Analyzing the External Sector

Overview

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Overview

I. Basic Structure of Balance of Payment
II. Useful Concepts & Indicators
   1. Exchange Rate
   2. What Determines Exchange Rate?
   3. Real (Effective) Exchange Rate
   4. External Competitiveness

I. Basic Structure of Balance of Payment

Above the line

- Current Account
- Capital and Financial Account
- Errors and omissions

Overall Balance

Below the line

- Financing

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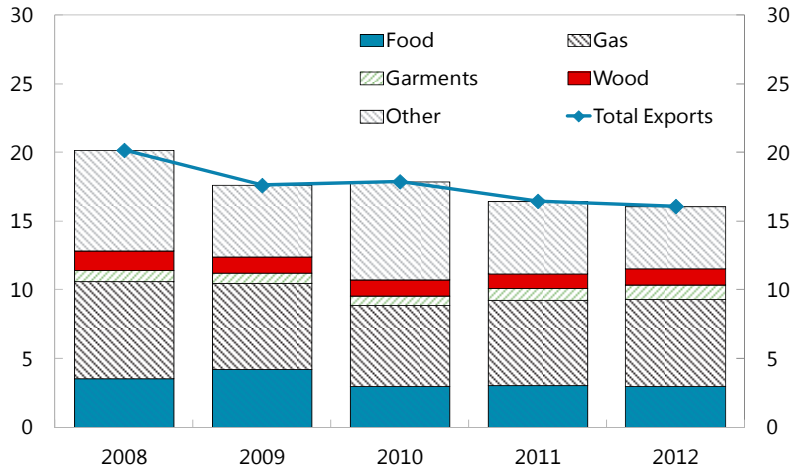
Basic Structure of Current Account Balance (Real Transactions)

- Trade Balance (Goods) = Exports – Imports
- Trade Balance (Services) = Exports – Imports
- Net Income (e.g., Interest, Profit Repatriation)
- Net Transfers (Official, Private)

Current Account Balance

Main Exports

(In percent of GDP)



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Basic Structure of Financial and Capital Account Balance (Financial Transactions)

Capital Account *(e.g., Debt forgiveness)*

Financial Account

Direct Investment

Portfolio Investment

Other Investment (e.g., net loans—disbursements minus repayment; currency and deposits)

Financial and Capital Account Balance

Basic Structure: Financing

Flows	Stocks
-Overall Balance = Financing	
Change in Net Financial Reserves	→ Foreign Reserve Levels
Change in Arrears	→ Stock of Arrears
Exceptional Financing	

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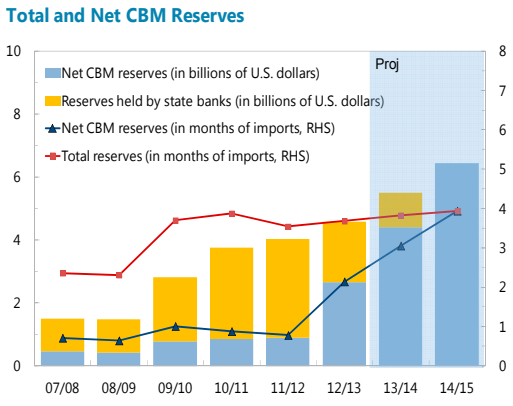
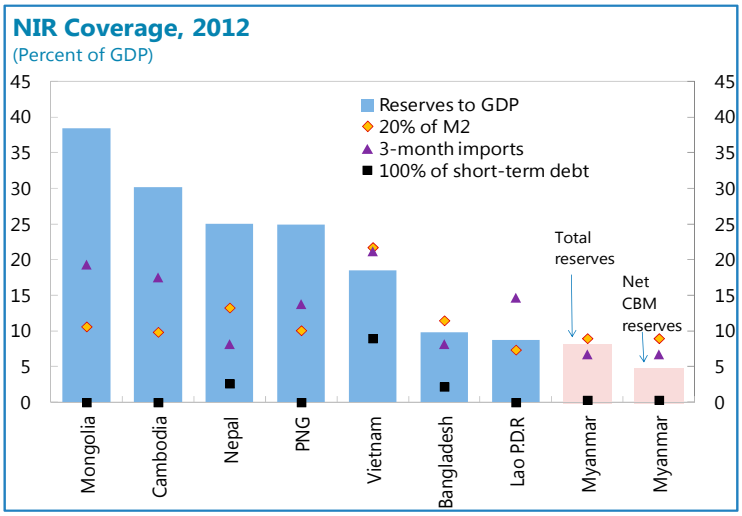
Reserve Adequacy

- In relation to trade: import coverage
  - Rule of thumb: reserves should cover 3 months of imports
- In relation to capital flows: how vulnerable is country to sudden capital outflow?





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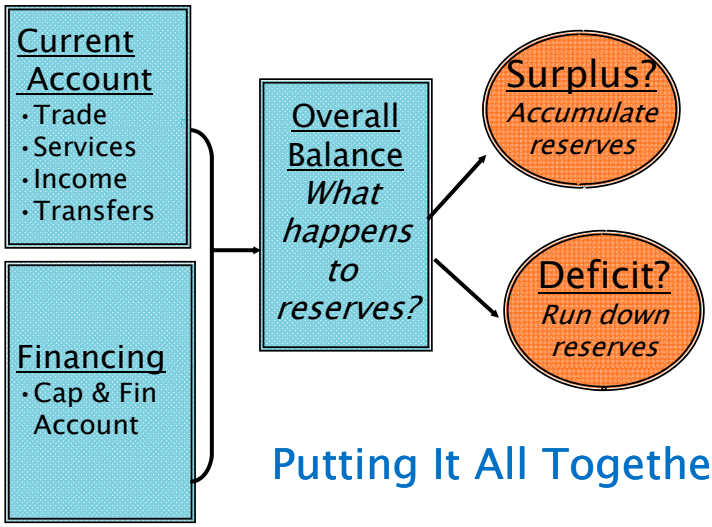

Putting It All Together …

Analzying Myanmar's BOP

Exercise

What are the most important positions in Myanmar's BOP?

- Analysis in US$ and GDP terms
- What to look for?
  - Explain IMF chart
  - Reserve adequacy

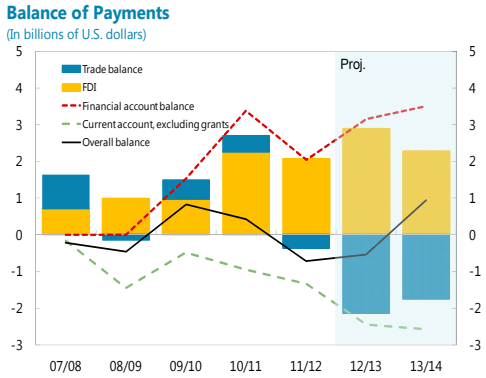

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Table 3. Myanmar: Balance of Payments, 2009/10–2013/14
(In millions of US$, unless otherwise indicated)

	2009/10	2010/11	2011/12	2012/13 Est.	2013/14 Proj.
Current account	-489	-952	-1,338	-2,452	-2,578
Trade balance	512	445	-371	-2,140	-1,760
Exports, fob	7,578	8,629	10,065	10,288	11,803
Of which: Gas	2,927	2,523	3,282	3,563	4,311
Imports, mostly cif	-7,067	-8,184	-10,437	-12,428	-13,563
Nonfactor services, net	-204	-482	-432	-74	-79
Income, net	-1,103	-1,145	-1,024	-747	-1,356
Of which: Interest due	-289	-306	-560	-94	-174
Transfers, net	307	231	490	509	618
Official	85	64	41	28	98
Private	222	167	449	481	519
Capital and financial account	1,533	3,388	2,043	3,156	3,516
Direct investment, net	963	2,249	2,057	2,880	2,261
Other investment	207	114	4	926	1,354
MLT debt disbursements	564	500	605	1,085	1,560
Repayments due	-357	-386	-600	-159	-206
Other flows	363	1,025	-19	-650	-100
Errors and omissions	-212	-2,018	-1,430	-1,241	0
Overall balance	832	418	-725	-537	938
Financing	-832	-418	725	537	-938
Gross official reserves (increase: -)	-1,329	-945	-272	-537	-938
Change in arrears (increase: +)	498	528	997	-6,056	-4,792
Exceptional financing (positive: +)	0	0	0	6,056	4,792

II. Useful Concepts & Indicators

Exchange Rate

Kyat-US dollar exchange rate:

- Devaluation
- Appreciation

For what does the exchange rate matter?

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What Determines Exchange Rate?

- Availability of foreign exchange

Depends on …

→Balance of Payment (in general)

→Overall balance (in particular)

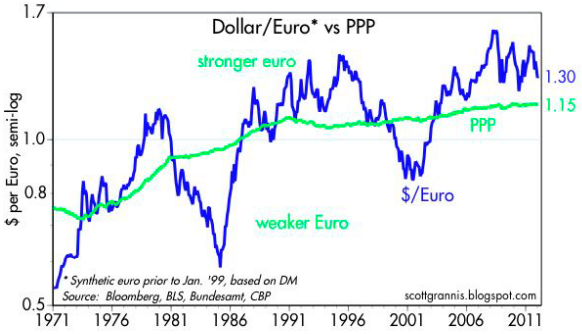
What Determines Exchange Rate? (cont.)

- Price differential:

Similar good in two countries should cost about the same

→ exchange rate corrects for price differential

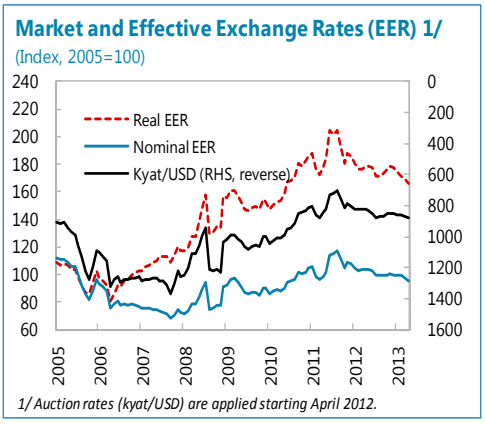
→ Called 'Purchasing Power Parity'



Real (Effective) Exchange Rate

Comparing the price level in Myanmar with that of other countries, all expressed in kyat:

$$RER = \frac{CPI^{kyat}_{Myanmar}}{CIP^{US\$}_{US} \cdot \frac{kyat}{US\$}} = \frac{CPI^{kyat}_{Myanmar}}{CIP^{kyat}_{US}}$$



External Competitiveness

Example of real exchange rate and exports:

$$\text{Export volume} = f(\text{PD}/\text{PD}^* \cdot \text{ER}); \text{YR}^*; \ldots)$$

Price effect (-)

Foreign income effect (+)

where:

- ER = nominal exchange rate (in home currency per $)
- PD = domestic price level (in home currency)
- PD* = foreign price level (in $)
- YR* = foreign income (proxied by real GDP)

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Thank You!

The concepts discussed here provide you with an introduction to the external sector but there is much more!