



Balance of Payments Statistics Workshop

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Financial Account and IIP

Introduction (financial account)

- The financial account shows transactions that take place between residents and nonresidents and involve financial assets and liabilities.
- The overall balance of the financial account is called net lending/net borrowing. Net lending means that, in net terms, the economy supplies funds to the rest of the world (acquisition and disposal of financial assets minus incurrence and repayment of liabilities).
- Net borrowing means the opposite.

Classification

- The financial account (and the IIP) is classified into five functional categories:
 - ✓ Direct Investment
 - ✓ Portfolio Investment
 - ✓ Financial Derivatives
 - ✓ Other Investment
 - ✓ Reserve Assets

Classification

- In the standard components of the BOP and the IIP, every functional category shows a breakdown by instrument and then by institutional sector and maturities (when it applies).
- Additionally, at every level of the breakdown, functional categories are shown according to them being referred to a transaction or a position related with an asset or a liability.

Classification

- Portfolio investment is shown as an example of the standard components' classification:

Portfolio Investment (BOP presentation)		
	Net Acquisition of Financial Assets	Net Incurrence of Liabilities
Equity and investment fund shares		
Central Bank		
Deposit-taking corporations		
General Government		
Other sectors		
Other financial corporations		
Nonfinancial corporations,households,and NPISHs		
Debt securities		
Central Bank		
Short term		
Long term		
Deposit-taking corporations		
Short term		
Long term		
General Government		
Short term		
Long term		
Other sectors		
Short term		
Long term		
Other financial corporations		
Short term		
Long term		
Nonfinancial corporations,households,and NPISHs		
Short term		
Long term		

Financial Account (BPM5 vs BPM6)

- In BPM5 the financial account flows were separated into those that showed inflows (credits) and those that showed outflows (debits).
- The BPM6 gives precedence to the separation of the flows according to them being related to a transaction in assets or to a transaction in liabilities, rather than being inflows (credits) or outflows (debits).
- Increases in both, assets and liabilities, are shown with positive signs.

BOP Presentation

BALANCE OF PAYMENTS

	Credits	Debits	Net
Current Account			
Goods and Services			
Goods			
Services			
Primary Income			
Secondary Income			
Capital Account			
Nonproduced Nonfinancial assets			
Capital Transfers			
	Net Acquisition of Assets	Net Incurrence of Liabilities	Net
Financial Account			
Direct Investment			
Portfolio Investment			
Financial Derivatives			
Other Investment			
Reserve Assets			
Errors and Omissions			

BOP (signs)

Financial Account	
(signs)	
Net Acquisition of Assets	Net Incurrence in liabilities
+ (Increase/Debit)	+ (Increase/Credit)
- (Decrease/Credit)	- (Decrease/Debit)

International Investment Position (IIP)




- The IIP is a statistical statement that shows at a point in time the value and composition of:
 - ✓ Financial assets of residents of an economy that are claims on nonresidents and gold bullion held as reserve assets, and
 - ✓ Liabilities of residents of an economy to nonresidents

Integrated IIP

- The international accounts (balance of payments, international investment position as well as other changes in financial assets and liabilities) can be put together in the Integrated Statement of the International Investment Position.
- This statement shows, for every period, how to move from an initial position to a final position by means of:
 - ✓ Balance of payments transactions (financial account)
 - ✓ Other changes in the financial assets and liabilities

IIP Presentation

INTEGRATED INTERNATIONAL INVESTMENT POSITION								
Position at the Beginning of the Period		Net Acquisition of Assets	Net Incurrence of Liabilities	Net	Other Changes in Financial Assets and Liabilities			Position at the End of the Period
					Changes in Volume	Revaluations		
						Exchange Rate Changes	Other Price Changes	
	Direct Investment Portfolio Investment Financial Derivatives Other Investment Reserve Assets							

-  International Investment Position
-  Financial Account
-  Other Changes in Financial Assets and Liabilities

Integrated IIP

INTEGRATED INTERNATIONAL INVESTMENT POSITION STATEMENT

		Credits	Debits	Net				
		Current Account Goods and Services Goods Services Primary Income Secondary Income Capital Account Nonproduced Nonfinancial assets Capital Transfers						
Position at the Beginning of the Period		Net Acquisition of Assets	Net Incurrence of Liabilities	Net	Other Changes in Financial Assets and Liabilities			Position at the End of the Period
					Changes in Volume	Revaluations		
						Exchange Rate Changes	Other Price Changes	
	Financial Account Direct Investment Portfolio Investment Financial Derivatives Other Investment Reserve Assets							
	Errors and Omissions							

Other Changes in Financial Assets and Liabilities(OCAL)

- Shows changes in financial positions that arise for reasons other than transactions between residents and nonresidents.
- Other changes differ from transactions in terms of their economic nature and accounting entries.
- A transaction is an interaction between two institutional units by mutual agreement.
- “Other changes” are changes in the value or volume of assets and liabilities that arise from other economic events.

OCAL

- As already stated, apart from the financial account and the IIP, the OCAL account is fundamental to explain the whole international accounts set.

IIP	Initial Position
Financial Account	+ Transactions in the period (financial account)
Other Changes in Financial Assets and Liabilities	+ Other changes in volume + Revaluations during the period attributable to: Exchange rate variations Changes in other prices
IIP	Final Position

OICAL Presentation

Other Changes in Financial Assets and Liabilities		
	Revaluations	
Changes in Volume	Exchange Rate Changes	Other Price Changes

OICAL (volume changes)

- Any changes in the value of assets and liabilities that are due neither to transactions nor to revaluation.
- ✓ Reclassifications (no effect on net IIP): whenever a financial asset or liability changes its characteristics or status without there having been a cross-border transaction.
 - Conversion of loans into debt securities (negotiable loans).
 - **Default of debts.**
 - Transactions between residents (different sectors) of existing foreign assets/liabilities.
 - Changes of functional category (FDI-PI).

OICAL (volume changes)

✓ Other volume changes:

- **Accounting cancellations and write-offs:** Debt renegotiations may imply the reduction of the outstanding position by recognizing a market situation and therefore is not a transaction (no BOP entry)*.
- **The economic surge and extinction of assets:** One economic unit takes possession of another economic unit's asset without full compensation (expropriation), the difference between the payment and the market value of the asset is a volume change. Also, destruction of assets for natural reasons is a volume change
- **Change of residence of an economic agent:** All assets and liabilities this agent had in the economy of his previous residence become assets and liabilities of his new economy of residence.

**Whenever a debt is condoned by the creditor due to his own will (not forced by market conditions) there is no OICAL. This case is regarded as a capital transfer meant to finance the repayment of the debt and therefore is recorded in the capital account.*

OCAL (volume changes)

Debt cancellation

In order to support Nicaragua, the US government cancels a 300 debt loan it had previously granted to the Nicaraguan government. In the same period, the Nicaraguan government is offering to exchange Nicaraguan Treasury Bonds at half their nominal value because it is no longer able to repay at full value. A US investor accepts the deal and exchanges old bonds of 100 for new bonds of 50.

Nicaragua (IIP Integrated Statement)					
	Initial Position	BOP Transactions		OCAL Volume	Final Position
		Credits	Debits		
Current Account					
Capital Account					
Transfers		300			
		Assets	Liabilities		
IIP Net	-400				-50
Liabilities					
Financial Account	400		-300	-50	50
Portfolio Investment					
Debt Securities					
General Government	100			-50	50
Other Investment					
Loans					
General Government	300		-300		0

OCAL (volume changes)

Expropriations

A local firm with FDI abroad is expropriated by the government of the country where its affiliates are located. The foreign government compensates the resident firm with 200, an amount that is equivalent to 40% of the the total equity of those affiliates.

	Initial Position	BOP Transactions		OCAL Volume	Final Position
		Assets	Liabilities		
Assets	500	0		-300	200
Direct Investment					
Equity	500	-200		-300	0
Other Investment					
Currency and Deposits	0	200		0	200

OCAL (volume changes)

Change of residence of an economic agent

A Bahamian national changed his residence from New York to Nassau. His NY bank account has an outstanding balance of 100, his apartment there is worth 500 and the outstanding value of his mortgage is 200.

	Initial Position	BOP Transactions		OCAL Volume	Final Position
		Assets	Liabilities		
NET IIP	0			400	400
Assets	0	0		600	600
Financial Account					
Direct Investment	0			500	500
Other Investment					
Currency and Deposits	0			100	100
Liabilities	0		0	200	200
Other Investment					
Loans	0			200	200

OICAL (volume changes)

✓ Monetization/Demonetization:

- Change in the classification of gold bullion from nonmonetary to monetary (demonetization is the opposite).
- When a monetary authority sells gold bullion (reserve assets) to a nonmonetary nonresident agent there is an export of gold (goods) and a gold bullion demonetization that is shown as OICAL for the monetary authority.
- If this sale is made to a nonmonetary resident agent there is no international transaction (no BOP) but there is gold demonetization.

OICAL (revaluations)

- They occur as a consequence of changes in the money value of financial assets and liabilities.
- ✓ **Exchange rate changes.** They arise as a result of variations in relative exchange rates between the currency of denomination of an asset/liability and the recording currency of the statistics.
- ✓ **Other price changes.** Price variations of a different origin, like volatility in the price of the assets.

OICAL (revaluations)

Exchange rate variations

The local government received a 100 million euros loan from the German government in a period when the euro was worth 0.80 per US dollar. In the current period the euro deppreciates and the new exchange rate is 1/1. National BOP and IIP statistics are shown in US dollars.

	Initial Position	BOP Transactions		OICAL Exchange Rate	Final Position
		Assets	Liabilities		
Liabilities	125			-25	100
Other Investment					
Loans	125			-25	100

OICAL (revaluations)

Other prices variations

At the beginning of the year a resident investor has 1,000 shares of a non resident firm, the price of each share is one dollar. During the recording period the price of the shares increases 15%. The investor's share in the firm is 8%.

	Initial Position	BOP Transactions		OCAL Other Prices	Final Position
		Assets	Liabilities		
Assets	1,000			150	1,150
Portfolio Investment					
Equity	1,000			150	1,150

OCAL

Year 1

- An investor from country A acquires a firm in country B for 1,200 million dollars.
- To finance this acquisition, the investor issues bonds in the European market by 500 million euros payable in 10 years, the rest is financed with his own funds.
- The exchange rate euro/dollar is 1.1 euros per dollar.

Year 2

- The euro/dollar exchange rate is 1/1.
- The government of country B expropriates the firm. For this purpose it offers to pay only 60% of the equity as follows:
 - 1) One half with cash directly to the investors.
 - 2) The other half selling shares to local investors.
- Because of the expropriation, the firm in country A faces financial troubles, therefore the price of the bonds in the European market have dropped 30%. The firm itself buys them back, half in the secondary market (30% off) and the other half with no discount.

OCAL (exercise)

Year 1

	Initial Position	BOP Transactions		OCAL			Final Position
		Assets	Liabilities	Exchange Rate	Other Prices	Volume	
Net IIP	10,000.0						10,000.0
Assets	10,000.0	454.5					10,454.5
Direct Investment	0.0	1,200.0					1,200.0
Portfolio Investment							
Other Investment							
Currency and Deposits	10,000.0	-745.5					9,254.5
Liabilities	0.0		454.5				454.5
Direct Investment							
Portfolio Investment	0.0		454.5				454.5

OICAL (exercise)

Year 2

	Initial Position	BOP Transactions		OICAL			Final Position
		Assets	Liabilities	Exchange Rate	Other Prices	Volume	
Net IIP	10,000.0			-38.6	68.2	-480.0	9,549.5
Assets	10,454.5	-425.0		0.0	0.0	-480.0	9,549.5
Direct Investment	1,200.0	-720.0				-480.0	0.0
<i>Cash</i>		<i>-360.0</i>				<i>-240.0</i>	
<i>Sale of shares</i>		<i>-360.0</i>				<i>-240.0</i>	
Other Investment	9,254.5	295.0		0.0	0.0	0.0	9,549.5
Currency and Deposits	9,254.5	295.0		0.0	0.0	0.0	9,549.5
<i>Expropriation</i>		<i>360.0</i>					
<i>Sale of shares</i>		<i>360.0</i>					
<i>Bonds Par</i>		<i>-250.0</i>					
<i>Bonds discount</i>		<i>-175.0</i>					
Liabilities	454.5		-425.0	38.6	-68.2	0.0	0.0
Portfolio Investment	454.5		-425.0	38.6	-68.2	0.0	0.0
<i>Bonds Par</i>	<i>227.3</i>		<i>-250.0</i>	<i>22.7</i>			<i>0.0</i>
<i>Bonds discount</i>	<i>227.3</i>		<i>-175.0</i>	<i>15.9</i>	<i>-68.2</i>	<i>0.0</i>	<i>0.0</i>

-227.3*1.1

-227.3*0.7*1.1

(227.3*1.1)-(227.3*1)

(227.3*0.7*1.1)-(227.3*0.7*1)

-227.3*0.3

Errors and Omissions

- The double entry system used in BOP accounting requires the recording of two entries for each transaction of the same size and opposite sign.
- For example, an export record (credit/inflow) has to be matched by a counter-entry (debit/increase in assets/decrease in liabilities/outflow) of the same amount.

Balance of Payments		
	Credit	Debit
Current Account		
Goods	X	
	Net Increase in Assets	Net Incurrence in Liabilities
Financial Account		
Other Investment		
Currency and Deposits	A	
Trade Credit and Advances	C	
Other Accounts Receivable	D	
Reserve Assets	B	

A: Paid in cash and deposited abroad in the exporter's banking account.

B: Paid in cash. The foreign currency was sold to the central bank.

C: The exporter granted trade credit to the importer.

D: The importer issues a document recognizing the amount owed to the exporter.

Errors and Omissions

- Whenever the BOP compiler is unable to identify the counter-entry for an identified transaction or whenever he/she finds it with a different value, a residual will arise. This residual is known as errors and omissions.

An exports transaction is reported in the customs records with a value of 100.

The exporter sells 60 to the resident central bank and gets local currency.

The rest is deposited in a banking account abroad.

The BOP compilers are not able to get information on residents' banking accounts abroad.

Balance of Payments			
	Credit	Debit	Net
Current Account			
Goods	100		100
	Net Increase in Assets	Net Incurrence in Liabilities	Net
Financial Account			-60
Other Investment			
Currency and Deposits			
Reserve Assets	60		-60
Errors and Omissions			-40

Errors and Omissions

- Therefore, this item arises because in practice, counterpart entries recorded by the compilers in the BOP statement are frequently over/under valued (errors) or they are simply not recorded at all (omissions).
- An alternative way to interpret errors and omissions, is that they are that part of the changes in the reserve assets that is not being explained by the rest of the transactions in the statistical statement.

Errors and Omissions

The following two examples show how errors and omissions arise. In the first case all recorded transactions, other than reserves, add up to a net income of 95 whereas reserves show an increase of 95. Therefore, no errors and omissions arise. In the second case, the transactions recorded amount to a net income of 110 whereas reserves again grow by 95, leaving a net outflow of 15 unexplained (errors and omissions).

BALANCE OF PAYMENTS

	Credits	Debits	Net	
Current account	100	120	-20	
Capital account	15	10	5	
	Net acquisitions of assets	Net incurrence in liabilities	Net	
Financial Account	135	150	15	
Reserve assets	95		-95	
Other financial account items	40	150	110	
Errors and Omissions			0	= (95) - (-20+5+110)

	Credits	Debits	Net	
Current account	100	120	-20	
Capital account	15	10	5	
	Net acquisitions of assets	Net incurrence in liabilities	Net	
Financial Account	120	150	30	
Reserve assets	95		-95	
Other financial account items	25	150	125	
Errors and Omissions			-15	= (95) - (-20+5+125)

Errors and Omissions

- A small or even zero value in errors and omissions doesn't necessarily mean that the BOP statement is adequately capturing all or most of the relevant transactions.
- It can also mean that large "credit" transactions are being omitted or highly miss-valued at the same time that other large "debit" transactions are also being omitted or highly miss-valued.
- The sign of "errors and omissions" indicates the kind of transactions that are being omitted or miscalculated. A negative sign suggests that debit transactions are being underestimated or that credit transactions are being overestimated.