The Balance of Payments

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Definition

- The balance of payments is a systematic record of the transactions between Australian and foreign residents
- The balance of payments is made up of two components, the current account and the capital and financial account
- The two accounts must always balance

The Current Account

- The current account is made up as follows
  - The Trade Balance (Net Exports)
    - The Goods Balance
    - The Service balance
  - The Income Balance
- The trade balance is the more volatile of the two due to the fact that the goods balance often fluctuates as a result of changes in commodity prices
- The income balance will almost always be in deficit due to the existence of the savings investment gap

Reasons for the Current Account Deficit

- The Savings Investment Gap (Structural)
  - Due to Australia's high capital demands but low domestic savings firms must borrow overseas in order to meet investment demands
  - As a result interest must be payed back on these loans and this is recorded as a debit on the income balance
- Level of Economic Growth (Cyclical)
  - As economic activity increase investment demands will increase and as a result firms are forced to borrow more overseas
  - Hence as the economy the income deficit will, ceteris paribus, increase

The Capital and Financial Account

- The capital account is largely irrelevant
- The financial account is made up as follows
  - Direct Investment (+10%)
  - Portfolio Investment (Largest) (Speculative)
  - Reserve Assets

Drivers of the Current Account Balance

- The Terms of Trade
  - Impact the Trade Balance
- Australia's international competitiveness
  - Impacts our Trade Balance
- The exchange rate
  - Acts a balancing mechanism
- Australia's level of national savings
  - Impact the income balance
- Level of foreign investment
  - Impact the income balance