Exercise walk-through

Current account of the balance of payments ▪ 6.4

eXercise

You must be able to

- state the four sections of the current account
- explain a current account deficit and surplus
- analyse policies to correct a deficit

Method — The current account

- **Four sections: trade in goods 货物贸易**, **trade in services 服务贸易**, **primary income 初次收入** (wages, interest, profit from abroad), **secondary income 二次收入** (aid, gifts).
- **Deficit 逆差**: more money flows out than in. **Surplus 顺差**: more flows in than out.
- **Correct a deficit by:** cutting demand, a **depreciation 贬值**, trade protection, or raising **competitiveness 竞争力**.

Answer shapes: K + App + An + Ev (a justified judgement, for discuss questions).

Method — The current account

Cargo ships carry goods — the trade-in-goods part of the current account

Method — The current account

Appreciation

(currency rises in value)

exports dearer,
imports cheaper →
exports fall, imports rise

Depreciation

(currency falls in value)

exports cheaper,
imports dearer →
exports rise, imports fall

Exam: appreciation hurts export competitiveness; depreciation can boost net exports (SPICED)

How a stronger or weaker currency feeds through to export and import prices

Practice 2.1 ▪ 2 marks

State the four sections 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 more money flows out of a country than into it on the current account (it buys more from abroad than it sells) (2 for a clear definition; 1 for a partial idea).

Practice 2.3 ▪ 1 mark

State one way a government could reduce a current account deficit.

Solution 2.3

Method: The current account

Worked steps

any one of: cut total demand; let the currency depreciate; use trade protection; raise competitiveness (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 the country's gold reserves

D a loan from a foreign bank

Solution 3.1

Method: The current account

A the sale of government bonds to foreigners

B trade in services ✓

C the country's gold reserves

D a loan from a foreign bank

Worked steps

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

Exam-style 3.2 ▪ 4 marks

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

Solution 3.2

Method: The current account

Worked steps

[4] For **each** of two reasons: K 1 + An 1 — *high demand for imports*: rising incomes mean people buy more foreign goods → imports exceed exports; *low competitiveness*: home goods are dear or low-quality → exports are low while imports are high → a deficit.

Exam-style 3.3 ▪ 8 marks

Discuss whether a current account deficit is always a problem for a country.

Solution 3.3

Method: The current account

Worked steps

[8] K/App/An up to 5 + Ev up to 3. **A problem if:** it is large and persistent, the country must borrow or sell assets to pay for it, and it signals weak competitiveness. **Not always:** a deficit caused by importing machines and capital goods can raise future output, and a country with strong investment inflows can sustain one. **Judgement (Ev):** a small, temporary deficit (especially to buy capital goods) is not a worry, but a large, lasting one financed by borrowing is — so it depends on the cause and how it is financed.