BISMA

I INTERNAL EXAM PAPER 2019

MBA I Sem International Financial Management

Set- B [Solution]

Q.1 What do you mean by balance of Payment?

Balance of payments (BOP) accounts are an accounting record of all monetary transactions between a country and the rest of the world. These transactions include payments for the country's exports and imports of goods, services, financial capital, and financial transfers.

The IMF definition

The International Monetary Fund (IMF) use a particular set of definitions for the BOP accounts, which is also used by the Organization for Economic Cooperation and Development (OECD), and the United Nations System of National Accounts (SNA).

The main difference in the IMF's terminology is that it uses the term "financial account" to capture transactions that would under alternative definitions be recorded in the *capital account*. The IMF uses the term *capital account* to designate a subset of transactions that, according to other usage, form a small part of the overall capital account.[6] The IMF separates these transactions out to form an additional top level division of the BOP accounts. Expressed with the IMF definition, the BOP identity can be written:

The IMF uses the term *current account* with the same meaning as that used by other organizations, although it has its own names for its three leading sub-divisions, which are:

The goods and services account (the overall trade balance)

The primary income account (factor income such as from loans and investments)

The secondary income account (transfer payments)

Q. Explain the current account, capital account of balance of Payment?

Or

What are factors affecting the components of BOP account?

Current Account transactions: The Current accounts records the transaction in merchandise and invisibles with the rest of the world.

Merchandise covers imports and exports and invisibles includes travel transportation insurance , investment and other services. The current account mainly consists of 4 types of transactions.

Exports and imports of goods

{Exports of goods are credits (+) to the current account { Imports of goods are debits (-) to the current account

Exports and imports of services

{Exports of services are credits to the current account (+) {Imports of services are debits to the current account (-).

{Interest, dividends and other income received on U.S. assets held abroad are

Credits

(+)

{Interest, dividends and payments made on foreign assets held in the U.S. are

Debits

(-).

Since 1994, the U.S. has run a net debit in the investment income account: more payments are made to foreigners than foreigners make to U.S. investors.

Current transfers

{Remittances by Americans working abroad, pensions paid by foreign countries to their citizens living in the U.S., aid offered by foreigners to the U.S. count as credits.

{ Remittances by foreigners working in the U.S., pensions paid by the United States to its citizens living abroad, aid offered to foreigners by the U.S. count as debits (-) As expected the U.S. runs a deficit in current transfers.

The sum of these components is known as the current account balance. A negative number is called a current account deficit and a positive number called a current account surplus. As expected, given that it runs a surplus only in the services component of the current account, the U.S. runs a substantial current account deficit.

In the case of the **capital account** an increase (decrease) in the county foreign financial assets are debit (credit) whereas any increase (decrease) in the country foreign financial liabilities are credits (debits).

The transaction under the Capital account are Classified

Foreign Investment

Loans

Banking Capital

Rupee debt services

Other debt capital

Loans include the concessional loans received by the government' or public sector bodies , long term loan and medium term borrowings from the commercial capital market in the form of loans Bond issue and short term credits. Disbursement received by Indian resident entities is the credit Items while payment and loans made by the Indians are the credit items

All inflow of the foreign capital comes credit item of the Balance of payment/Banking capital covers the changes in the foreign assets and liabilities of commercial banks whether privately owned or the comparative and government owned.

A decrease in assets and increase in liability is a credit item.

The item Rupee debt services defined as the cost of meeting inters payments and regular contractual repayments of the principal of a loan along with the any administrate charges in rupee by India.

OR

What are factors affecting the components of BOP account?

1) Exports of goods and services affected by following factors
The prevailing rate of domestic currency
Inflation rate
Income of foreigners
World price f the commodity
Trade barriers.

2) Imports of Goods and services
Level of Domestic Income
International prices
Inflation rate

Value of Domestic Currency
Trade Barriers

Q.3 what do you mean by country Risk and explain the different type of risk that need to considered while investing in foreign country?

A collection of risks associated with investing in a foreign country. These risks include political risk, exchange rate risk, economic risk, sovereign risk and transfer risk, which is the risk of capital being locked up or frozen by government action. Country risk varies from one country to the next. Some countries have high enough risk to discourage much foreign investment.

Country risk can reduce the expected return on an investment and must be taken into consideration whenever investing abroad. Some country risk does not have an effective hedge. Other risk, such as exchange rate risk, can be protected against with a marginal loss of profit potential.

The United States is generally considered the benchmark for low country risk and most nations can have their risk measured as compared to the U.S. Country risk is higher with longer term investments and direct investments, which are investments not made through a regulated market or exchange.

Economic and Political Risk

The following are two main sources of risk that need be considered when investing in a foreign country.

Economic risk: This risk refers to a country's ability to pay back its debts. A country with stable finances and a stronger economy should provide more reliable investments than a country with weaker finances or an unsound economy.

Political risk**:** This risk refers to the political decisions made within a country that might result in an unanticipated loss to investors. While economic risk is often referred to as a country's *ability* to pay back its debts, political risk is sometimes referred to as the *willingness* of a country to pay debts or maintain a hospitable climate for outside investment. Even if a country's economy is if the political climate is unfriendly (or becomes unfriendly) to outside investors, the country may not be a good candidate for investment