

INTERNATIONAL ECONOMICS

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OVERVIEW

INTERNATIONAL ECONOMICS

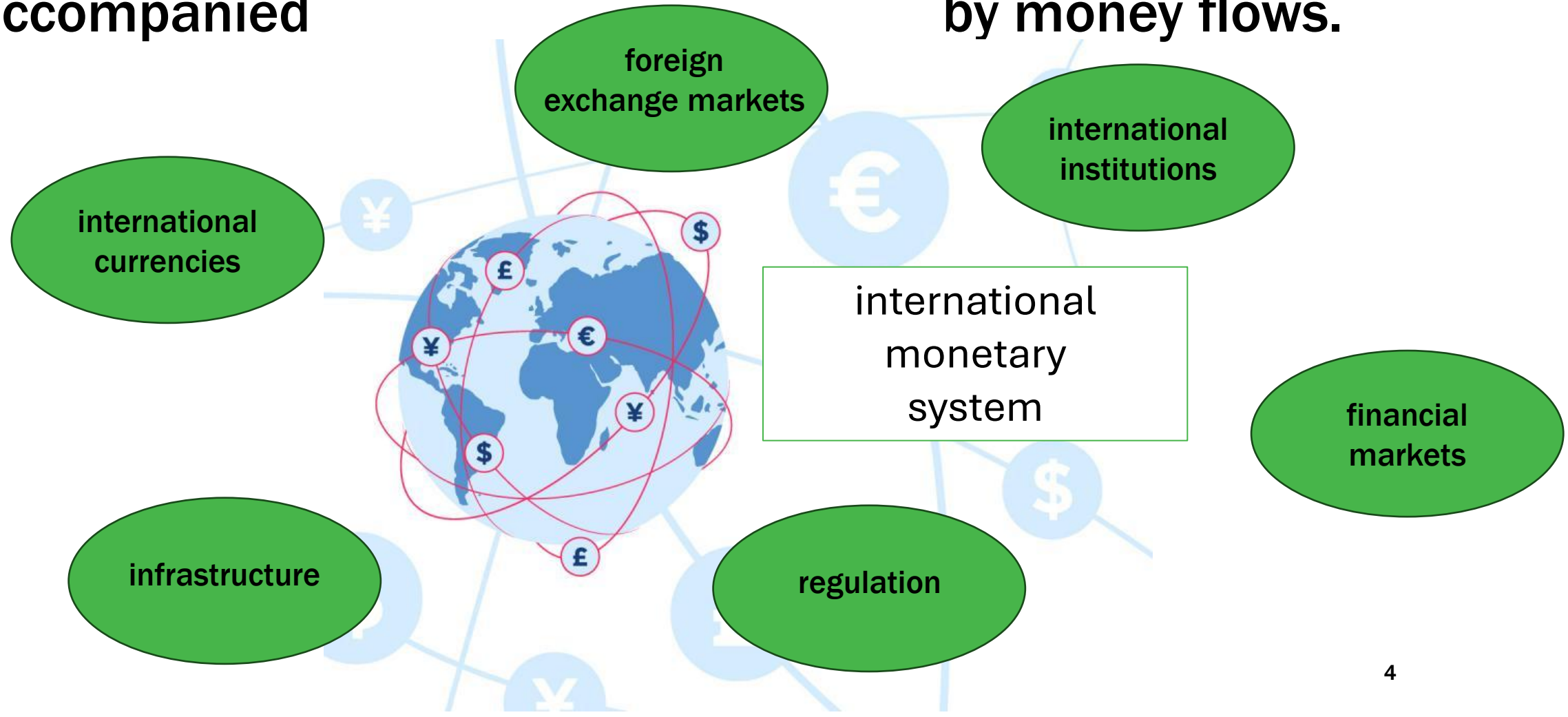
- CH1: CONSEQUENCES OF INTERNATIONAL TRADE
- CH2: INTERNATIONAL PAYMENTS
- CH3: ROLE OF INTERNATIONAL MONETARY FUND (IMF)

CHAPTER 2 (LPD9): INTERNATIONAL PAYMENTS

1. INTERNATIONAL PAYMENTS
2. FOREIGN EXCHANGE MARKET AND FLOATING EXCHANGE RATES
3. STABLE EXCHANGE RATES

1. INTERNATIONAL PAYMENTS

International transactions (between countries) are accompanied by money flows.



On different levels...

- in terms of flows of goods and services (international trade)

e.g. import and export transactions

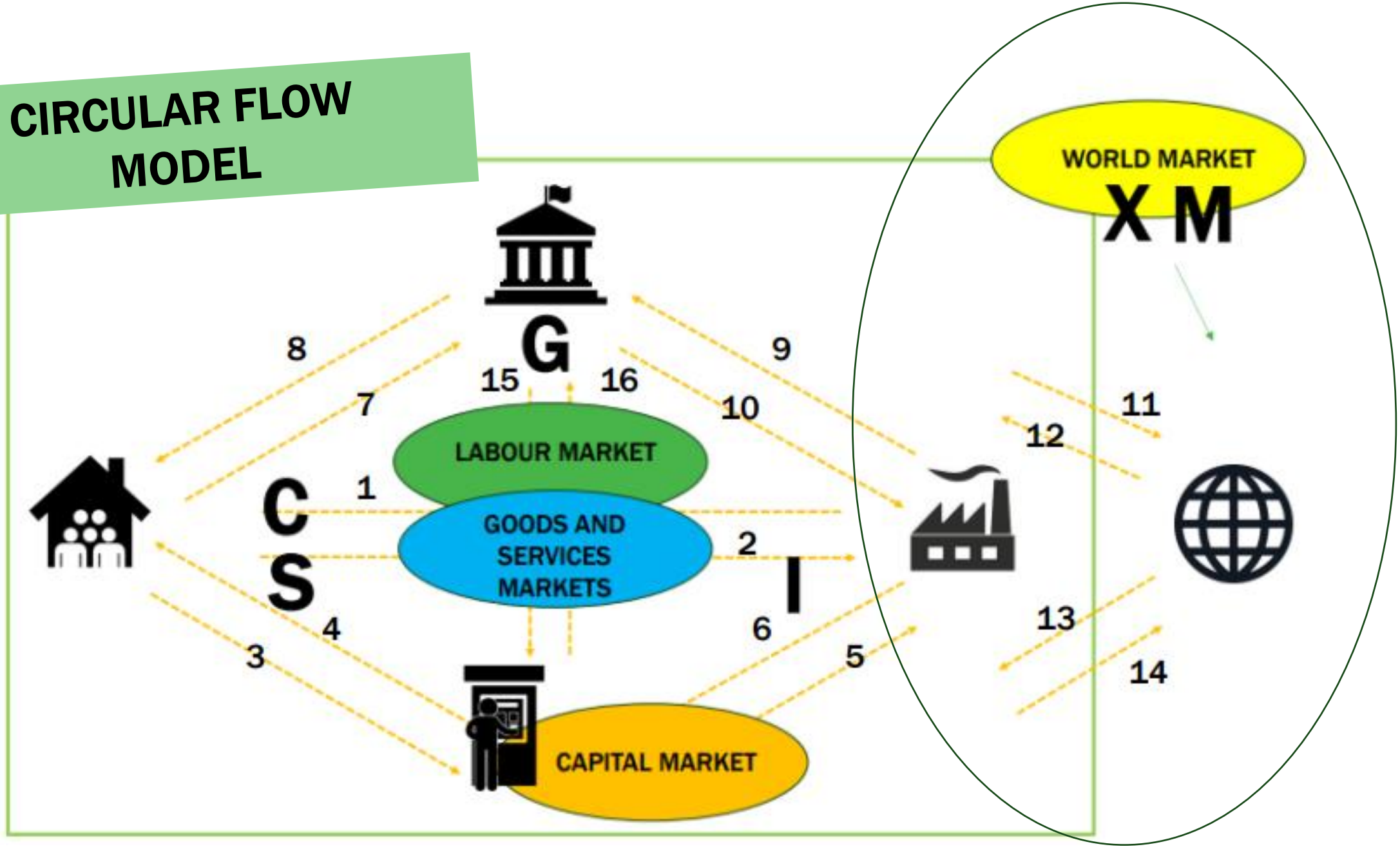
- in terms of capital flows

e.g. international loans, development aid, FDI

- in terms of migration flows

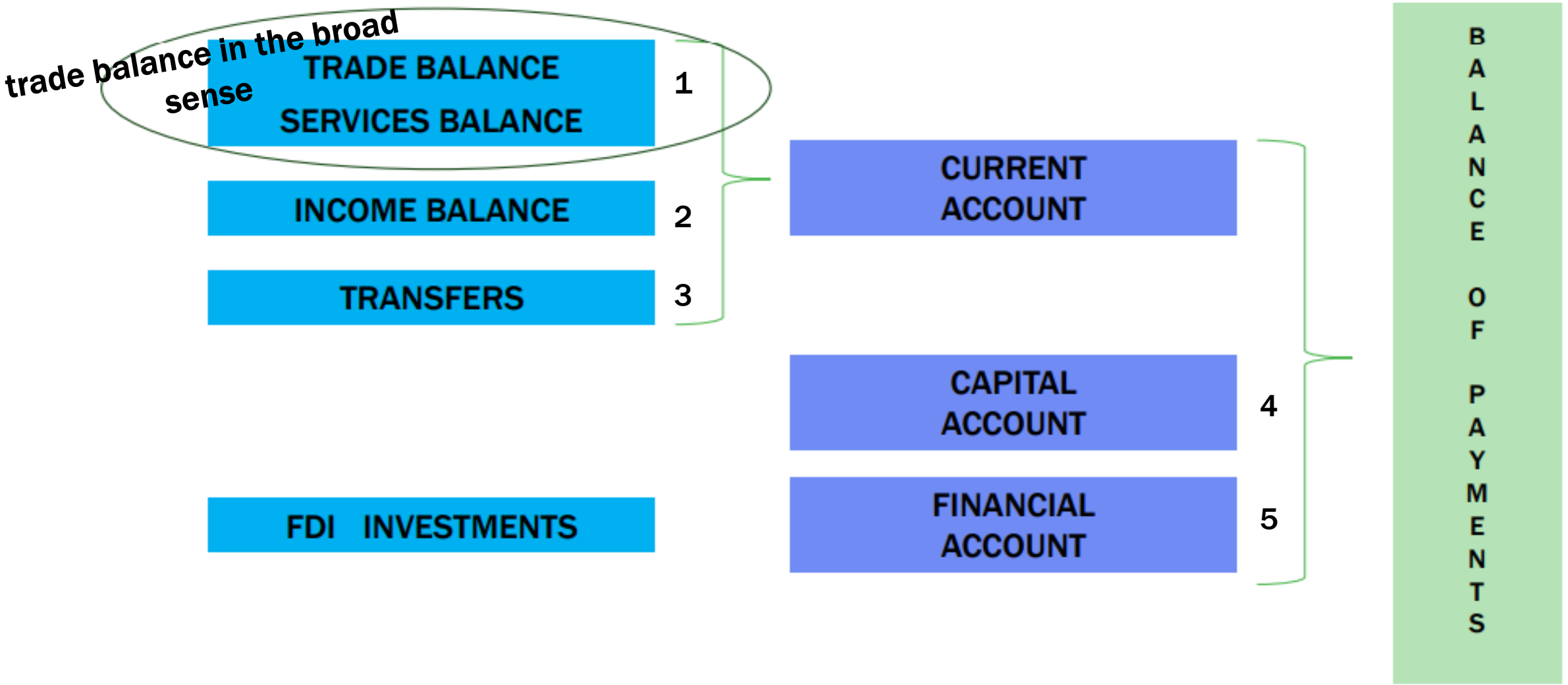
e.g. income transfers in the context of cross-border work

CIRCULAR FLOW MODEL



BALANCE OF PAYMENTS

Overview of all incoming and outgoing cash flows of a country



1 Imports and exports of goods >>> trade balance X-M
services >>> services balance

2 Labour and capital income
e.g. incoming and outgoing wages/salaries of cross-border work
e.g. incoming and outgoing dividends and interest

3 Transfers
e.g. contributions to EU (membership), development aid

4 Unilateral transactions

e.g. debt cancellation (small part of balance of payments)

5 Investments

e.g. FDI (!)

important part of balance of payments!

deficit: incoming capital < outgoing capital

surplus: incoming capital > outgoing capital

Example for Belgium…

Betalingsbalans

Aanpassen | Export | Mijn Queries

Eenheid	Miljoenen euro's			
Stroom	Saldo (net)			
Frequentie	Jaarlijks			
Periode	2021	2022	2023	2024
Rubriek				
Lopende rekening	9 295	-10 918	1 167	-2 342
Kapitaalrekening	1 081	990	1 143	-910
Financiële rekening	[illegible]	-10 137	2 217	5 614

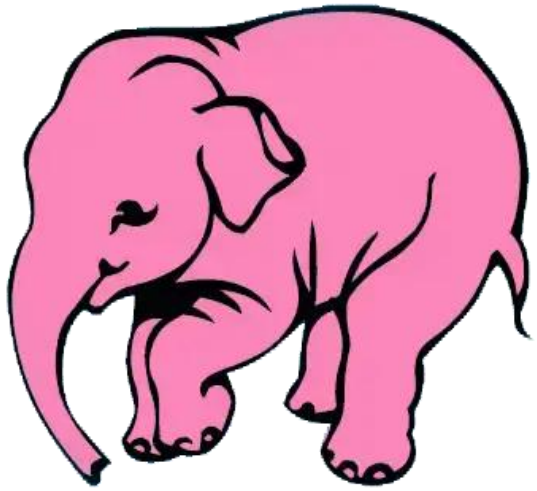
2024: * current account deficit (increased consumption and therefore imports)
* surplus on the financial account (net capital inflow)

2. FOREIGN EXCHANGE MARKET AND FLOATING EXCHANGE RATES

(We'll elaborate on this section and the next section with an example.)

Brewery Huyghe from Melle (near Ghent) produces the specialty beer Delirium Tremens

Turnover is approximately €45 million;
83% of this is exported,
including to the U.S.





Step 1: transaction

Brewery Huyghe organizes a shipment of beer by container to the U.S.

Customer is supermarket chain Walmart.

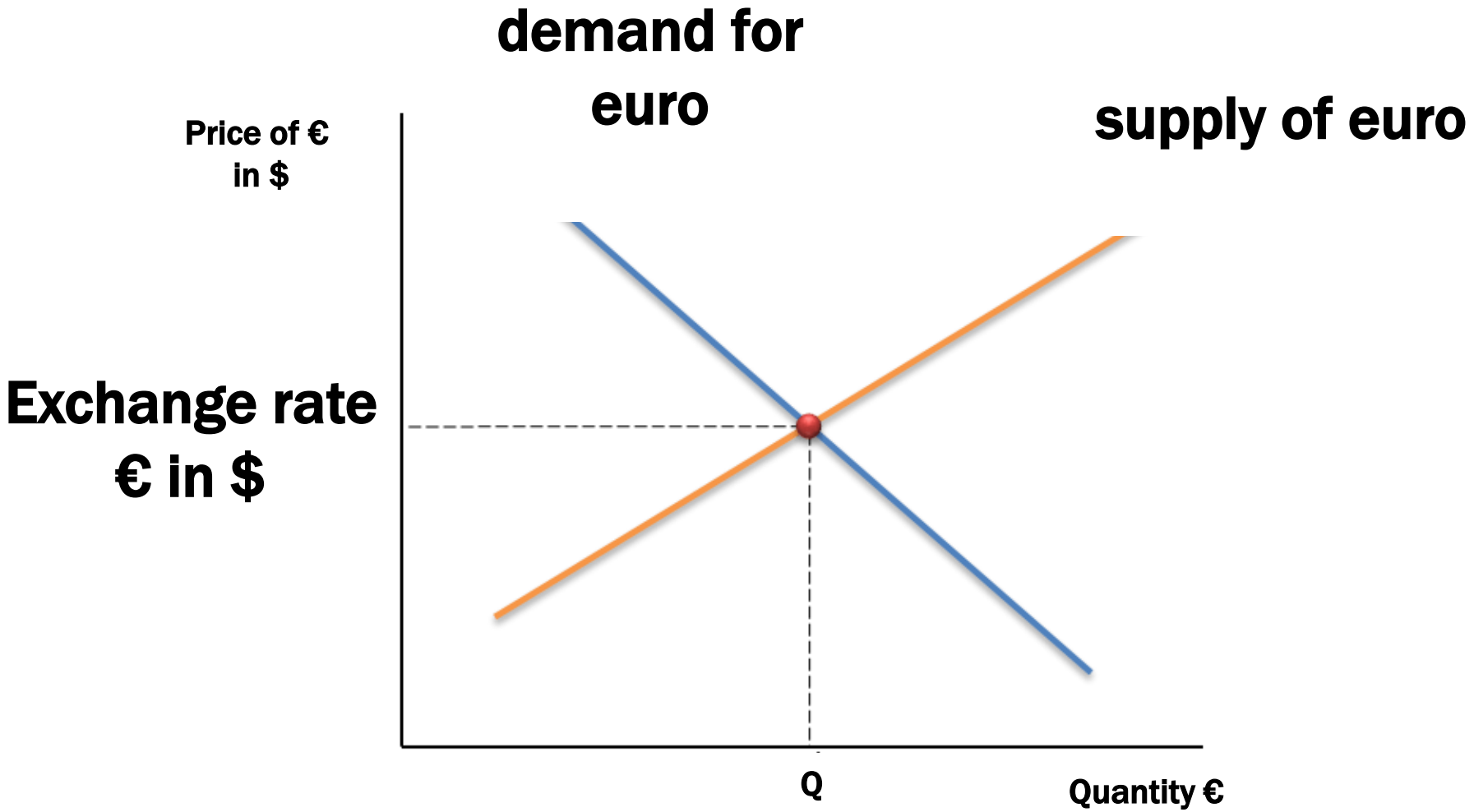
Value of the shipment is €40,000

Step 2: payment

Walmart pays the €40,000 invoice by converting $ in the bank account into €

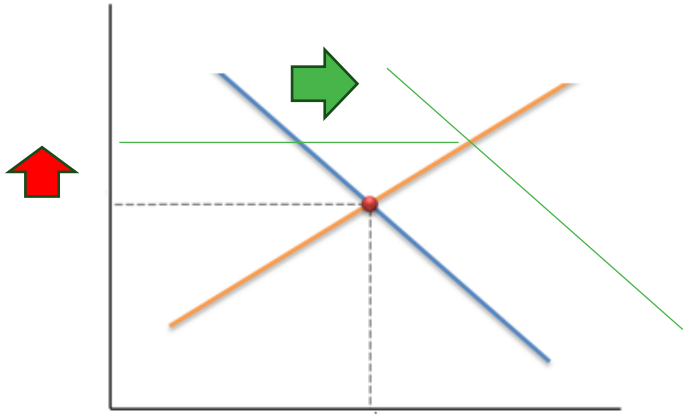
Exchange rate: 1€ = 1,17$ >>> invoice value in $ = $46.800

Exchange rate is established on the foreign exchange market



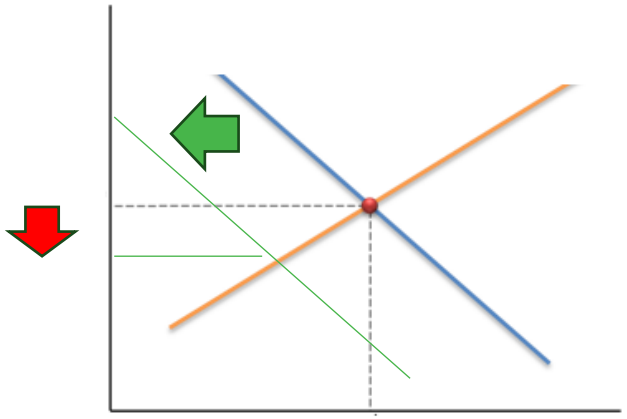
Exchange rate fluctuates due to shifts in supply (and demand)

example: € in $



Appreciation = exchange rate increases

D increases
S drops



Depreciation = exchange rate drops

D drops
S increases

Causes of demand shifts (and supply shifts)

example: € in $

Demand is increasing (supply is decreasing)	Demand is decreasing (supply is increasing)
More imports of European goods by U.S. Interest rates more attractive to investors in Europe versus U.S.	Less imports of European goods by the U.S. Interest rates more attractive to investors in the US versus Europe

Demand is increasing (supply is decreasing)	Demand is decreasing (supply is increasing)
Instability of the $: € is more attractive for investors Inflation in the U.S. higher than in Europe Speculation: € expected to rise	Instability of the €: $ is more attractive for investors Inflation in Europe higher than in the U.S. Speculation: $ expected to rise

System of floating exchange rates

Standard system worldwide!

Advantages

- Automatic balance of payments adjustment
  e.g. Deficit
  >>> currency depreciates due to fall in demand
  >>> products are becoming cheaper worldwide
  >>> exports are rising
  >>> balance of payments deficit is falling (and vice versa)

Advantages

- Central bank can operate autonomously (currency is not linked to another currency)

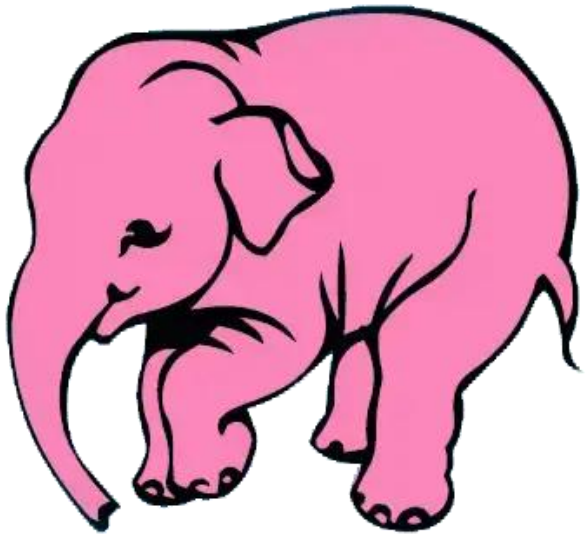
Disadvantages

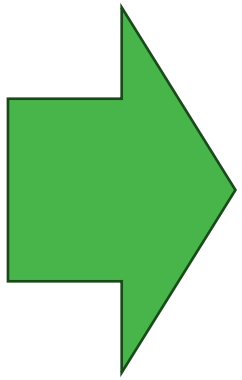
- Exchange rate uncertainty
- Volatility (e.g. speculative movements)

Pound to Euro Tumbles as Speculation Hits Sterling

3. STABLE (of fixed) EXCHANGE RATES

Huyghe Brewery also exports beer
to Denmark







Denmark is a member of the EU, but not of the euro zone!

DANISH CROWN (DK)



INFO

Denmark uses the Danish krone as its official currency.

While it is a member state of the European Union, it has not joined the eurozone or adopted the euro.

The country negotiated the right to opt out from participation under the Maastricht Treaty of 1992. In 2000, the government held a referendum on introducing the euro, which was defeated with 53.2% voting no and 46.8% voting yes.

The Danish krone is part of an ERM mechanism, so its exchange rate is tied to within a 2.25% range of the euro.

An exchange rate mechanism (ERM) is a framework used by governments and central banks to manage and stabilize the relative value of a domestic currency against foreign currencies

Step 1: transaction

Huyghe Brewery organizes a shipment of beer by container to Denmark

The customer is supermarket chain Coop.

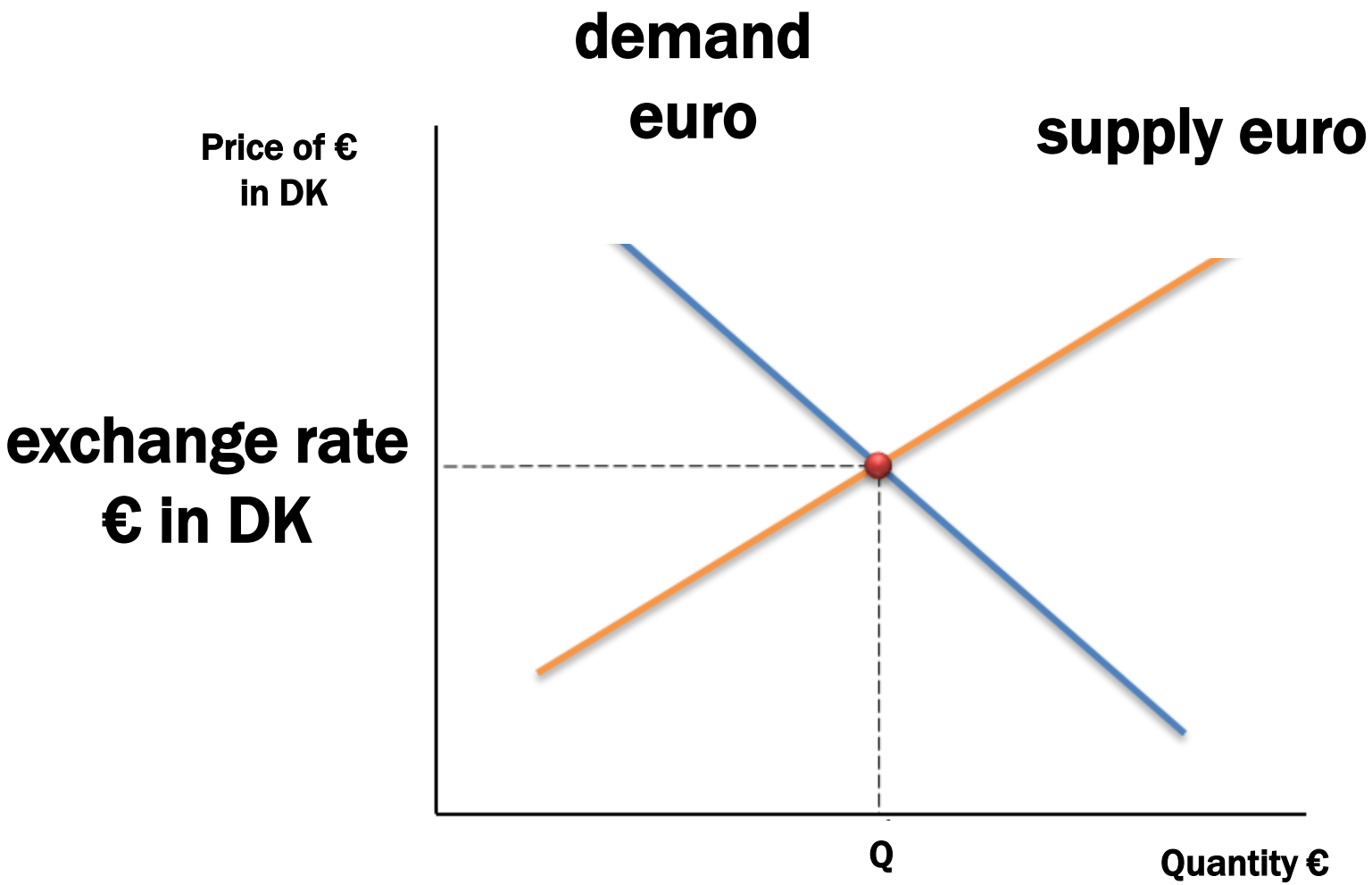
Value of the shipment is €40,000

Step 2: payment

Coop makes payment of the invoice of €40,000 by converting DK into € in the bank account

Exchange rate: 1€ = 7,47DK >>> invoice value in DK = 298.800DK

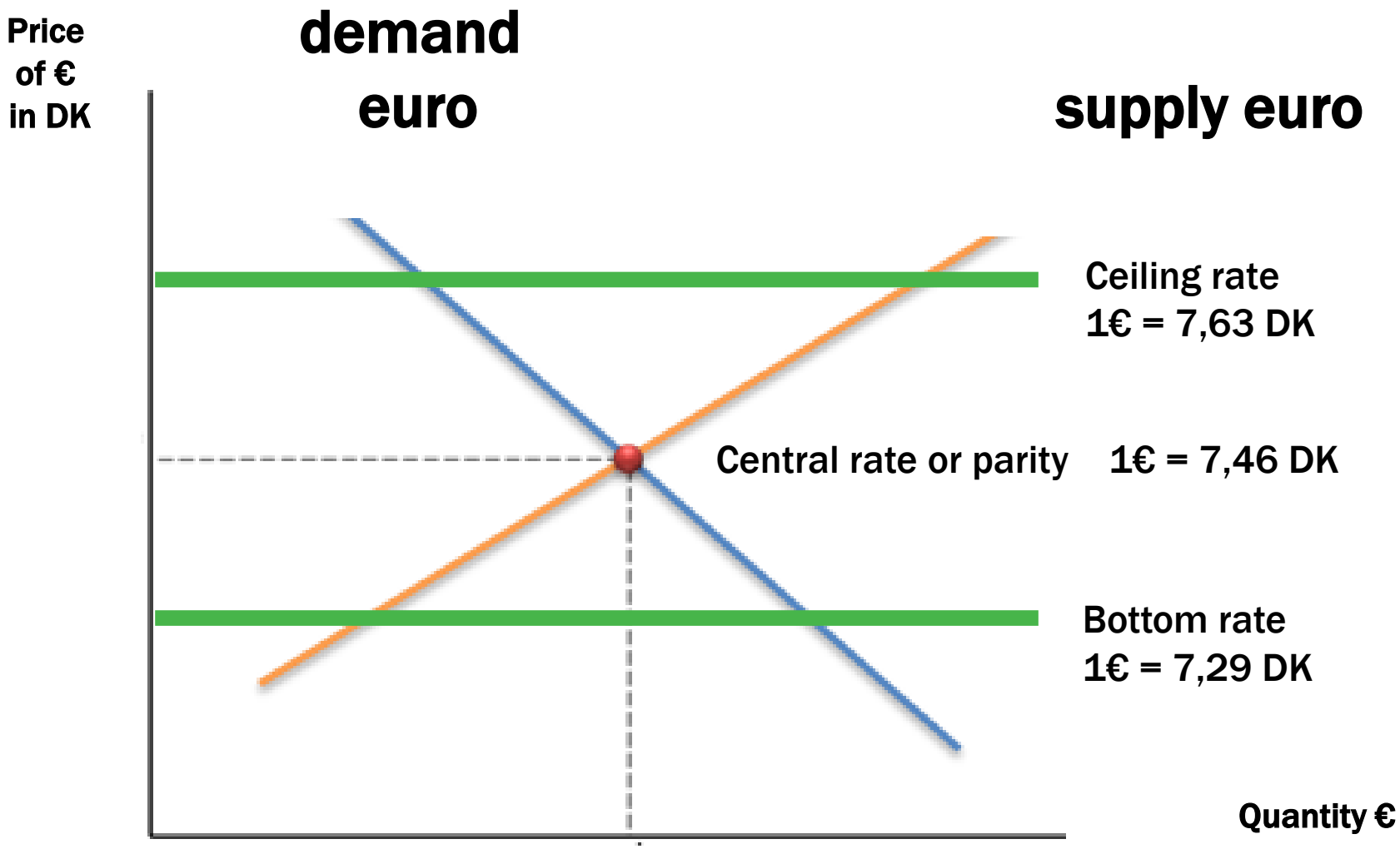
Exchange rate is established on the exchange market



Supply and demand will shift, causing the exchange rate to rise or fall,

But…
the fluctuations are limited!
STABLE (or fixed) EXCHANGE RATE SYSTEM

System of fixed or stable exchange rates

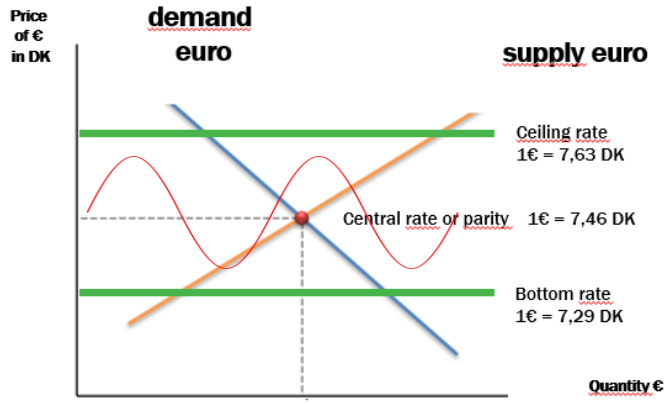


Explanation (part 1):

Central banks of the euro area (ECB) and Denmark set a central rate or parity. They also set a maximum margin of fluctuation in relation to the central rate or parity.

In this case: +2,25% >>> ceiling rate
- 2,25% >>> bottom rate

The Danish central bank ensures that fluctuations remain within the maximum margins.



Explanation (part 2):

DK becomes too strong

Scenario 1:
WHAT IF THE EXCHANGE RATE FALLS BELOW THE BOTTOM RATE?

Initially, the Danish central bank, will sell ("print") DK and buy €

The value of the DK will drop against the €;
the value of the € will increase against the DK

THIS IS CALLED: DEPRECIATION OF THE DK
APPRECIATION OF THE €

The Danish central bank will increase its foreign currency reserves

Draw a depreciation of the DK against the €:

Explanation (part 2):

DK becomes too weak

Scenario 2:
WHAT IF THE EXCHANGE RATE INCREASES ABOVE BELOW THE CEILING RATE?

Initially, the Danish central bank, will buy DK and sell €

The value of the DK will increase against the €;
the value of the € will drop against the DK

THIS IS CALLED: APPRECIATION OF THE DK
DEPRECIATION OF THE €



The Danish central bank will decrease its foreign currency reserves

Draw an appreciation of the DK against the €:

INFO

As well as buying and selling foreign currency directly, the Danish central bank uses domestic interest rates to influence the exchange rate.

DK becomes too strong	DK becomes too weak
Central bank lowers interest rates >>> lower interest rates make it less attractive for foreign investors to park their money in Denmark >>> this lowers demand for the DK, causing the exchange rate to drop again	Central bank raises interest rates >>> higher interest rates make it more attractive for foreign investors to park their money in Denmark >>> this creates additional demand for the DK, causing the exchange rate to rise again

Explanation (part 3):

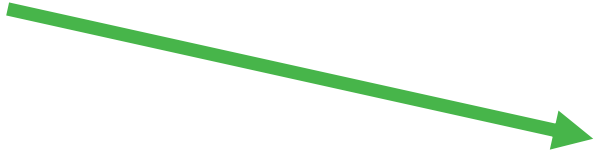
WHAT IF THE CENTRAL BANK INTERVENTIONS DO NOT HAVE AN EFFECT?

REVALUATION OF THE DK AGAINST THE €	DEVALUATION OF THE DK AGAINST THE €
The DK becomes stronger The parity moves from 1€ = 7,46DK to for example 1€ = 7,20DK	The DK becomes weaker The parity moves from 1€ = 7,47DK to for example 1€ = 7,80DK

INFO

Revaluations and devaluations are the result of a decision process between the Danish central bank and the ECB

The entire "deviation tunnel" moves downwards (revaluation) or upwards (devaluation)



Maximum deviation margins remain the same

The Danish central bank holds enormous foreign exchange reserves and pursues a very strict interest rate policy to keep the exchange rate stable.

An official devaluation or revaluation is an extreme political and economic measure of last resort that is only employed if the market value of the DK becomes permanently destabilised by a severe economic crisis and the central bank is no longer able to rectify this using its reserves.

Draw a revaluation of the DK against the €:

Draw a devaluation of the DK against the €:

System of fixed or stable exchange rates

System is only applied to certain currencies (e.g. DK and €)

Advantages

- No exchange rate risks
- No volatility

Disadvantages

- No automatic balance of payments adjustment
- No autonomy of central bank

Historical base: Bretton Woods System (after WWII)

Link naar de lessen geschiedenis

1 Fixed exchange rates against the dollar

Each participating country fixed a fixed exchange rate of its currency against the US dollar.

Small fluctuations around this parity were allowed (usually ±1%).

2 Dollar pegged to gold

The US dollar was exchangeable for gold: $35 per ounce of gold. Other countries thus indirectly linked their currency to gold via the dollar.



GREATER SECURITY AND STABILITY IN WORLD TRADE AFTER WWII

Exchange rate risks eliminated by the introduction of EMU (€)

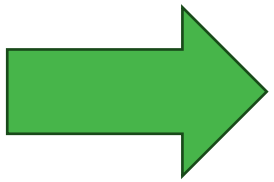
1 One currency → no more exchange rates

Before EMU, each country had its own currency (franc, mark, lira, peseta, etc.). Trade between countries therefore always entailed exchange rate fluctuations.

2 Single currency

The European Central Bank (ECB) introduces a currency.

There is no longer a national monetary policy. No sudden devaluations or revaluations between member states.



BUT... THIS LOSS OF MONETARY AUTONOMY MEANS THAT SOME EU COUNTRIES DO NOT PARTICIPATE IN THE EURO, OTHERS ARE DIVIDED

Weinig publieke steun voor euro in Polen: toetreding tot eurozone lijkt onwaarschijnlijk

- Uit een recente opiniepeiling blijkt dat het Poolse publiek sterk gekant is tegen de invoering van de euro als nationale munt binnen de komende tien jaar.

- Dit verzet is ingegeven door zorgen over inflatie en verlies van monetaire controle, terwijl voorstanders wijzen op potentiële voordelen zoals lagere transactiekosten en grotere handelsintegratie.

- Door de lage publieke steun en het feit dat Polen niet voldoet aan de criteria voor fiscale stabiliteit die vereist zijn voor invoering van de euro, lijkt toetreding tot de eurozone in de nabije toekomst onwaarschijnlijk.

Write-down the key-content of the article in a few bullet-points

Bulgarije verdeeld over invoering euro

In 2007 trad Bulgarije toe tot de EU, en sindsdien hebben verschillende Bulgaarse regeringen pogingen gedaan om van de euro de nationale munt te maken. Toch is het Balkanland, dat 6,7 miljoen inwoners telt, sterk verdeeld over die stap, blijkt uit opiniepeilingen, die overigens laten zien dat het bedrijfsleven overwegend positief is.

Anderen vrezen echter dat gebruik van de euro de prijzen zal opdrijven. Daarnaast is er ook veel wantrouwen richting de Bulgaarse regering, die deze maand is afgetreden vanwege een verhitte discussie over voorgestelde belastingverhogingen. Tel daarbij op dat in een land dat historisch, cultureel en politiek gezien banden heeft met Rusland, velen wantrouwend zijn tegenover verdere loyaliteit aan Europa.

Write-down the key-content of the article in a few bullet-points