Exercise walk-through

Current account of the balance of payments ▪ 6.3

eXercise

You must be able to

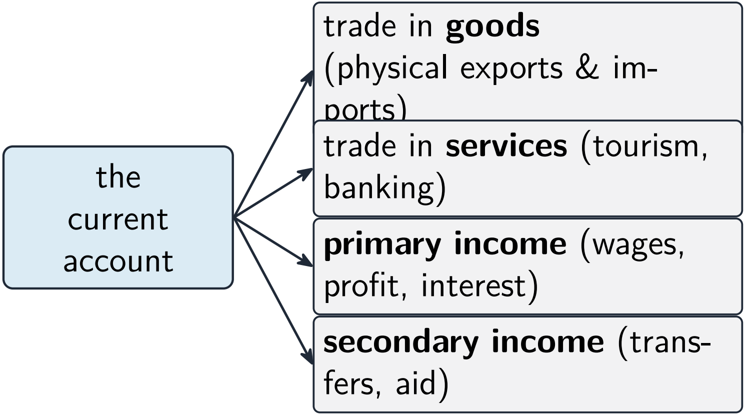
- state the four parts of the current account
- explain a current account deficit and surplus
- analyse the causes and consequences of a current account deficit

Method — The current account

- **Trade in goods 货物贸易** and **trade in services 服务贸易** (exports − imports of each).
- **Primary income 初次收入**: income from work and investment abroad. **Secondary income 二次收入**: transfers (e.g. aid).
- **Deficit 赤字**: a country buys more from abroad than it sells. **Surplus 盈余**: the opposite.
- A long deficit can mean rising debt to other countries.

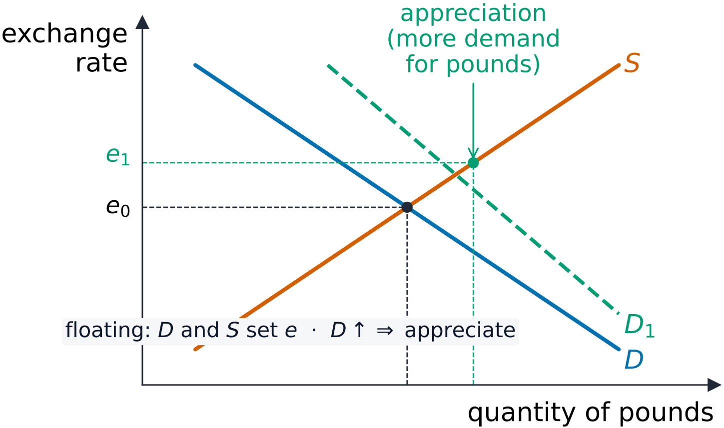
Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

Method — The current account



The current account adds up four flows

Method — The current account



A persistent deficit means more of the currency is sold, pushing its value down

Practice 2.1 ▪ 2 marks

State the four parts of the current account.

Solution 2.1

Method: The current account

Worked steps

trade in goods; trade in services; primary income; secondary income (2 for all four; 1 for two or three).

Practice 2.2 ▪ 2 marks

Define the term *current account deficit*.

Solution 2.2

Method: The current account

Worked steps

when the money leaving a country for imports and other current-account outflows exceeds the money entering from exports and inflows (2 for a clear definition; 1 for a partial idea).

Practice 2.3 ▪ 1 mark

State one cause of a current account deficit.

Solution 2.3

Method: The current account

Worked steps

any one of: a strong currency making exports dear; high domestic demand pulling in imports; low competitiveness; high inflation (1).

Exam-style 3.1 ▪ 1 mark

Which is part of the **current account**?

A the sale of government bonds to foreigners

B trade in services

C foreign direct investment

D changes in foreign currency reserves

Solution 3.1

Method: The current account

A the sale of government bonds to foreigners

B trade in services ✓

C foreign direct investment

D changes in foreign currency reserves

Worked steps

B. Trade in services is part of the current account.

Exam-style 3.2 ▪ 6 marks

Explain two reasons why a country might run a current account deficit.

Solution 3.2

Method: The current account

Worked steps

[6] For **each** of two reasons: AO1 1 + AO3 up to 2 — e.g. *strong currency*: a high exchange rate makes exports dear and imports cheap $\rightarrow$ more imports, fewer exports $\rightarrow$ deficit. *High domestic demand*: rising incomes raise spending on imports $\rightarrow$ the import bill grows $\rightarrow$ deficit. Maximum 3 each.

Exam-style 3.3 ▪ 12 marks

Discuss whether a current account deficit is always a problem for an economy.

Solution 3.3

Method: The current account

Worked steps

[12] AO1/AO2/AO3 up to 8 + AO4 up to 4. **A problem if:** it is large and persistent, financed by rising debt, and signals poor competitiveness. **Not always:** a deficit caused by importing capital goods can raise future capacity, and a country with strong investment inflows can sustain it. Judgement: a small, temporary deficit from investment is not a worry, but a large, persistent one financed by borrowing is — it depends on the cause and how it is financed.