Balance of payment

International finance (B.com. hons. in finance)

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Balance of payment:- balance of payment (BOP) is a comprehensive record of economic transactions of the residents of a country with the rest of the world during a given period of time usually one year.

 According to kindleberger, "Balance of payment is a systematic record of all economic transactions between the residents of the reporting country and residents of foreign countries during a given period of time ".

of Payments

Balance of payment includes all the transactions that are made by corporates, individuals, and the government. Thus, it helps in monitoring the funds for the development of the country. So, when all the elements are added in the BOP, it should essentially sum up to zero. Thus, the inflows and outflows of a country should balance out. But in reality, this does not happen. This statement is useful to identify whether the country has a surplus or deficit.

A consistently positive BoP reflects more foreign investment and money coming into the country and not much of its currency being exported. On the other hand, adverse or negative BOP indicates more outflow of money compared to inflows. BoP records are kept in standard double entry book keeping under which inflows are recorded as credit whereas outflows are recorded as debit

The BOP for a country is vital for the following reasons:

- It reveals the economic and financial details of a country.
- The BOP statement can be an indicator to determine whether the currency of a country is appreciating or depreciating.
- Also, BOP helps the government on trade and fiscal policies.

- Thus, it provides important information to understand and analyze the economic dealings of one country with the other
 Balance of payment contains three sets of accounts : (structure of BOP)
 - 1. Current account
 - 2. Capital account
 - 3. Overall Balance of Payment

<u>**Current account:-**</u> current account or income account of BOP includes the flow of all goods and services between one country and the rest of the world. It includes

<u>1.Commodity imports and exports</u>

2.Service imports and exports

The current account is usually subdivided into **visible** and **invisible**s. Visible items refer to goods i.e., those We can see and touch when they cross international borders invisible Items refer to all those services, which we cannot see or touch like insurance and banking services.

The main components of the current account are:

- 1. Trade in goods (visible balance)
- 2. Trade in services (invisible balance), e.g. insurance and services
- 3. Investment incomes, e.g. dividends, interest and migrants remittances from abroad

4. Net transfers – e.g. International aid.

Deficit and surplus

- A deficit on the current account means that the value of imports is greater than the value of exports.
- A surplus on the current account means that the value of imports is less than the value of exports

<u>Capital account:-</u> Capital of BOP records all those transactions, between the residents of a country and the rest of the world, which cause a change in the assets or liabilities of the residents of the country or its government. It is related to claims and liabilities of financial nature.

Thus, if a resident invests or loans money abroad, then the rest of the world owes a claim to that resident, who in turn has an equivalent asset. All capital inflows are classified as credits and all capital outflows as debits .

Components of Capital Account: **The main components of capital account are:**

1. Borrowings and landings to and from abroad: It includes:

A. All transactions relating to borrowings from abroad by private sector, government, etc. Receipts of such loans and repayment of loans by foreigners are recorded on the positive (credit) side.

B. All transactions of lending to abroad by private sector and government. Lending abroad and repayment of loans to abroad is recorded as negative or debit item.

2. Investments to and from abroad: It includes:

A. Investments by rest of the world in shares of Indian companies, real estate in India, etc. Such investments from abroad are recorded on the positive (credit) side as they bring in foreign exchange.

B. Investments by Indian residents in shares of foreign companies, real estate abroad, etc. Such investments to abroad be recorded on the negative (debit) side as they lead to outflow of foreign exchange.

3. Change in Foreign Exchange Reserves:

The foreign exchange reserves are the financial assets of the government held in the central bank. A

change in reserves serves as the financing item in India's BOP. So, any withdrawal from the reserves is recorded on the positive (credit) side and any addition to these reserves is recorded on the negative (debit) side. It must be noted that 'change in reserves' is recorded in the BOP account and not 'reserves'.

A. Surplus in capital account arises when credit items are more than debit items. It indicates net inflow of capital.

B. Deficit in capital account arises when debit items are more than credit items. It indicates net outflow of capital.

Overall Balance of payment:- Total of country's balance of payment on current and capital account is known as overall balance of payment.

BOP Disequilibrium:-

The **BOP** deficit or surplus indicate imbalance in the **BOP**. This imbalance is interpreted as **BOP Disequilibrium**. A country's **balance of payments** is said to be in **disequilibrium** when its autonomous receipts (credits) are not equal to its autonomous **payments**(debits).

Types of Disequilibrium

Disequilibrium in balance of payments can be classified as follows : -

(a) Temporary Disequilibrium – Temporary disequilibrium in the form of deficits or surpluses tend to last for a short period of time. They are the result of temporary changes in the economy like - crop failure, seasonal fluctuations, effect of weather on agricultural production, etc. Such a disequilibrium may occur once a while and gets automatically corrected. It does not pose a serious problem for a country.

(b) Fundamental Disequilibrium – There is no precise definition of the term fundamental disequilibrium. Economists generally define fundamental disequilibrium as - "a deep rooted persistent deficit or surplus in the BOP of a country." It is a chronic BOP deficit, according to IMF. It is of long term nature and a matter of serious concern for the country.

(c) Cyclical Disequilibrium – Cyclical fluctuations in the business activity also lead to BOP disequilibrium. Cyclical disequilibrium occurs because – (i) Trade cycles follow different paths and patterns in different countries. (ii)Different countries follow different stabilization programmes. (iii) Differences in price and income elasticities of demand for imports.

(d) Structural Disequilibrium – Structural

disequilibrium occurs due to structural changes in the economy. Some of the structural changes would include – changes in technology, changes in tastes and preferences, changes in long – term capital movements, etc.

There are several factors which cause disequilibrium in the BOP indicating either surplus or deficit.

Such causes for disequilibrium in BOP are listed below:

(i) Economic Factors:

(a) Imbalance between exports and imports. (It is the main cause of disequilibrium in BOR), (b) Large scale development expenditure which causes large imports, (c) High domestic prices which lead to imports, (d) Cyclical fluctuations (like recession or depression) in general business activity, (e) New sources of supply and new substitutes

(ii) Political Factors:

Experience shows that political instability and disturbances cause large capital outflows and hinder Inflows of foreign capital.

(iii) Social Factors:

- (a) Changes in fashions, tastes and preferences of the people bring disequilibrium in BOP by influencing imports and exports;
- (b) (b) High population growth in poor countries adversely affects their BOP because it increases the needs of the countries for imports and decreases their capacity to export.

Measures to correct disequilibrium in BOP: (i) Export promotion:

Exports should be encouraged by granting various bounties to manufacturers and exporters. At the same time, imports should be discouraged by undertaking import substitution and imposing reasonable tariffs.

(ii) Import:

Restrictions and Import Substitution are other measures of correcting disequilibrium.

(iii) Reducing inflation:

Inflation (continuous rise in prices) discourages exports and encourages imports. Therefore, government should check inflation and lower the prices in the country.

(iv) Devaluation of domestic currency:

It is reduction in the value of the domestic currency in relation to foreign currencies will make domestic goods cheaper to foreigner and raise the price of foreign goods. So , exports will be encouraged and imports discouraged.

(v) Depreciation:

Like devaluation, depreciation leads to fall in external purchasing power of home currency.

Explain the relationship between the balance of payment and exchange rates of a country.

The exchange rate is the ratio of one currency to another currency. Exchange rates are also determines the value of one country's currency to another currency and the balance of payment is statistical that comprises transactions between residents and non-residents during a period. The purpose of this study is to examine exchange rates impact on the balance of payment (BOP). There is a close relationship between balance of payment and the exchange rates of a country currency. For the purpose of understanding the relationship between the balance of payment and the exchange rate. There are two types of situations:

1. Flexible Exchange Rate System.

2. Fixed Exchange Rate System.

Flexible Exchange Rate System and Balance of Payment.

Under the flexible exchange rate system, the equilibrium spot exchange rate, like any other market price, is

determined by the equality of market demand for and supply of currencies generated on trade, investments (assets), hedging, arbitrage and speculative accounts.

The exchange rates are freely flexible and there will not be a deficit or surplus in the balance of payment because such imbalances are automatically adjusted in the foreign exchange markets.

When the exchange rates change i.e. depreciate or appreciate, there will be change in balance of payments due to change in imports and exports i.e. terms of trade. Depreciation makes the imports more expensive. The prices of exportable are expressed in the currency of home country where the prices of importable are measured in the currencies of the exporting countries. Thus, after rupee depreciates the rupee prices of importable rise relative to the rupee prices of exportable causing a deterioration in the commodity terms of trade. Thus, exchange. rate is adjusted without the intervention of central bank.

Fixed Exchange Rate System and Balance of Payment.

Under the fixed exchange rate system a government is committed to maintain the stated or official par value of its currency, allowing the deviation of currency value from the par value only within a fixed or an agreed upon percentage, say one per cent on either side of the par value. The central bank intervenes in the foreign exchange market to maintain the par value and if it could not be maintained the exchange rate is officially devalued or revalued. Thus, under the fixed exchange rate system a deficit in the balance of payment is adjusted by money supply changes and the consequent changes in the price level. The exchange rate is not used as a tool for correcting the imbalance in the balance of payments.

Under the fixed exchange rate system, a deficit in the balance of payment is adjusted by a fall is national income if the resources are not fully employed.

Mechanisms for Adjusting the BOP

Because of either a big deficit or surplus threatening economic stability, governments might decide to tackle BOP imbalances. However, this is not merely a decree but a series of economic measures that gradually guide the economy in the intended direction.

Adjustment of Exchange Rates

Adjustments of exchange rates affect the value of exports and imports.

A devaluation can help to reduce a trade deficit. A weaker currency makes exports more profitable and imports more expensive. Therefore, exports should grow and imports should fall, thus correcting the deficit. However, if local exporters rely on imported components, the effect might be limited because their production costs will rise as well.

If the country has a trade surplus, a currency appreciation will make exports less profitable and imports will become cheaper. This will gradually cause exports to fall, and as imports grow, the account rebalances.

In countries with a fixed exchange rate, governments can decree exchange rate adjustments. However, most countries have floating rates, so market movements will tend to restore balance. Nonetheless, governments might expand or reduce national reserves in foreign currency to push the exchange rate in the desired direction.

Adjustment of Internal Prices and Demand

The **adjustments of internal prices and demand** aim to correct imbalances by affecting local consumption habits and thus the demand for imported goods.

To reduce a trade deficit, governments might increase interest rates, which moderates overall consumption and therefore, the demand for goods and services. Another option is to impose taxes on imports, which makes them more expensive. As a result, imports will tend to fall and the imbalance will become smaller

A trade surplus will cause more money to enter the economy, increasing the demand for goods and services. Therefore, imports and inflation will tends to grow, restoring the balance. However, by lowering interest rates or expanding public expenditure, government can help to increase local demand.

<u>Theories of exchange rate</u> <u>determination:</u>

<u> 1. Purchasing Power Parity Theory (PPP):</u>

The PPP theory applies to commodities. There are two variants of the PPP: the absolute PPP theory and the relative PPP theory. PPP states that there is a link between prices in two countries and the exchange rate between the currencies of both the countries.

Basic assumptions:-

i. There are no transportation costs for transporting a commodity from one country to another (transportation costs are zero),

ii. There are no costs for converting one currency into another (currency conversion costs are zero).

iii. There are no restrictions on the movement of commodities between countries. That is, there are no trade barriers or quotas.

Absolute PPP Theory:

The Law of one price states that an identical product should have the same price in two countries. According to the PPP theory, the law of one price should operate for an identical commodity sold in two countries. Therefore, the price of a product in country X and the price of an identical product in country Y (in Y's currency) should be such that, the ratio of the prices is the exchange rate between the currencies of the two countries.

When P_X is the price of a product in country X, P_Y is the price of an identical product in country Y, X is the currency of country X; and Y is the currency of country Y, then:

 $\frac{\text{Price of a product in country X}}{\text{Price of a product in country Y}} = \frac{\text{Currency of country X}}{\text{Currency of country Y}}$

or $(P_X \div P_Y) = (X \div Y)$ Since $(X \div Y)$ is the direct rate for country X, $(P_X \div P_Y) = X/Y$

When the Law of one price is violated, arbitrage opportunities arise—commodities that sell at a lower price in country X will be transported to country Y (recall that transportation costs are assumed to be zero) and sold at the higher price prevailing there. This will continue till prices in both countries equalize. Absolute PPP is not relevant with respect to non-tradable goods (such as electricity, healthcare services) that cannot be transported to another country and are not traded in international markets.

Relative PPP Theory:

When the inflation rate is higher in country X than in country Y, the price of goods in X will increase more than the price of goods in Y. Since the Law of one price states that an identical product should have the same price in both countries, X's currency will depreciate with respect to Y's currency. The rate of depreciation is equal to the inflation differential. Therefore, the relative version of PPP states that there is a link between the expected exchange rate $E(S_n)$ and expected inflation rates (I) in two countries. According to relative PPP, price changes due to differences in inflation are the cause and exchange rate changes are the effect. But if it is the other way round— that is an undervalued currency causes price change in a country the extent of price change is termed the 'pass through' effect. Since the future price of a commodity is affected by the expected inflation rate, the prices of a commodity in country X and in country Y are affected by the expected inflation rates in the two countries.

When P is the commodity's current price, and I the expected inflation rate, the price of the commodity an year later (P₁) is:

 $\mathbf{P}_{1}=\mathbf{P}_{0}\left(1+\mathbf{I}\right)$

In country
$$X - P_{X_1} = P_{X_0} (1 + I_X)$$

In country
$$Y - P_{Y_1} = P_{Y_0} (1 + I_Y)$$

The ratio of the prices one year later is $-[P_{Xo}(1 + I_X)] \div [P_{Yo}(1 + I_Y)]$

This can be written as $S_{X/Y} [(1 + I_X) \div (1 + l_Y)]$ as $(P_{Xo} \div P_{Yo})$ is the current spot rate, $S_{X/Y}$. Since the expected exchange rate one year later, $E(S_{X/Y})$, is a ratio of the prices

one year later, it is nothing but -E(S_{X/Y}) = S_{X/Y}[(1+ I_X) + (1 + I_Y)](1)

The above equation can be rearranged as $E(S_{X/Y}) \div S_{X/Y} = [(1 + I_x) + (1 + I_Y)]$

The left hand side of this equation can be written as $-1 + \{[E(S_{X/Y}) - S_{X/Y}] \div S_{X/Y}\}$

where {[$E(S_{X/Y}) - S_{X/Y}$] ÷ $S_{X/Y}$ } is nothing but the rate of change in the spot rate.

Denoting { $[E(S_{X/Y}) - S_{X/Y}] \div S_{X/Y}$ } by 'e' – (1 + e) = $[(1 + I_X) \div (1 + I_Y)]$

On simplification, $e = (I_X - I_Y) + (1 + I_Y)$

The denominator on the right hand side, $(1 + I_Y)$ can be ignored for small values of I_Y Then, $e \approx (I_X - I_Y)$... (2) This equation states that e is approximately equal to $(I_X - I_Y)$. Since e is nothing but $\{[E(S_{X/Y}) - S_{X/Y}] \div S_{X/Y}\}$, the relative PPP theory states that the rate of change in the spot rate is approximately equal to the inflation differential. When this condition holds true, the market is in equilibrium. Relative PPP is closer to reality than absolute PPP, because it accommodates non-tradable goods too—the theory talks of changes in prices (captured by changes in a price index whose composition includes non-tradable goods).

<u>2. Interest Rate Parity Theory (IRP):</u>

It is also called the covered interest parity theory. The theory states that there is a link between the nominal interest rates in two countries and the exchange rate between their currencies.

The theory applies to financial securities, and it makes the following assumptions:

i. When a currency is converted into another, or when a financial security is bought or sold, there are no costs involved. That is, transaction costs are zero.

ii. Money can freely flow between both the countries and there is full mobility of capital.

iii. An investor can choose to invest in financial securities that are denominated in the currency of the country where

he resides (domestic currency-denominated financial securities) or to invest in financial securities that are denominated in the currency of a foreign country (foreign currency-denominated financial securities). If he chooses to invest in foreign currency-denominated financial securities, he will hedge his foreign exchange risk through operating in the forward market.

Based on the above assumptions, the theory states that the forward exchange rate for two currencies $(F_{X/Y})$ is determined by the current spot rate $(S_{X/Y})$, and the nominal interest rates $(i_X \text{ and } i_Y)$ in two countries.

The forward rate is:

 $F_{X/Y} = S_{X/Y} \{ [1 + i_X] \div [1 + i_y] \}$...(3) Rearranging the above equation (which is similar to the equation for the expected spot rate $E(S_{X/Y})$ in relative PPP theory), gives –

 $(F_{X/Y} - S_{X/Y}) \div S_{X/Y} = (i_x - i_y) \div (1 + i_y)$

Note that the term $(F_{X/Y} - S_{X/Y})$ on the left hand side of the above equation is negative when $F_{X/Y} < S_{X/Y}$ (the forward rate is at a discount to the current spot rate). When $F_{X/Y} > S_{X/Y}$, it means that the forward rate is at a premium to the current spot rate. When the denominator $(1 + i_F)$ on the right hand side of equation is ignored for small values of i_y , then equilibrium is said to exist when,

 $(F_{X/Y} - S_{X/Y}) \div S_{X/Y} \approx (i_x - i_y)$ (4) When the left hand side of (4) is greater than the interest rate differential $(i_X - i_F)$, profit-making opportunities through covered interest arbitrage, exist. According to the IRP, when the quoted forward rate is identical to the forward rate calculated using equation 2, an investor will be indifferent to investing in securities denominated in domestic currency or foreign currency, if the return in either case is identical. When he is indifferent to the currency denomination of the financial securities, equilibrium exists.

If however, the quoted forward rate is not the same as the forward rate calculated using equation 2, an investor can make a profit by borrowing in one currency, converting it into another currency, investing the proceeds, and covering himself against exchange rate risk. This process is called covered interest arbitrage (CIA).

The Fisher Effect & the International Fisher Effect

The Fisher Effect

The Fisher effect theory suggests that differences in the nominal interest rates between two economies equal the expected changes of inflation rates.

Interest rate differentials = Expected inflation rates differentials

According to the PPP principle, the exchange rates, and the inflation rates are linked. The Fisher effect links exchange rates and inflation rates with interest rates.

The International Fisher Effect

The international Fisher effect (or Fisher's open hypothesis) is a hypothesis that suggests

differences in nominal interest rates between two economies equal the expected changes in the spot exchange rates of those countries.

Interest rate differentials = Expected change in the spot exchange

The MONETARY APPROACH

The Monetary Approach focuses on the monetary policies of two countries in order to determine their currency exchange rate. The Monetary Approach uses two dynamics to determine an exchange rate, the price dynamics and the interest rates dynamics.

A change in the domestic money supply leads to a change in the level of prices and a change in the level of prices leads to a change in the exchange rate.

Monetary Approach Assumptions

The monetary model assumes:

(i) A freely-floating exchange rate regime (not a fixed exchange rate regime)

(ii) Minimal interventions by central banks

(iii) The aggregate supply curve is vertical

(iv) The prices of tradable goods are immediately adjusted to any change in the dynamics that affect them

(v) The transmission mechanism through prices to the exchange rate is immediate

The Monetary Policies

In general, a monetary policy focuses on the money supply of an economy. The available money supply is determined by:

(a) the amount of money in circulation, and

(b) the level of interest rates.

Countries that apply expansionary monetary policies in order to increase the amount of money in circulation will face inflationary pressures. This usually leads to a devaluation of the currency exchange rate. On the contrary, countries that apply tight monetary policies decrease the amount of money in circulation and see their currencies appreciate.

Money Supply & Money Demand

Money supply is generally determined according to the central bank objectives. This is happening by:

(a) adjusting the level of interest rates, and

(b) controlling the amount of printed money in circular.

Money demand is a more complex variable determined by:

- (a) the available income
- (b) the level of interest rates
- (c) the level of prices, and

(d) future income and price expectations

Portfolio Balance Approach

The Portfolio Balance Approach Explained

The portfolio balance approach is an extension of the monetary exchange rate models focusing on the impact of bonds. According to this approach, any change in the economic conditions of a country will have a direct impact on the demand and supply for the domestic and the foreign bond. This shift in the demand/supply for bonds will in turn influence the exchange rate between the domestic and foreign economies.

The key advantage of the portfolio approach when compared to traditional approaches is that the

financial assets tend to adjust considerably faster to news economic conditions than tradable goods. Nevertheless, based on empirical evidence, the portfolio balance approach is not an accurate predictor of exchange rates.

The Assumptions of Portfolio Balance Approach

The portfolio balance approach is based on several assumptions:

- 1. The purchasing power parity (PPP) does not hold
- 2. The uncovered interest parity does not hold
- 3. The exchange rate is expected unchanged

4. Only three (3) assets are available for investment for each household: money, domestic bonds, and foreign bonds

5. Bonds are not perfect substitutes

6. Assumes perfect capital mobility without capital controls and similar barriers to investment

7. Assumes narrow transaction costs and high completion in the money markets

Portfolio Balance Approach Key Points

- Emphasizes on the importance of global financial markets (especially as concerns the bond markets)
- Assumes the existence of arbitrage between two economies
- Offers a realistic and simplistic analysis framework
- The portfolio balance approach, based on empirical evidence, hasn't proven an accurate predictor of exchange rates

3. The Balance of Payments Theory:

The balance of payments theory of exchange rate maintains that rate of exchange of the currency of one country with the other is determined by the factors which are autonomous of internal price level and money supply. It emphasises that the rate of exchange is influenced, in a significant way, by the balance of payments position of a country.

A deficit in the balance of payments of a country signifies a situation in which the demand for foreign exchange (currency) exceeds the supply of it at a given rate of exchange. The demand for foreign exchange arises from the demand for foreign goods and services. The supply of foreign exchange, on the contrary, arises from the supply of goods and services by the home country to the foreign country.

In other words, the excess of demand for foreign exchange over the supply of foreign exchange is coincidental to the BOP deficit. The demand pressure results in an appreciation in the exchange value of foreign currency. As a consequence, the exchange rate of home currency to the foreign currency undergoes depreciation.

A balance of payments surplus signifies an excess of the supply of foreign currency over the demand for it. In such a situation, there is a depreciation of foreign currency but an appreciation of the currency of the home country.

The equilibrium rate of exchange is determined, when there is neither a BOP deficit nor a surplus. In other words, the equilibrium rate of exchange corresponds with the BOP equilibrium of a country. The determination of equilibrium rate of exchange can be shown through Fig.



Fig. 22.8

In Fig. 22.8, the demand for and supply of foreign exchange are measured along the horizontal scale and rate of exchange is measured along the vertical scale. D is the negatively sloping demand function of foreign currency. S is the positively sloping supply function of foreign currency. The equilibrium rate of exchange is OR_0 which is determined by the intersection between the demand and supply functions of foreign currency where $D_0R_0 = S_0R_0$. The equality between the demand for and supply of foreign exchange signifies also the BOP equilibrium of the home country. If the rate of exchange is OR_1 which is higher than the equilibrium rate of exchange OR_0 , the demand for foreign currency D_1R_1 falls short of the supply of foreign currency S_1R_1 . In this situation, the home country has a BOP surplus.

The excess supply of foreign exchange lowers the exchange value of foreign currency relative to home currency. The

appreciation in the exchange rate of home currency reduces exports and raises imports. In this way, the BOP surplus gets reduced and the system tends towards the BOP equilibrium and also the equilibrium rate of exchange.

If the rate of exchange is OR_2 which is lower than the equilibrium rate of exchange OR_0 , the demand for foreign currency D_2R_2 exceeds the supply of foreign currency S_2R_2 . The excess demand of foreign currency D_2S_2 signifies the BOP deficit. As a result of the excess demand for foreign currency, the exchange value of foreign currency appreciates while the home currency depreciates. The depreciation of the exchange value of home currency leads to a rise in exports and a decline in imports. Thus the BOP deficit gets reduced and the exchange rate appreciates to approach finally the equilibrium rate of exchange OR_0 where the BOP is also in a state of equilibrium.

Merits:

The balance of payments theory of rate of exchange has certain significant merits. Firstly, this theory attempts to determine the rate of exchange through the forces of demand and supply and thus brings exchange rate determination in purview of the general theory of value. Secondly, this theory relates the rate of exchange to the BOP situation.

It means this theory, unlike PPP theory, does not restrict the determination of rate of exchange only to merchandise trade. It involves all the forces which can have some effect on the demand for and supply of foreign currency or the BOP position.

Criticism: The BOP theory of exchange rate is criticized mainly on the following grounds: (i) Assumption of Perfect Competition:

This theory rests upon the assumptions of perfect competition and free international trade. In fact there are serious imperfections in the market on account of trade and exchange restrictions imposed by the different countries. Therefore, the BOP theory is clearly unrealistic.

(ii) No Causal Connection between Rate of Exchange and Price Level:

The BOP theory assumes that no causal connection exists between the exchange rate and the internal price level. Such an assumption is false. The variations in the internal price level can certainly have their impact on the balance of payments situation which in turn can affect the rate of exchange.

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