

The Balance of Payments

- The Balance of Payments (BOP) accounts are a summary of the nation's financial relationships with the rest of the world.
- It records the market value of goods, services and financial assets that domestic residents exchange with foreigners from other nations during an accounting period.
- There are three balance of payments concepts:
 - (a) the balance on a current account
 - (b) the balance on capital account
 - (c) the overall balance.
- The current account measures the flow of goods, services and income across national borders.
- The capital account measures the capital outflow and the capital inflow into the economy.
- The overall balance account records the transactions of reserve assets such as gold and foreign currencies by official government agencies.
- The balance of payments is a bookkeeping system that records both sides of any transactions involving domestic resident and a resident abroad.
- If the total of debit entries or import recorded in the current account exceeds the sum of the credit entries or exports and net factor incomes from abroad, then, there is a deficit in the current account and vice versa.

The sum of the current account balance and capital account balance is the overall balance that states a net debit or credit. If it is a net credit, then domestic residents are receiving more payments from abroad. This surplus in the overall balance requires the central bank to accumulate the excess foreign assets and add to its holding of foreign currencies as foreign exchange reserves.

The overall balance is achieved through official financing - the authorities absorb the finance required for overall balance by accumulating foreign exchange reserves or making a deposit with monetary authorities overseas such as the International Monetary Fund when there is an overall surplus. This accumulation of reserves is shown as a negative value of the sum of the capital and current accounts.

- A negative value to the reserves thus represents an increase in the official reserves held and a positive value is a decrease in the holding of official reserves by the central bank.