

# Overview on the Balance of Payments and its Importance in Economic Analysis



# Table of Contents

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<b>Introduction</b>	<b>2</b>
<b>Part I: Concept and Components of the Balance of Payments</b>	<b>3</b>
<b>First: Residency</b>	<b>3</b>
<b>Second: Economic Transactions</b>	<b>4</b>
<b>1. Current Account</b>	<b>4</b>
<b>A. Balance on Goods</b>	<b>5</b>
<b>B. Balance of Services</b>	<b>5</b>
<b>C. Income Account</b>	<b>6</b>
<b>2. Capital Account</b>	<b>6</b>
<b>3. Financial Account</b>	<b>7</b>
<b>Part II: Importance of the Balance of Payments</b>	<b>8</b>
<b>Conclusion</b>	<b>9</b>

# Preface

This 7<sup>th</sup> Issue titled “**Overview on the Balance of Payments and its Importance in Economic Analysis**” is one of a series of quarterly reports the Central Bank of Kuwait has been issuing since November 2022. **Part I** hereof titled “**Concept and Components of the Balance of Payments**” defines the Balance of Payments (BOP) and its main concepts and accounts. Under the caption “**Importance of the Balance of Payments**” comes **Part II** to shed light on the importance of BOP from the state’s perspective, policymakers and researchers, as well as at the level of individuals. This 7<sup>th</sup> issue is the second for 2024.

CBK has been issuing a series of quarterly reports as part of its ongoing efforts to keep pace with the best global trends used by central banks to enhance disclosure and transparency practices, by covering some thoroughly selected economic, monetary and banking topics to raise awareness and briefly introduce CBK’s efforts in terms of monetary and financial stability. **The 1<sup>st</sup> Issue (November 2022) titled “Overview of the Key Economic, Monetary and Banking Developments”** reviewed the most prominent developments in the State of Kuwait, and highlighted the key indicators in some selected countries. **The 2<sup>nd</sup> Issue (February 2023) titled “Overview on Inflation, Monetary Policy and Sustainable Finance”** introduced the key indicators of monetary policy trends in advanced economies, the gradual tightening of CBK’s monetary policy, and the green (sustainable) financing. **The 3<sup>rd</sup> Issue (May 2023) titled “CBK’s Efforts on AML/CFT and Customer Protection”** highlighted the CBK’s supervisory efforts in the field of AML/CFT and protecting the rights of customers subject to its supervision. **The 4<sup>th</sup> Issue (September 2023) “A Glimpse into the Impact of Digital Transformation on Financial Stability, the Foremost Global Developments and Monetary Policy Trends”** focused on the digital transformation journey in the banking system globally and locally, highlighted the global developments and monetary policy trends in some selected central banks, and provided a brief overview of CBK’s monetary policy trends. **The 5<sup>th</sup> Issue, titled “Nature of Central Banks”** discussed central banks’ functions and independence, and enhancement of their financial resources and the channels through which the impact of monetary policy is transmitted into economic activity. It also demonstrated the international central banks’ experiences after the financial and economic crises/pandemic, and the importance of enhancing financial resources. It focused on the exchange rate channel as the most important channel through which the impact of monetary policy is transmitted to macro variables. **The 6<sup>th</sup> Issue (March 2023) titled “Artificial Intelligence: Advantages and Challenges”** exhibited the impact of artificial intelligence technologies on the global economy, and utilization thereof to boost innovation and development in the economic and banking sectors.

# Introduction

Great importance is attached to the indicators and statistics developed by the International Monetary Fund (IMF) to measure the external sector's performance in the IMF's member states for analyzing the performance of the national economy during the period for which these indicators are prepared compared to other periods. Correspondingly, it lends itself as a platform for a possible comparison with other economies, including those indicators in the BOP statistics. Therefore, **the 7<sup>th</sup> Issue (September 2024) "Overview on the Balance of Payments and its Importance to the Economic Analysis"** comes as part of the quarterly reports the CBK has been issuing since November 2022. This edition provides **a simple definition of, and overview on, the the balance of payments to enable individuals understand its components, and recognize its importance for decision-makers, those interested in economic affairs, and all segments of society.**

**Part I** hereof **"Concept and Components of the Balance of Payments"** introduces the BOP's key concepts, related definitions and the main accounts, including (Current Account, Capital Account and Financial Account), along with examples of these accounts' components. **Part II "The importance of the balance of payments"** focuses on the importance of the BOP from the State's perspective at the level of policy makers, researchers, and those interested in economic affairs, as well as at the level of individuals.

# Part I:

## Concept and Components of the Balance of Payments

Once “Balance of Payments” is heard, the first question that comes to mind is: “What is the Balance of Payments?”

The following enumeration, including definitions, would answer this question:

### Balance of Payment

**Is a statistical statement that summarizes the transactions between residents and nonresidents during a period (year or quarter). It is also a statement of the inflows and outflows on the economic transactions of residents in a certain economy with residents of other economies.**

The above definition covers two main terms: “Residency”, Resident and Nonresident, and “Economic Transactions” that would be further explained as follows:

### First: Residency

#### When is a person regarded as a resident of an economy?

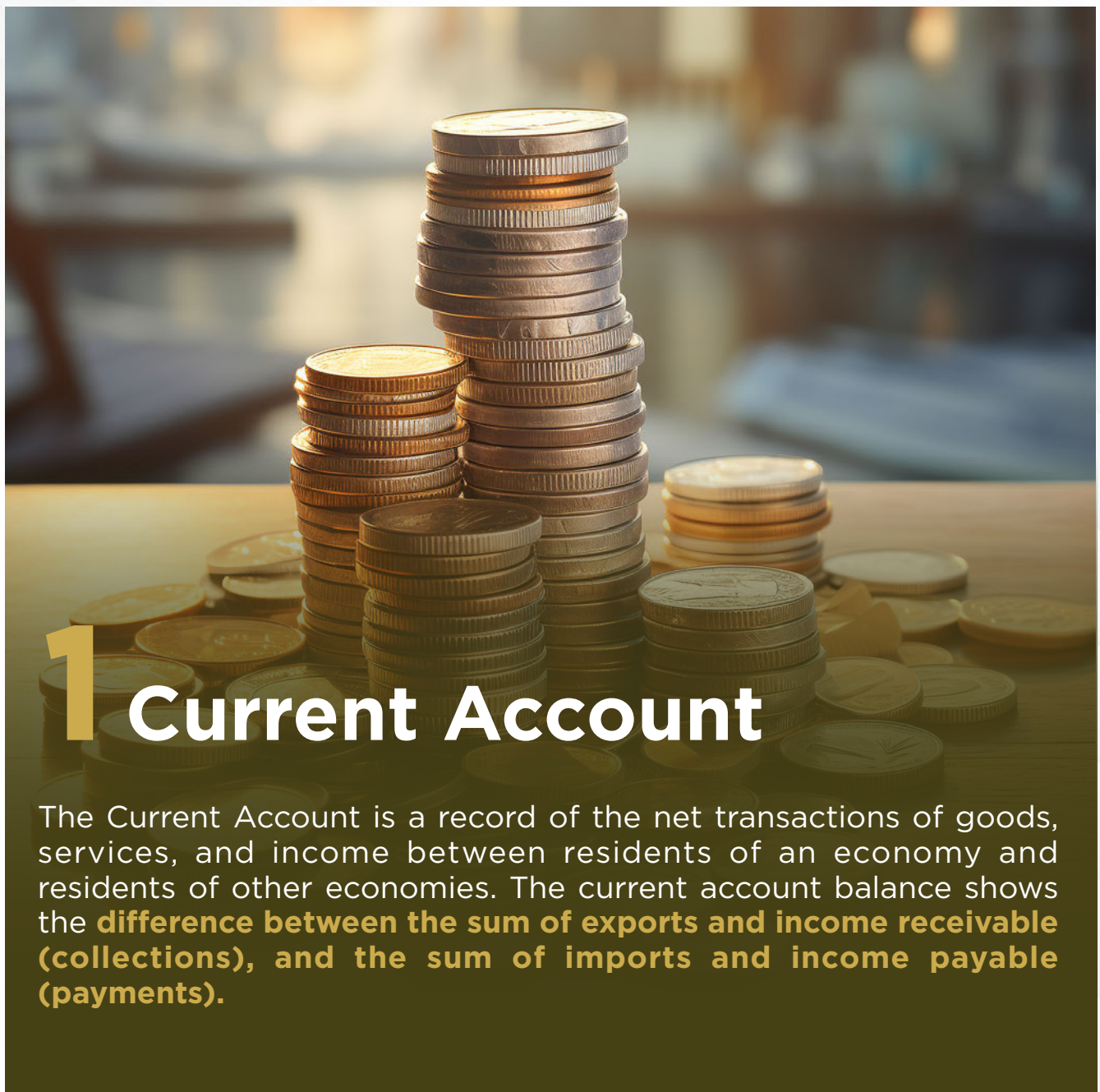
A person (including companies) is regarded as a resident of a country or an economy if resides or intends to reside in that country for more than one year.

In addition, the concept of residency is not contingent on nationality. **For example, if a person from country (Y) moves/travels to country (X) for work or residency for over a year, that person shall be reagrded as a resident in country (X) not country (Y).**

**Second:**

# Economic Transactions

Economic transactions in BOP (also known as components of the BOP) consist of three main accounts: Current Account, Capital Account, and Financial Account. The following is a brief overview of each account:



## 1 Current Account

The Current Account is a record of the net transactions of goods, services, and income between residents of an economy and residents of other economies. The current account balance shows the **difference between the sum of exports and income receivable (collections), and the sum of imports and income payable (payments).**

## A. Balance on Goods:

It includes exports and imports of goods, including raw materials, intermediate goods, and finished goods (manufactured, capital or consumer). In other words, all exports of goods to the outside world, and imports of goods from abroad are recorded in this account.



## B. Balance of Services:

The Services Account reflects the net value of receivables (exports) and payables (imports) occurring between the local economy and other economies in relation to services transactions. These are represented by the following services:



**Transportation**



**Travel**



**Finance**



**Communication**



**Computer**



**Information**



**Equity**



**Other**

The balance on goods and/or services account surplus indicates that the value of exports (collections) is higher than imports (payments). Meanwhile, a deficit indicates that imports are higher than exports.

### C. Income Account:

It consists of two main accounts, namely the Primary Income and the Secondary Account. The Primary Account captures the return receivable to individuals and institutions for their contribution to production (laborforce in the production process, and the income associated with the ownership of financial assets, i.e. return on financial investments). The Secondary Income captures the current transfers between residents and nonresidents of an economy. It records various types of current transfers between economies, and includes personal transfers (expatriates' remittances) and other current transfers (including current transfers associated with international cooperation, governments, multinational organizations or charities).

Therefore:

$$\text{The Current Account} = \text{Net Balance on Goods} + \text{Net Balance of Services} + \text{Net Income}$$

## 2 Capital Account

The Capital Account shows credit and debit entries for nonproduced nonfinancial assets and capital transfers between residents and nonresidents.





# 3 Financial Account

The Financial Account covers the financial claims and liabilities on transactions between residents and nonresidents in the local economy during a specific period. In other words, it shows the net acquisitions of financial assets and the transactions that result in change of the financial liabilities. Transactions on the financial assets and financial liabilities can be classified as: (Direct Investment, Portfolio Investment "securities", derivatives, other investments "deposits, loans, commercial credit, others", official reserve assets)

## The theoretical case refers to the BOP equilibrium

Equilibrium position of BOP entries

Balance of Current Account and  
Capital Account

=

Balance of Financial  
Account

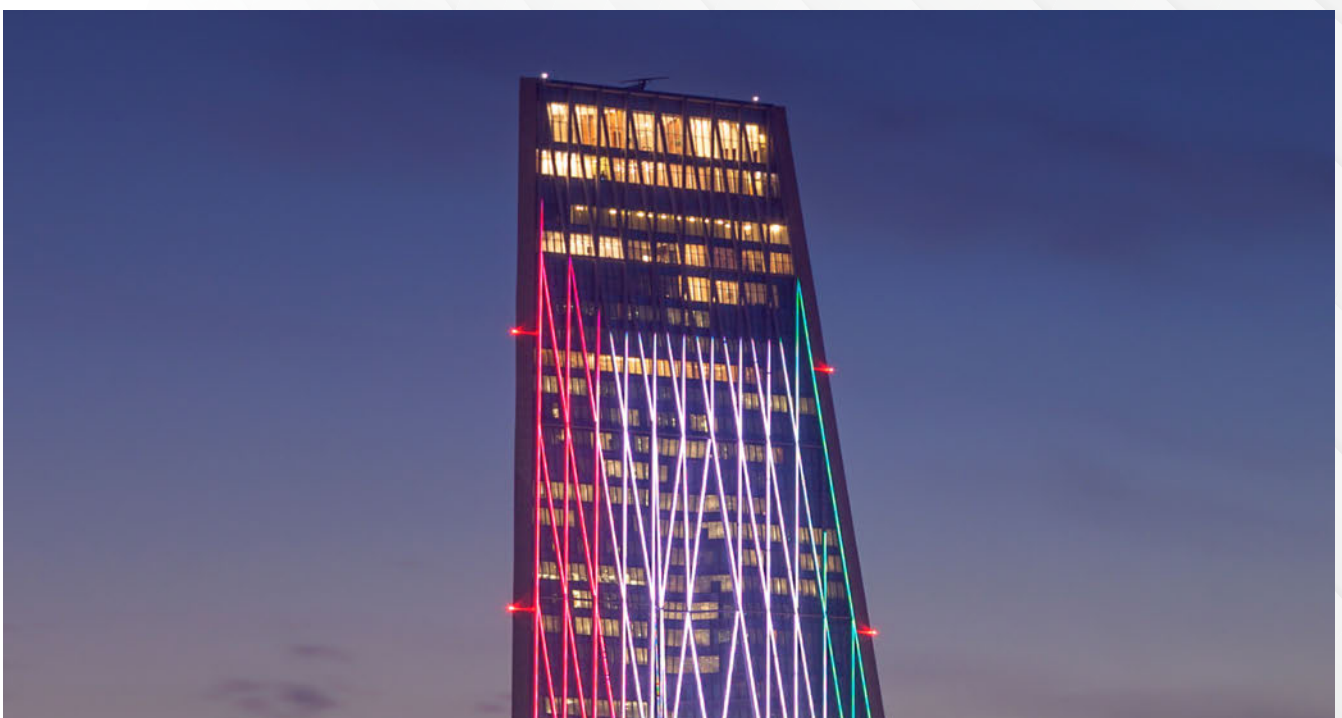
In practice, imbalances arise from shortcomings in source data (inability to collect all debit and credit transactions in the BOP accounts, and different data sources), and means of data preparation. Therefore, a separate account (item) titled "Omissions and Errors (Net)" is included under BOP accounts to indicate imbalances in the BOP, which is derived as a "residual value" based on the value of net lending/net borrowing in the BOP statistics.

As the caption suggests, “Omissions and Errors (Net)” indicates all “Errors” (BOP items that are misstated), and “Omissions” (BOP components that are not recorded) that occurred during a specific period during the preparation of the BOP, which is a common feature in the BOP data.

$$\text{Omissions and Errors (Net)} = \text{Current Account} + \text{Capital Account} - \text{Financial Account}$$

## Part II: Importance of the Balance of Payments

The above enumeration highlights the importance of preparing statistics of BOP that summarizes the economic transactions of an economy with the rest of the world, and helps the governments and decisionmakers to analyse the potential of a particular industry’s growth and formulate policy to support that growth. It also enables researchers and those interested in the economic affairs as well as the individuals to recognize the degree of interconnection of the local economy with the global economies, and the country’s economic conditions compared with the other economies.

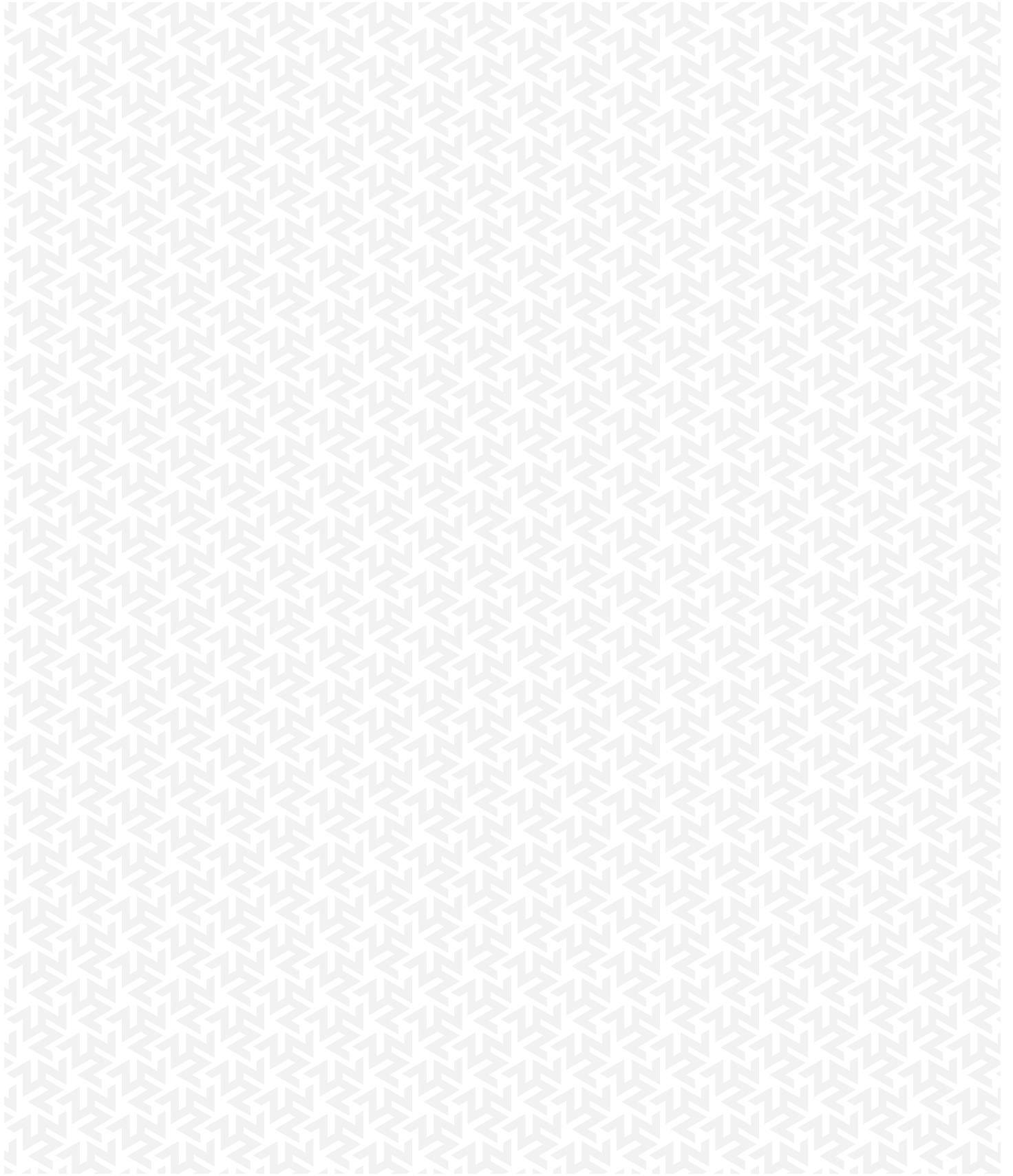


# Conclusion

The BOP is of great significance to the economic analysis of any country, reflecting the degree of interconnection of the local economy with the global economies. The economic transactions captured under BOP reflect, in terms of content, the structure, strength and competitiveness of the national economy, as well as its response to changes in external forces that can affect production.

For more details on the methodology of BOP preparation for the State of Kuwait, visit the website of the National Summary Data Page (NSDP) for the State of Kuwait:

<https://www.cbk.gov.kw/ar/statistics-and-publication/nsdp>



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