Trade (BOT):** It is the difference between the value of a country's exports and imports of goods over a specified timeframe. The export of products is recorded as a credit in the BOT, whereas the import of goods is recorded as a debit. It is also referred to as the Trade Balance.

- **Balance of Invisibles:** The difference between a country's exports and imports of invisible over a certain time frame is known as the balance of invisible. Services, transfers, and income movements between countries are all examples of invisible.

Fig. 6.1: Components of Current Account



Open Economy: It is one that conducts business with other countries in a range of methods. The majority of modern economies are open.

Capital Account: All overseas asset transactions are recorded in the Capital Account. An asset is any type of wealth that may be held, such as money, stocks, bonds, government debt, and so on. The purchase of assets is recorded as a debit item on the capital account.

Components of Capital Account:

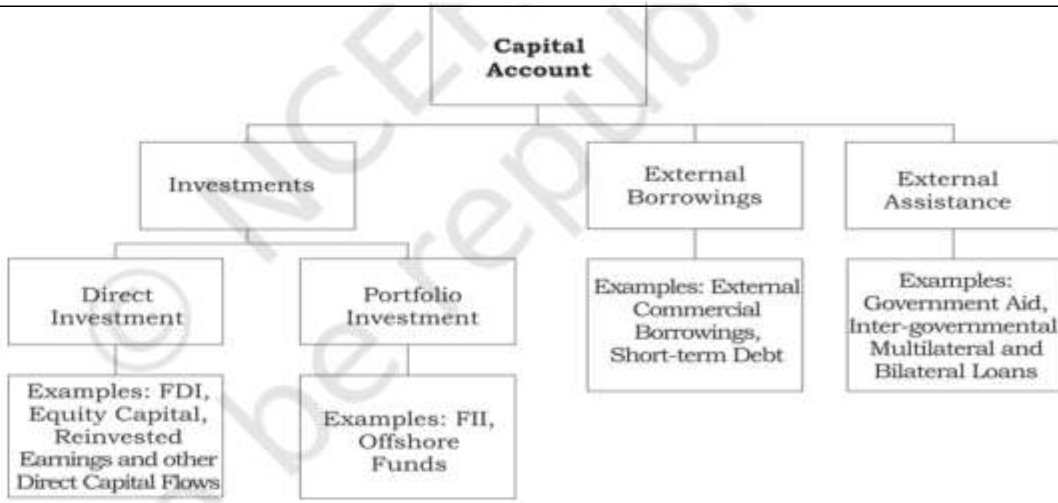
- **Investments:**

a. **Direct Investment:** Equity Capital, FDI, Reinvested Earning, and other Direct Capital Flows.

b. **Portfolio Investment**: Offshore Funds, FII.

- **External Borrowings**: Includes Short-term Debt, External Commercial Borrowings.

- **External Assistance:** Multilateral and Bilateral Loans, Government Aid, Inter-governmental Aid.



Deficit of Balance of Payment Account:

- When a country has a balance of payments deficit, it imports more goods, capital, and services than it exports. It must take from other countries in order to pay for its imports.
- A deficit in the balance of payment happens when total payment surpasses total receipts; ergo BOP = Credit < Debit.
- A deficit of the balance of payment can be amended through an official reserve deal which signifies the sale of foreign exchange by the Reserve Bank.

Autonomous Transactions:

- When international economic transactions are made for reasons other than bridging the balance of payments gap, they are referred to as autonomous transactions.
- One reason might be to make money. In the balance of payment, these items are referred to as "above the line" items.
- This type of transactions is free of the condition of the balance of payment account.
- Autonomous items allude to those international economic exchanges, which happen because of some economic intention, for example, profit maximization.

Accommodating Transactions:

- The gap in the balance of payments, or whether there is a deficit or surplus in the balance of payments, determines accommodating transactions, also known as

  "Below the line" items. In other words, the net consequences of autonomous transactions determine them.
- Accommodating transactions are repaying capital exchanges that are intended to address the disequilibrium in the balance of payments, i.e., the autonomous items.
- If the balance of payment has a surplus or deficit, accommodating transactions are carried out on purpose to balance the balance of payments surplus or deficit.

Errors and Omissions:

- It is difficult to keep accurate records of all international transactions. As a result, in addition to the current and capital accounts, there is a third element of the balance of payment called errors and omissions, which reflects this.

- The entries made under this head relate for the most part to leads and lags in the detailing of exchange
- It is a balancing entry that is expected to counterbalance the exaggerated or underestimated components.

BoP Deficit	Balanced BoP	BoP Surplus
Overall Balance < 0	Overall Balance = 0	Overall Balance > 0
Reserve Change > 0	Reserve Change = 0	Reserve Change < 0

Demand for Foreign Exchange: People require foreign exchange because they want to buy goods and services from other countries, send gifts abroad, and buy financial assets from a specific country. The demand for foreign exchange falls as the flexible exchange rate rises and vice versa.

Foreign Exchange Market:

- The foreign exchange market is the market where national currencies are exchanged for one another.

- Commercial banks, foreign exchange brokers, other authorized dealers, and monetary authorities are the main participants in the foreign exchange market.

- The foreign exchange markets are the first and most established financial markets and remain the premise whereupon the remainder of the financial edifice is built. It provides global liquidity, ideally with reasonable stability.

Foreign Exchange Rate: An exchange rate is the worth of a country's currency versus that of another nation or an economic zone, also termed as Forex rate. Most of the trade rates are free-floating and will rise or fall based on market interest on the lookout. A few monetary forms are not free-floating and have limitations. It connects different countries' currencies and allows for cost and price comparisons across territorial boundaries.

1. **Demand for Foreign Exchange:** People require foreign exchange because they want to buy goods and services from other countries, send gifts abroad, and buy financial assets from a specific country. The demand for foreign exchange falls as the flexible exchange rate rises and vice versa.
2. **Supply of Foreign Exchange:** Foreign currency flows into the home country for the following reasons - a country's exports lead to foreigners purchasing its domestic goods and services; foreigners send gifts or make transfers, and foreigners purchase a home country's assets. The foreign exchange supply has a positive relationship with the foreign exchange rate. When the foreign exchange rate rises, so does the supply of foreign exchange, and vice versa.