

WHAT IS THE ACCOMMODATING ITEM IN THE BALANCE OF
PAYMENTS?

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Abstract

Balance of payments accounts are constructed using a double-entry accounting principle such that total credits equal total debits. Modelling each entry independently will not guarantee this equality. It is therefore important to identify the counterpart entries or “accommodating” items that ensure that total credits equal total debits. This short paper identifies the accommodating item for the UK by presenting institutional evidence on the means of payment for international transactions. The paper contributes to the debate about whether the net overseas assets of banks are determined by the non-bank private sector or by the banks themselves. It also sheds light on statistical attempts to measure the volatility of various investment flows. The conclusions of the paper are likely to apply to any developed country with a well-developed banking system.

Key words: Balance of payments, autonomous, accommodating, bank deposits, volatility

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1. Introduction

The UK balance of payments (ONS, 1998a) records, in principle, every transaction between UK residents and overseas residents. The format of presentation for the UK accounts changed substantially in 1998 and the new structure is shown in Figure 1¹. The balance of payments accounts essentially follow a double entry accounting procedure for each transaction. "In theory, every credit entry in the current, capital and financial accounts should be matched by a corresponding debit entry so that total current, capital and financial account credits should equal total debits" (ONS, 1998a, p. 5)².

This accounting principle leads to the distinction often made between underlying, originating or "autonomous" transactions, and those which are merely the financial counterparts or the "accommodating" transactions (Pain and Westaway, 1990; Davies, 1990; Sodersten and Reed, 1994). The distinction is usually attributed to Meade (1951) but was used earlier by Machlup and Kindleberger (Turner, 1991). Meade (1951) explains his distinction as follows:

'Accommodating' payments may be made by private persons.... or they may be made by public authorities.... They may be automatic, i.e. unplanned and unforeseen... or they may be discretionary, i.e. planned and foreseen.... Their distinguishing feature is that they have taken place only because the other items in the balance of payments are such as to leave a gap of this size to be filled.... the distinguishing feature of autonomous payments is that they take place regardless of the size of the other items in the balance of payments. (p. 11)

For this paper we adopt the following conceptual definitions. **Autonomous transactions** are any transactions not restricted by the

size of other balance of payments transactions. **Accommodating transactions** are the counterpart entries that ensure that total credits equal total debits and will usually be the financial counterpart or means of payment for the original autonomous transaction.

The distinction between autonomous and accommodating items is important for theoretical and empirical modelling of the balance of payments. Autonomous transactions may be modelled independently of other items using the relevant economic theory. Accommodating transactions, however, are dependent on the other items and should be modelled as identically equal to the autonomous transactions such that total credits equal total debits. Modelling each credit and debit entry independently will not ensure that total credits equal total debits. It is therefore important to identify the accommodating items in the balance of payments.

This paper presents institutional information on the means of international payment and uses this to identify the accommodating item for the UK. The paper contributes to the debate on whether the net overseas assets of banks are determined by banks themselves or by the non-bank private sector. It also sheds light on statistical attempts to measure the volatility of various investment flows. The conclusions of the paper are likely to apply to any developed country with a well-developed banking system.

The paper is organised as follows. Section 2 describes the four possible means of payment for international transactions. Section 3 uses this information to identify the balancing item for the UK. Section 4 explains why banks as a whole cannot change their net overseas assets and discusses the implications of transactions in reserve assets. Section 5 concludes and explains the implications of the analysis.

2. The means of payment for international transactions

There are four possible means of payment for international transactions: barter, cash, bank deposits, and other financial instruments. (The same means are available for domestic payments but our focus here is on international transactions.)

a) Barter

Pure, simple or straight barter involves the simultaneous exchange of goods without reference to price or currency. No money changes hands. It is one of several forms of countertrade which may be defined as “a reciprocal agreement for the exchange of goods or services” (Levi, 1996, p. 577). Other forms of countertrade include clearing arrangements, switch trading, counterpurchase, offsets, and buy-backs (see Townsend, 1986 and Korth, 1987 for further details). Under clearing arrangements or clearing account barter, a country agrees to purchase a specified value of goods from another country over a typically lengthy period. This is barter extended over time. Again, no money is involved (Korth, 1987, p. 4). With switch trading, a broker may be used to facilitate switching a claim in goods from one company or country to another. This may form part of a clearing arrangement.

The important point about these barter transactions is that the accommodating item in the balance of payments will be under trade in goods along with the initial autonomous transaction. For example, if the UK accepted £100 worth of wheat in exchange for the sale of £100 worth of oil, the export of oil would be recorded as a credit entry of £100, while the import of wheat would be recorded as a debit entry of £100. The two entries would offset each other within the current account and there would be no other balance of payments entry.

However, barter is now “rarely used” and switch trading is “rare except in India and China” (DTI, 1996, pp. 10-12). This is partly

because “many companies will sell only in exchange for money (primarily hard currency); this could be for reasons of accounting practice, customs or exchange requirements, tax laws, bank demands or simple corporate policy” (Korth, 1987, p. 3). While offsets, buy-backs and other forms of countertrade are still used, almost all countertrade contracts today involve an associated financial transaction (Linger, 1997). Hence, almost all UK exports and imports of goods and services will have an accommodating entry in the financial account of the balance of payments.

b) Cash

It is possible for UK residents to pay for £100 worth of imports of goods and services by sending foreign notes and coins to the supplier. The autonomous import of goods would be recorded as a debit entry of £100 in the current account. The accommodating payment would be recorded as a credit entry of £100 under transactions in foreign notes and coins in the other investment section of the financial account. This reflects a decrease in UK overseas assets. Similarly, UK residents may accept sterling notes and coin in payment of exports to overseas residents. In general, for security reasons and transport costs, notes and coins are not likely to be a significant means of payment, except for some tourist expenditures (ONS, 1997). Indeed, these entries are estimated from tourist expenditures in the UK (ONS, 1998a, p. 123-24). However, these items are typically less than 0.1% of other investment transactions.

c) Bank deposits

A purchase by a UK resident of £100 worth of overseas goods or securities may be paid for by a transfer of bank deposits. For goods, the autonomous transaction will be recorded as a debit entry in the current account. For the purchase of equity or debt securities, the autonomous transaction will be recorded as debit entry in the portfolio investment section of the financial account. The accommodating

transaction will be recorded as a credit entry in the other investment section of the financial account. However, the precise location of this entry, and whether UK overseas assets decrease or UK overseas liabilities increase, depends upon how the deposit transfer is made. (The different ways of instructing banks to make these transfers are discussed in Davies and Kearns (1989) and are not of interest here.)

There are six possible cases to consider as illustrated in the bank asset-liability T-accounts (Kim, 1993) shown in Figure 2. In case (a), the UK resident transfers £100 from his deposit account with an overseas bank to the deposit account of the overseas (ROW) resident, also with the overseas bank. In case (b), the UK resident transfers £100 from his deposit with a UK bank to the UK bank account of the overseas resident. In cases (c) and (d), the UK resident transfers £100 from his UK bank account to the overseas bank account of the overseas resident. In (c) the interbank settlement (step 2) is effected by the UK bank crediting the deposit of the overseas bank, while in (d) the UK bank debits its account with the overseas bank. In cases (e) and (f), the UK resident transfers £100 from his overseas bank account to the UK bank account of the overseas resident. Again, the exact mode of interbank settlement determines which case applies.

The point about these examples is that while UK net overseas assets will fall, it may be recorded as a decrease in overseas assets or an increase in overseas liabilities. Further, the transaction may be recorded as a change in the overseas deposit assets of UK non-bank residents, or a change in the overseas deposit assets or liabilities of UK banks. Without further information on the mode of transfer, only the net change in overseas assets, and the net transaction in the other investment section of the financial account can be predicted.

d) Other financial instruments

It is possible for residents to accept other financial instruments in payment for the supply of goods or assets. Kim (1993) describes four basic methods of payment for international trade.

Under 'cash in advance', "the seller requests payment in cash in whole or in part before shipping the merchandise" (Kim, 1993, p. 359). The term is a misnomer, as cash (in the form of notes and coins) will rarely be used; payment will ultimately be made by bank deposit transfer. Under 'open account', goods are sold on agreed credit terms with payment due a certain time after the invoice date. There is no accompanying negotiable instrument such as a bill of exchange or promissory note (Kim, 1993, p. 360). With a 'documentary draft', the UK supplier sends a draft or bill of exchange ordering the foreign purchaser to pay say £100 on demand (a sight draft) or by a given date (a time draft). The trade documents and title to the goods are not released until the importer has accepted the draft. Under 'letter of credit', the foreign purchaser requests its bank to issue a letter of credit. This is "a notification letter issued by the bank to the seller stating that it will make payments on behalf of the buyer under specified conditions" (Kim, 1993, p. 362). The UK supplier will then ship the goods and send the necessary trade documents and a draft (the payment order) to the letter of credit bank (see Kim, 1993, and Clark, Levasseur and Rousseau, 1993, for further details).

Table 1 indicates the relative importance of the different methods of payment in international trade. It confirms the claim by Kim (1993) that documentary draft and letters of credit are the most widely used methods of payment. This implies that a financial instrument such as a draft or bill of exchange will accompany most of the international trade in goods. However final payment is still likely to be by bank deposit transfer. If the export of goods and the final bank settlement are made in the same accounting period, the transactions will be recorded in the balance of payments as discussed in (c) above. If

payment is made in an earlier or later accounting period than the shipment of goods, then the implied trade credit should be recorded under trade credit in the other investment section of the financial account. As UK data on trade credit is of poor quality it is quite likely that some trade credit will not be identified. This temporary accommodating item will then be recorded under net errors and omissions. The only exception is identified trade credit between related firms, which is recorded under direct investment (ONS, 1998a, p. 122).

3. The accommodating item in the UK balance of payments

The preceding section suggests the following conclusions. The use of barter is rare. Cash is mainly used for tourist expenditures and is not numerically significant. Other financial instruments such as bills of exchange are only used as an intermediate form of payment. Therefore we conclude that bank deposit transfer is the main means of payment for international transactions, and that net bank deposits are the main accommodating item in the UK balance of payments. However it may not be possible to identify precisely where, in the other investment section, the accommodating item will be recorded. In general, only the *net* change in the sum of UK banks' deposit assets abroad, UK non-banks' deposit assets abroad, and UK banks' overseas deposit liabilities can be predicted. At a more aggregate level, we may identify *net* changes in other investment as a whole as the accommodating item. This is because any autonomous items within this account, such as overseas borrowing or lending, will have its accommodating or offsetting entry recorded in the same section.

Pain and Westaway (1990) seem to agree with this identification of the accommodating item, but do not provide a full supporting argument. Bakker (1993) also agrees that net bank assets are accommodating (determined by the private sector rather than by banks themselves), but his argument is presented in terms of foreign currency assets rather than overseas assets. Turner (1991) tentatively

attempts to distinguish between autonomous and accommodating flows on the basis of a "simple statistical test" (p. 89). While he concludes that short-term bank flows are the most accommodating item, his analysis fails to take account of the nature of international payment and settlement as discussed above. If barter, cash and other financial assets are not used to pay for transactions, then net bank deposit transfer must be the accommodating item. The proof depends upon institutional knowledge and an understanding of balance of payments accounting. A statistical test cannot be used to prove this result.

There are some exceptions to this rule that should be noted. Reinvested earnings are recorded under investment income in the current account and under direct investment in the financial account such that one entry will be a credit and the other a debit of equal size. These earnings are treated as paid and then reinvested although no money is actually transferred. As these two items net out, there is no difficulty in using net other investment (or the net change in bank deposits) as the accommodating item.

Transfers are payments or receipts where there is no corresponding exchange of goods, services or assets. From a purely statistical accounting viewpoint, transfers are accommodating items as they represent a statistical construction to ensure total credits equal total debits. However, from an economic point of view, they are autonomous items, as they are not restricted by the size of other balance of payments transactions. The associated movement of goods or claims to financial assets, which are used to effect the transfer, will be the accommodating item. If the transfer were in the form of a good or financial security, then the accommodating item would be recorded under trade in goods or under portfolio investment. As these entries will net out with the transfer, we may still use net other investment (or the net change in bank deposits) as the overall accommodating item. When the transfer is in the form of a bank deposit, the above rule

applies without complication. In general, most identified UK transfers seem to be financial transfers of this form.

A take-over or acquisition of another company will be recorded under direct investment. If the acquisition is financed by cash (bank deposits), the accommodating item will be as discussed above. If the acquisition is paid for by the acquirer issuing its own shares or bonds, the accommodating item will be recorded under portfolio investment. As these two entries net out, we may still use net other investment as the overall accommodating item.

Finally there is the issue of unrecorded transactions. If an accommodating bank deposit transfer is recorded, but the autonomous trade credit, portfolio investment or other financial transaction is not, then it will be captured under net errors and omissions. Hence, if bank deposits are recorded accurately, we may safely view net errors and omissions as autonomous. If bank deposits are not recorded accurately, treating net errors and omissions as autonomous will imply a measurement error in the definition of our accommodating item. The assets and liabilities of UK banks are believed to be recorded quite accurately (ONS, 1996, p. 77; Bank of England, 1996). However, the data on overseas deposits of UK residents, excluding banks and securities dealers, "is not considered to be of good quality" (ONS, 1998a, p. 128). As the reported stocks of the latter are only about 11% of total UK overseas bank deposits, it may be quite safe to treat net errors and omissions as autonomous.

4. Autonomous bank transactions and reserve assets

It is important to clarify two possible misinterpretations of the above result concerning the accommodating nature of net bank deposits. First, banks may engage in autonomous international lending and borrowing, but this will only affect their gross overseas assets and liabilities, not their *net* overseas assets. Second, government

intervention in the foreign exchange market may be viewed as an autonomous transaction under a floating exchange rate system.

There has been a debate in the literature as to whether the net overseas assets of banks are determined by banks themselves or by the private sector (see Bakker, 1993, 1994; Boeschoten, 1994). Bakker (1993) argues that banks cannot change their net overseas assets. His argument is based on observations of banking practice and is conducted in terms of foreign currency assets rather than overseas assets per se. The analysis in the previous sections showed, using balance of payments accounting and institutional information on the means of international payment, that the net overseas assets of banks are affected by the private sector (through autonomous trade and investment transactions). Here we complete the argument by showing that banks' own lending and borrowing affects their gross but not their net overseas assets.

We use the asset-liability T-accounts in Figure 3 to show the implications of international bank lending and borrowing for net bank deposits. In example (a), a UK bank makes an autonomous loan of £100 to an overseas customer (ROW) and credits their UK deposit account. Overseas assets and liabilities both increase by £100 leaving net overseas assets unchanged. If the loan is credited to the overseas account of ROW, then net UK overseas assets are again unchanged. However, gross overseas bank assets may or may not increase depending upon the exact mode of interbank settlement (see examples (b) and (c) respectively).

We can use these same T-accounts to examine the autonomous purchase of £100 worth of overseas bonds by UK banks. Total net overseas assets of UK banks would remain unchanged. However, the bond purchase (step 1) would be recorded under portfolio investment, while the bank deposit transaction (step 2 or 3) would be recorded under other investment. Our rule concerning the accommodating nature of net bank deposits remains unchanged.

What if an overseas resident (ROW) transfers £100 from an overseas bank account to a UK bank account? Net overseas assets of UK banks are again unchanged. However, the gross assets (and liabilities) may or may not increase depending upon the mode of interbank settlement (as shown in examples (d) and (e) respectively). These same T-accounts would apply if the overseas resident purchased £100 of debt securities issued by a UK bank. Total net overseas assets of UK banks would remain unchanged. However, the (autonomous) bond purchase (step 3) would be recorded under portfolio investment, while the accommodating bank deposit transfer (step 2) would be recorded under other investment.

Now consider the effect of UK government intervention in the foreign exchange market through its exchange equalisation account (EEA) at the Bank of England. Suppose, in the first instance, that the government increases its reserve assets by purchasing £100 worth of foreign currency bonds from an overseas government. We use the T-accounts in Figure 4 to illustrate the balance of payments accounting. This time, bank A represents the banking Department of the Bank of England which acts as the banker for the government and is treated as a UK bank (ONS, 1998a, p. 139). The government pays for its purchase by reducing its deposit with the banking Department (step 1). The banking Department credits the account of the overseas government either directly (step 3 in example (a)) or through interbank settlement (step 2 and 3 in examples (b) and (c)). Net overseas UK bank assets will decrease by £100, while UK government reserve assets increase by £100. Hence, we can regard transactions in reserve assets as an autonomous transaction with net bank deposit transfer remaining as the accommodating item.

Similarly, examples (d) and (e) in Figure 4 illustrate the government increasing its foreign currency deposit reserve assets with banks abroad. (Reserve assets in the form of currency and deposits are only held with banks abroad, ONS, 1998b.) The banking Department

reduces the sterling deposit of the government (step 1) while the overseas bank credits the foreign currency deposit of the government (step 3). The interbank settlement is shown in step 2 (example (d) or (e) depending upon the mode of interbank settlement). Again, autonomous government reserve assets increase by £100, while UK bank net overseas assets fall by £100.

If the government operated a fixed exchange rate system, it would seem more reasonable to regard the change in reserve assets as an accommodating item as it would result from the government (passively) satisfying the private sector's need for foreign exchange. However, international transactions that did not require foreign currency, such as the purchase of an overseas bond denominated in sterling, could still be settled through the banking system as discussed previously. Under a fixed exchange rate system we may therefore expect both net bank deposits and reserve assets to form the accommodating item in the balance of payments.

5. Conclusions and implications

This paper has argued that net bank deposits – overseas deposit assets and liabilities of UK banks plus overseas deposits of UK non-bank residents - are the main accommodating item in UK balance of payments. For reasons given in the text, net other investment may also be viewed as the accommodating item if the analysis is to be conducted at a higher level of aggregation. If the UK operated a fixed exchange rate, we would expect changes in reserve assets and net bank deposits to function as the accommodating item. These conclusions are likely to apply to any developed or developing country with a well-developed banking system. They depend solely on institutional knowledge of international payments and an understanding of balance of payments accounting.

We also helped to clarify the debate over whether banks or the private sector determine the net overseas assets of banks. We showed that

banks as a whole cannot change their net overseas assets in a floating exchange rate system. Overseas bank loans and borrowing affect banks' gross assets but not their net overseas assets which are determined by other autonomous transactions (trade, direct and portfolio investment) in the balance of payments. While changes in net overseas assets of UK banks (or other investment) may be explained, changes in the gross assets are much harder to predict.

The main implication of the above argument concerns theoretical and empirical modelling of the balance of payments. Autonomous items, such as trade flows, direct investment and portfolio investment can be modelled independently of other components of the balance of payments using the relevant economic theory. The accommodating item however, defined for a floating exchange rate system as either the change in net bank deposits or net other investment, should be modelled as an identity equal to minus the sum of the autonomous transactions, such that total credits equal total debits. Bakker (1993) uses this approach to explain net Dutch bank assets but his single equation approach to explain all autonomous flows is quite restrictive (Boeschoten, 1994).

A second implication is that a deficit on the trade account, current account, or basic balance (Davies, 1990; Pain and Westaway, 1990) will be automatically 'financed' and does not need to be actively financed by raising interest rates to attract money into the country (Pain and Westaway, 1990). The payment for goods and investment is made and recorded at the same time as the autonomous transaction. The net transfer of bank deposits, however, may have implications for the exchange rate and hence monetary policy (Pain and Westaway, 1990).

A third implication concerns the debate over the volatility of investment flows and the short-term nature of certain transactions. Direct investment, and to some extent portfolio investment, is often viewed as a long-term capital flow in contrast to short-term, easily

reversible, and speculative banking flows – also known as “hot money” (Claessens, Dooley and Warner, 1995). Some researchers have attempted to assess this claim by examining statistical measures of volatility and persistence (e.g. Turner, 1991; Claessens, Dooley and Warner, 1995; Chuhan, Perez-Quiros and Popper, 1996). However, if net bank deposits are the accommodating item, they must be as volatile as the sum of net trade, direct investment and portfolio investment. Similarly, if net bank deposits are the means of payment for direct and portfolio investments, they must be as long-term or short-term as the autonomous investment. That is, the net banking flow will be reversed whenever the direct or portfolio investment is reversed – be this a few months or several years. Claessens, Dooley and Warner (1995) do not find ‘short-term’ capital (bank deposits and other private and public ‘short-term’ flows) to be systematically more volatile or less persistent than other capital flows. Turner (1991) also found that net direct and portfolio investments were as volatile as short-term net bank flows during 1983-89. This paper explains the reasons for these findings but also suggests that these statistical tests are of limited value without a proper understanding of the relationship between net banking and other components of the balance of payments.

Notes

1. The accounts are now prepared according to the fifth edition of the IMF Balance of Payments Manual (BPM5). For further details of the changes see ONS (1998a) and Lakin (1994).
2. In practice, a statistical adjustment is required to reflect net errors and omissions in recording transactions.

TABLES AND FIGURES

Table 1: The relative importance of different payment methods for international trade

<i>Method:</i>	Exporters' preferred terms of payment ¹		Preferred terms weighted by share of world exports ²
	No. countries	%	%
Cash in advance	5	3	2
Open account	8	5	21 ³
Documentary draft	41	26	46
Letter of credit	102	65	23
<i>Total</i>	156	100	92 ⁴

Notes: 1. The preferred terms of exporters is reported in a regular survey of export credit and collection methods based upon enquiries to banks. The data reported here is for December 1996.

2. Weighted by exports of goods of country in 1993. Trade shares are not likely to be significantly different in 1996.

3. The importance of open account is heavily influenced by the presence of Japan when weighted by world exports.

4. Data is not available for all countries.

Sources: *International Trade Finance*, 20 December 1996, Issue No. 277, p. 14.

Balance of Payments Statistics Yearbook 1996, Part 2, IMF, Washington DC.

Figure 1: Structure of the UK balance of payments accounts

	Credits	Debits	Balances
1. CURRENT ACCOUNT			
A. Goods and services			
1. Goods			
2. Services			
B. Income			
1. Compensation of employees			
2. Investment income			
2.1 Direct investment			
2.2 Portfolio investment			
2.3 Other investment (including earnings on reserve assets)			
C. Current transfers			
1. Central government			
2. Other sectors			
2. CAPITAL AND FINANCIAL ACCOUNTS			
A. Capital account			
1. Capital transfers			
2. Acquisition/disposal of non-produced, non-financial assets			
B. Financial account			
1. Direct investment			
2. Portfolio investment			
3. Other investment			
4. Reserve assets			
TOTAL			
Net errors and omissions			

Figure 2: Balance of payments accounting for bank deposit transfer

(a) A decrease in UK non-bank residents' overseas deposit assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.			UK deposit: -£100	
2.				
3.			ROW deposit: +£100	

(b) An increase in UK banks' overseas deposit liabilities

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	UK deposit: -£100			
2.				
3.	ROW deposit: +£100			

(c) An increase in UK banks' overseas deposit liabilities

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	UK deposit: -£100			
2.	B's deposit: +£100			Deposit at A: +£100
3.			ROW deposit: +£100	

(d) A decrease in UK banks' overseas deposit assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	UK deposit: -£100			
2.		Deposit at B: -£100	A's deposit: -£100	
3.			ROW deposit: +£100	

(e) An overall decrease in UK non-bank residents' overseas deposit assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.			UK deposit: -£100	
2.		Deposit at B: +£100	A's deposit: +£100	
3.	ROW deposit: +£100			

(f) A overall decrease in UK non-bank residents' overseas deposit assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.			UK deposit: -£100	
2.	B's deposit: -£100			Deposit at A: -£100
3.	ROW deposit: +£100			

Notes: UK deposit refers to deposits of UK residents, ROW deposit to deposits of overseas residents. Bank A is a UK bank and bank B an overseas bank. Step 1 refers to the withdrawal of funds, step 2 to the international interbank settlement (where necessary), and step 3 refers to the crediting of funds. Changes to UK overseas assets and liabilities are shown in **bold**. These transactions will be recorded in the UK balance of payments. The currency of the transactions has been ignored and all numbers are recorded in sterling. The six cases are described in the text.

Figure 3: Balance of payments accounting for autonomous bank transactions

(a) An overseas loan

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.		Loan to ROW: +£100		
2.				
3.	ROW deposit: +£100			

(b) An overseas loan via an overseas bank

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.		Loan to ROW: +£100		
2.	B's deposit: +£100			Deposit at A: +£100
3.			ROW deposit: +£100	

(c) An overseas loan via an overseas bank

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.		Loan to ROW: +£100		
2.		Deposit at B: - £100	A's deposit: -£100	
3.			ROW deposit: +£100	

(d) An autonomous increase in overseas non-bank deposit liabilities with UK banks

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.			ROW deposit: -£100	
2.		Deposit at B: +£100	A's deposit: +£100	
3.	ROW deposit: +£100			

(e) An autonomous increase in overseas non-bank deposit liabilities with UK banks

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.			ROW deposit: -£100	
2.	B's deposit: - £100			Deposit at A: -£100
3.	ROW deposit: +£100			

Notes: UK deposit refers to deposits of UK residents, ROW deposit to deposits of overseas residents. Bank A is a UK bank and bank B an overseas bank. Step 1 refers to the autonomous loan creation or deposit withdrawal, step 2 to the international interbank settlement (where necessary), and step 3 refers to the final crediting of funds. Changes to UK overseas assets and liabilities are shown in **bold**. These transactions will be recorded in the UK balance of payments. The currency of the transactions has been ignored and all numbers are recorded in sterling. The different examples are described in the text.

Figure 4: Balance of payments accounting for changes in reserve assets

(a) An increase in UK government (debt security) reserve assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	Gov't deposit: -£100			
2.				
3.	ROW deposit: +£100			

(b) An increase in UK government (debt security) reserve assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	Gov't deposit: -£100			
2.	B's deposit: +£100			Deposit at A: +£100
3.			ROW deposit: +£100	

(c) An increase in UK government (debt security) reserve assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	Gov't deposit: -£100			
2.		Deposit at B: - £100	A's deposit: -£100	
3.			ROW deposit: +£100	

(d) An increase in UK government (foreign currency deposit) reserve assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	Gov't deposit: -£100			
2.	B's deposit: + £100			Deposit at A: +£100
3.			Gov't deposit: +£100	

(e) An increase in UK government (foreign currency deposit) reserve assets

Step	UK bank A		Overseas bank B	
	Liabilities	Assets	Liabilities	Assets
1.	Gov't deposit: -£100			
2.		Deposit at B: - £100	A's deposit: -£100	
3.			Gov't deposit: +£100	

Notes: Gov't deposit refers to the deposit of the UK government, ROW deposit to the deposit of an overseas government. Bank A is the banking Department of the Bank of England and bank B an overseas bank. Step 1 refers to the autonomous deposit withdrawal to pay for the increase in reserve assets, step 2 to the international interbank settlement (where necessary), and step 3 refers to the final crediting of funds. Changes to UK overseas assets and liabilities are shown in bold. These transactions will be recorded in the UK balance of payments. The currency of the transactions has been ignored and all numbers are recorded in sterling. The different examples are described in the text.

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