25.1 The Balance of Payments Account (BOP Account)

1. The balance of payments account consists of the current account and the capital and financial account.

2. All receipts and obligations received from non-residents are recorded on the *(credit / debit)* side and all payments and liabilities to non-residents are recorded on the *(credit / debit)* side.

3. The components of the current account are goods, services, income and current transfers.

4.

Balance of visible trade	= (	Value of domestic exports of goods	+	Value of re-exports of goods	)	–	Value of imports of goods

5. When the value of total exports of goods is smaller than the value of imports of goods, the balance of visible trade is *(positive / negative)* and there is a visible trade *(surplus / deficit)*.

6.

Balance of invisible trade	=	Value of exports of services	–	Value of imports of services

7. In the current account, the component of income is also known as external factor income flows. The difference between income receivable from abroad and income payable abroad is known as the net income from abroad/net factor income from abroad.

8. The difference between current transfers from abroad and current transfers to abroad is known as the net current transfers.

9.

Current account balance	=	Visible trade balance	+	Invisible trade balance	+	Net income from abroad	+	Net current transfers

©Aristo Educational Press Ltd.

10. Which of the following would be included in the calculation of Hong Kong's current account balance?

☑ A Hong Kong resident purchases travel insurance from a Japanese insurance company.

☐ A Mainland resident buys a property in Hong Kong.

☐ A Hong Kong resident buys an air ticket to South Korea from a Hong Kong airline.

☐ A Hong Kong resident buys shares listed in the United States.

☑ A Hong Kong resident donates money to a charity organisation in Indonesia.

☑ A Hong Kong resident who owns a property in the Mainland receives rent from tenants.

☑ A French chef who lives in Hong Kong remits money to his family in France.

11. Explain how Hong Kong's current account will be affected by the following events.

(a) A Hong Kong resident buys souvenirs during his trip to Japan.

Imports of services will increase. This will reduce Hong Kong's current account surplus (or enlarge its deficit).

(b) A Hong Kong firm imports raw materials from the Mainland.

Imports of goods will increase. This will reduce Hong Kong's current account surplus (or enlarge its deficit).

(c) An Australia resident donates money to a charity organisation in Hong Kong.

Current transfers from abroad will increase. This will enlarge Hong Kong's current account surplus (or reduce its deficit).

12. Refer to the following information about the balance of payments account of a country.

Item	$ billion
Exports of goods	30
Imports of goods	45
Exports of services	25
Imports of services	10
Net factor income from abroad	10
Net current transfers	−30
Decrease in reserve assets	5

Based on the above information,

(a) the current account *(surplus / deficit)* is $20 billion.

(b) the balance of payments *(surplus / deficit)* is $5 billion.

©Aristo Educational Press Ltd.

25.2 Introduction to Exchange Rate

13. An exchange rate is the price of a currency in terms of another currency.

14. There are two main types of exchange rate systems: floating exchange rate system and fixed exchange rate system (pegged exchange rate system).

15. When a currency *(appreciates / depreciates)*, each unit of the currency can be exchanged for more of another currency.

25.3 Effects of a Change in the Exchange Rate

16. The following table shows a change in the exchange rate between the Hong Kong dollar (HKD) and the Australian dollar (AUD).

Year X	Exchange rate
September	HKD 1 = AUD 5.7
November	HKD 1 = AUD 5.5

(a) During the above period,

- the Hong Kong dollar has *(appreciated / depreciated)* against the Australian dollar; the Australian dollar has *(appreciated / depreciated)* against the Hong Kong dollar.
- the number of Australian tourists visiting Hong Kong will *(increase / decrease)*.
- the number of Hong Kong tourists visiting Australia will *(increase / decrease)*.
- the price of imports from Australia (in terms of Hong Kong dollars) will *(increase / decrease / remain unchanged)*.
- the price of imports from Australia (in terms of Australian dollars) will *(increase / decrease / remain unchanged)*.
- the volume of imports from Australia will *(increase / decrease)*.
- the total value of imports from Australia (in terms of Hong Kong dollars) *(will increase / will decrease / may increase, decrease or remain unchanged)*.
- the total value of imports from Australia (in terms of Australian dollars) *(will increase / will decrease / may increase, decrease or remain unchanged)*.
- the price of Hong Kong's exports to Australia (in terms of Hong Kong dollars) will *(increase / decrease / remain unchanged)*.
- the price of Hong Kong's exports to Australia (in terms of Australian dollars) will *(increase / decrease / remain unchanged)*.
- the volume of Hong Kong's exports to Australia will *(increase / decrease)*.
- the total value of Hong Kong's exports to Australia (in terms of Hong Kong dollars) *(will increase / will decrease / may increase, decrease or remain unchanged)*.
- the total value of Hong Kong's exports to Australia (in terms of Australian dollars) *(will increase / will decrease / may increase, decrease or remain unchanged)*.

©Aristo Educational Press Ltd.

(b) If the demand for imports from Australia is inelastic, the percentage increase in price will be *(larger / smaller)* than the percentage decrease in quantity demanded. The value of imports from Australia to Hong Kong (in terms of HKD) will *(increase / decrease)*, as shown below:

17. The table below shows a change in the exchange rate between the Hong Kong dollar (HKD) and the euro (EUR).

Year X	Exchange rate
January	HKD 1 = EUR 9.2
December	HKD 1 = EUR 9.0

Suppose the price of European jewellery (in terms of euros) did not change. Explain why the above change in the exchange rate would result in a decrease in the total export value of European jewellery (in terms of euros) to Hong Kong.

The euro has appreciated against the Hong Kong dollar. As the price of European jewellery (in terms of euros) did not change, the price of European jewellery (in terms of Hong Kong dollars) would increase, and Hong Kong would import less European jewellery. The demand for European jewellery would decrease. The quantity transacted would decrease. Thus, the total export value of European jewellery (in terms of euros) would decrease.

25.4 The Linked Exchange Rate System in Hong Kong

18. Under the linked exchange rate system in Hong Kong,

- the note-issuing banks can sell Hong Kong dollars to the Exchange Fund in return for US dollars at a fixed rate of US$1 to HK$7.8.
- when the US dollar depreciates against other currencies, the Hong Kong dollar *(appreciates / depreciates)* against other currencies accordingly.

©Aristo Educational Press Ltd.