

# The Balance of Payments


Lecture 26: The Current Account and International Transactions

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# Recap: Fiscal Policy

Last lecture: the government's lever for managing the economy:






- ✓ **Expansionary** — raise G / cut taxes → stimulate AD → fight recession
  - ✓ **Contractionary** — cut G / raise taxes → cool AD → fight inflation or debt
  - ✓ The **multiplier**: one euro of government spending triggers more than one euro of GDP
  - ✓ **Automatic stabilisers**: unemployment benefits and tax cycles cushion downturns automatically
  - ✓ **Portugal's story**: Troika austerity 2011–2014 → recovery → surplus 2019 → COVID stimulus 2020
- 👉 Today — the **last lecture** of the course 

We zoom out to the global picture: **how do we record all of a country's international transactions?**

# Part I: What is the Balance of Payments?

# Every Transaction With the World

Every time a Portuguese resident interacts economically with a foreign counterpart, that transaction needs to be recorded somewhere.

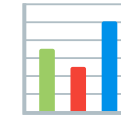
-  A German tourist pays €200/night at a Lisbon hotel
-  A Portuguese student buys a flight on Ryanair (Irish company)
-  Volkswagen sends dividend payments from its Portuguese plant to Germany
-  A Portuguese bank borrows from a French bank
-  Portugal receives EU structural funds

The

## **BALANCE OF PAYMENTS (BOP)**

is a systematic record of **all economic transactions** between residents of a country and the rest of the world over a given period of time. It always **balances** — every transaction has a debit and a credit entry.

# The Structure of the Balance of Payments



The BoP is divided into three main accounts:

## Current Account

Records flows of goods, services, income, and transfers

- Trade in goods
- Trade in services (*tourism is here*)
- Primary income (wages, dividends)
- Secondary income (remittances, aid)

## Capital Account

Records transfers of non-produced, non-financial assets

- EU structural funds & grants
- Debt forgiveness
- Relatively small for most countries

## Financial Account

Records flows of financial assets and liabilities

- Foreign Direct Investment (FDI)
- Portfolio investment (stocks, bonds)
- Other investment (bank loans)
- Reserve assets

### THE FUNDAMENTAL IDENTITY:

$$\text{Current Account} + \text{Capital Account} + \text{Financial Account} = 0$$

Every euro that leaves the current account must come back through the financial account — the BoP always balances.

# Part II: The Current Account in Depth

# Current Account Components

## CURRENT ACCOUNT

records **all flows of real resources** (goods, services, income) between a country and the rest of the world.

$$CA = \text{Trade in Goods} + \text{Trade in Services} + \text{Primary Income} + \text{Secondary Income}$$

Component	Credit (inflow)	Debit (outflow)
<b>Goods</b>	Exports of goods	Imports of goods
<b>Services</b>	Tourism receipts, transport	Tourism abroad, freight
<b>Primary income</b>	Wages earned abroad, dividends received	Profits sent to foreign owners
<b>Secondary income</b>	Remittances received, EU transfers	Remittances sent abroad, contributions

 **Tourism sits in “Services”** — one of the most important items in Portugal’s current account.

# Trade in Goods vs Trade in Services

 **Trade in goods** (the “visible trade balance”)  **Trade in services** (the “invisible trade


Physical products that cross borders: - Portugal **exports**: wine, cork, footwear, machinery, olive oil - Portugal **imports**: cars, petroleum, electronics, machinery

Portugal typically runs a **goods trade deficit** — imports more goods than it exports.

balance”)

Intangible services: - Portugal **exports services**: tourism (foreigners visiting), transport, financial services - Portugal **imports services**: travel abroad by Portuguese residents, shipping

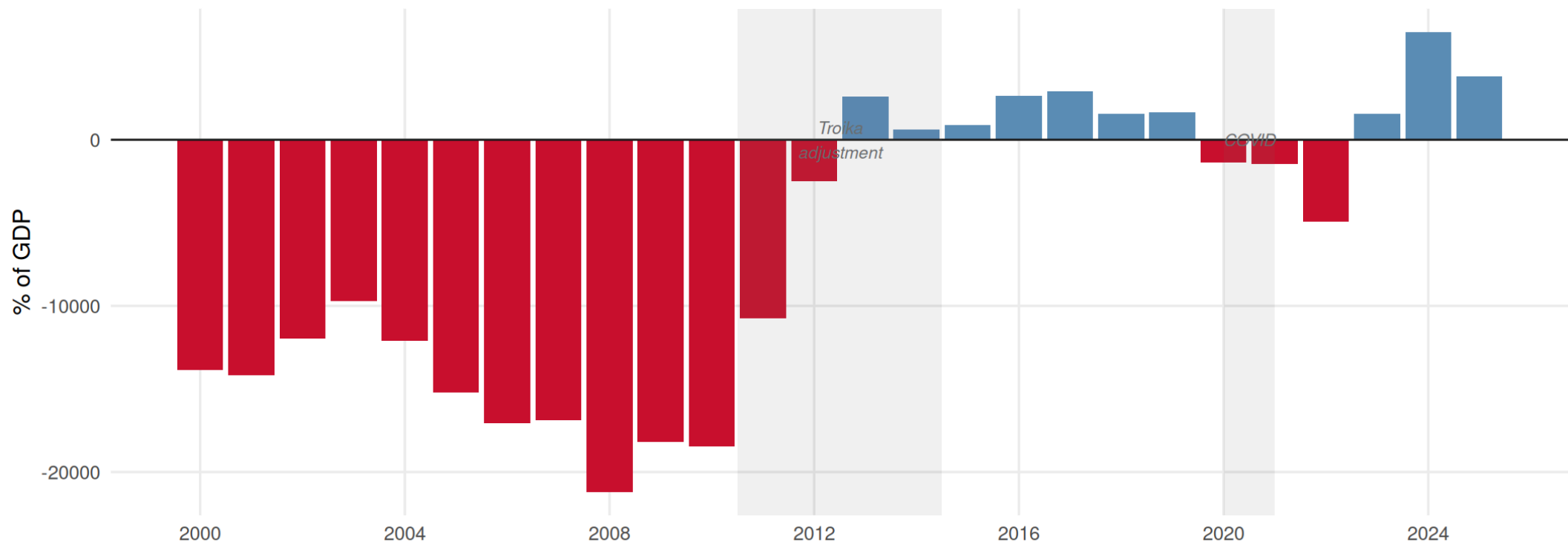
Portugal runs a **services trade surplus** — and **tourism is the main reason**.

 Tourism receipts are one of Portugal’s most powerful economic engines, consistently offsetting the goods deficit.

# Current Account Balance – Portugal

## Portugal: Current Account Balance (% of GDP)

Blue = surplus, Red = deficit



Source: Eurostat (tipsbp20)

👉 Portugal ran persistent **current account deficits** before 2013 — a key driver of the debt crisis. The adjustment to surplus was painful but necessary.

# Part III: Tourism in the Balance of Payments

# Tourism as an Export of Services

This is one of the most important conceptual points of the course:

## A FOREIGN TOURIST SPENDS MONEY IN PORTUGAL

That spending counts as an **export of services** — money flows **into** Portugal from abroad, appearing as a **credit** in the current account.

When a **Portuguese resident travels abroad**, that spending counts as an **import of services** — money flows **out** of Portugal, appearing as a **debit** in the current account.


### Inbound tourism = export of services

 German tourist in Algarve: spends €1,500

 British tourist in Lisbon: spends €800

 American tourist in Porto: spends €2,000

→ All of these **increase Portugal's current account credit**


 Portugal does not need to ship anything — the tourist comes to us. Tourism is an “invisible export.”

### Outbound tourism = import of services

 Portuguese family holidays in Spain: spends €1,200

 Portuguese student studies in UK: pays tuition €15,000

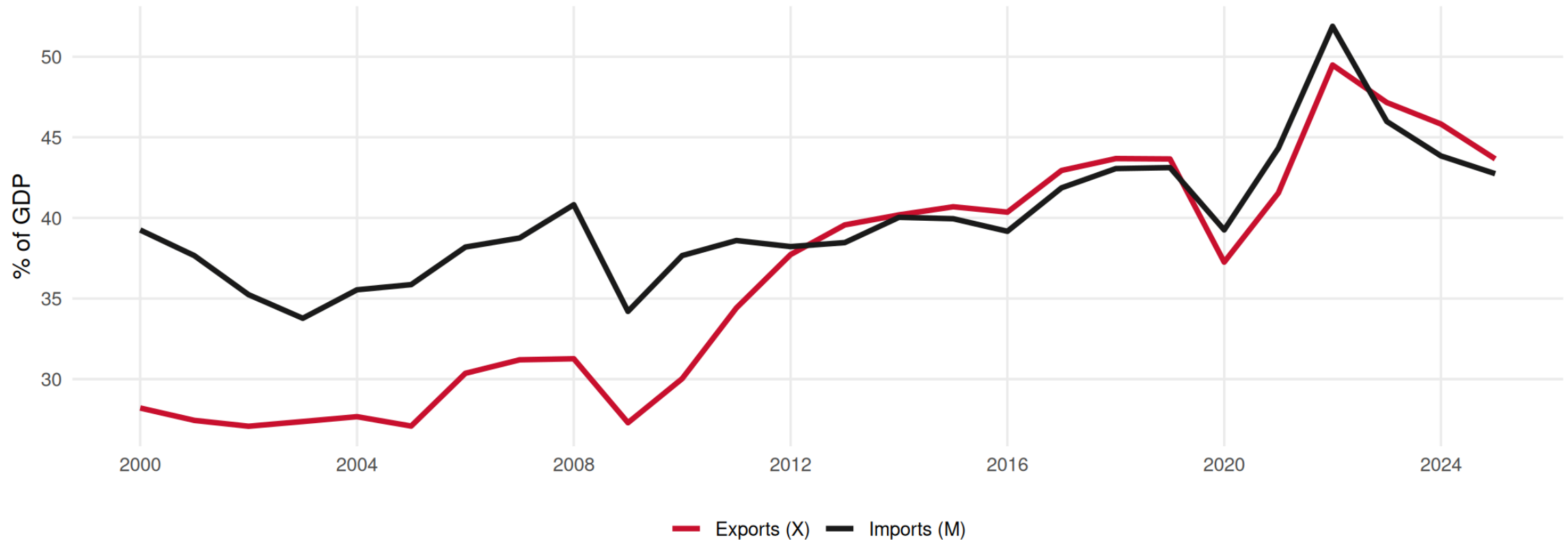
→ These **increase Portugal's current account debit**

 **Net tourism balance** = inbound receipts – outbound expenditure

Portugal's net tourism balance is **strongly positive** — we receive far more from foreign visitors than we spend abroad.

# Portugal's Tourism in the Current Account

Portugal: Total Exports and Imports of Goods & Services (% of GDP)



Source: Eurostat (nama\_10\_gdp). Includes goods and services.

# Why Tourism Matters So Much for Portugal

Tourism is Portugal's **most important single export** — larger than any manufactured good.

**What makes Portugal's tourism balance so powerful:**

- 1 **High receipts per visitor** — Lisbon and Algarve attract high-spending segments
  - 2 **Low import content** — Portuguese hospitality relies heavily on **domestic** food, wine, labour, and culture. Unlike manufacturing, it doesn't require importing lots of components.
  - 3 **Year-round growth** — pre-COVID, tourism demand was growing every year (2013–2019 was a golden period)
  - 4 **Services deficit elsewhere** — Portugal pays for freight, insurance, and financial services imported from abroad; tourism is the main offset
- 👉 When tourism collapses (as in 2020), Portugal's **current account deteriorates sharply** — as clearly visible in the chart.

## THE STRUCTURAL IMPORTANCE:

Portugal's historical **current account deficit** (pre-2013) was driven by importing more goods than it exported.

The **correction** came through:

1. Painful reduction of imports (recession cut demand)
2. **Massive growth of tourism exports** (2013–2019)

Tourism — as a service export — was essential to Portugal's economic rebalancing. This is a live example of the macroeconomic role tourism plays.

# Part IV: Exchange Rates and the Current Account

# The Exchange Rate

The

## EXCHANGE RATE

is the price of one currency in terms of another.

A **depreciation** of the euro (€ becomes cheaper relative to £, \$, etc.) → Portugal becomes cheaper for foreign visitors → **tourism exports rise**

An **appreciation** of the euro (€ becomes more expensive) → Portugal becomes pricier for non-euro visitors → **tourism exports fall**

### Portugal in the Eurozone:

Since 1999, Portugal uses the euro — **no independent exchange rate**.

The euro/sterling and euro/dollar exchange rates are determined by ECB policy and market forces, not by Portugal alone.

👉 A weak euro (as in 2022–2023) **boosted** UK and US visitor numbers in Portugal — holidays became cheaper in pound and dollar terms.

### Real vs Nominal Exchange Rate:

The **nominal** rate is the raw currency ratio.

The **real** exchange rate adjusts for inflation differences:

$$q = \frac{e \times P^*}{P}$$

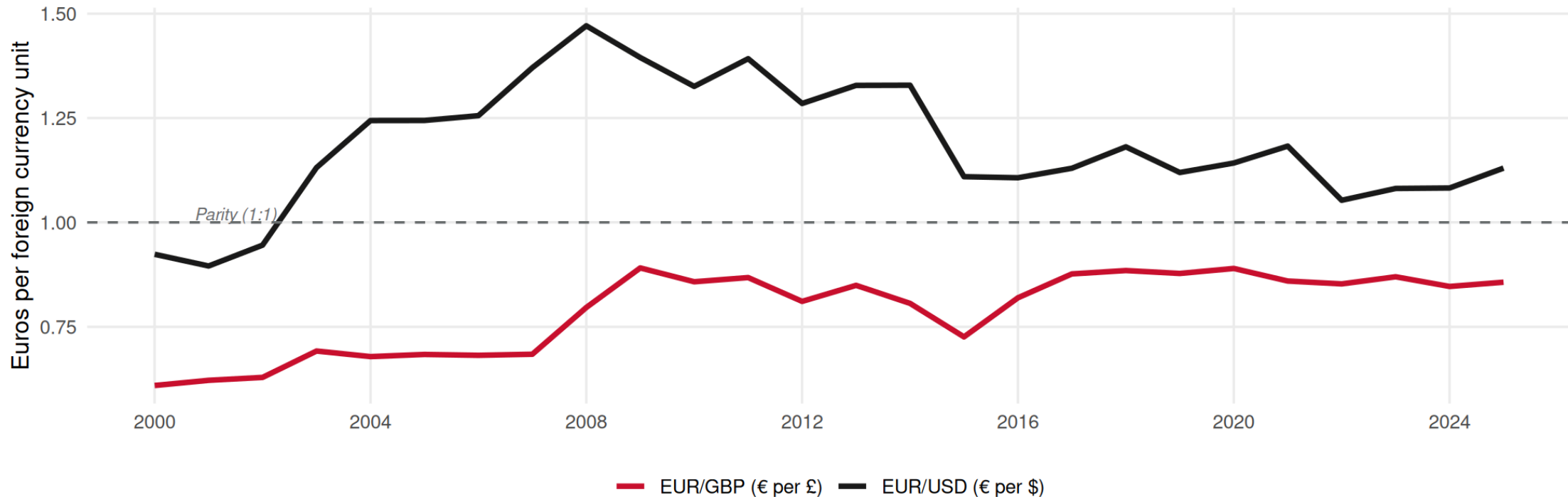
Where  $e$  = nominal rate,  $P^*$  = foreign prices,  $P$  = domestic prices.

👉 If Portuguese inflation is higher than UK inflation, Portugal becomes **relatively more expensive** for British tourists — even if the nominal exchange rate is unchanged.

# Exchange Rates and Tourism Flows

## EUR/GBP and EUR/USD Exchange Rates (annual average)

Higher value = euro is stronger (more expensive for UK/US visitors)



Source: Eurostat (ert\_bil\_eur\_a)

👉 Brexit (2016) caused a **sharp GBP depreciation** — British tourists found Portugal more expensive overnight. A key example of exchange rate risk for tourism.

# Part V: Tying It All Together

# The Macro Block — What We Have Learned

Over the last seven lectures, we have built a complete macroeconomic framework:




## Measurement tools:

- ✓ **Aggregation** — summing individual transactions into economy-wide totals
- ✓ **GDP** — the economy's total output (C+I+G+NX)
- ✓ **Inflation (CPI/HICP)** — the general price level
- ✓ **Balance of Payments** — recording all international transactions

## Policy tools:

- ✓ **Monetary policy (ECB)** — interest rates control credit and spending
- ✓ **Fiscal policy (Government)** — taxes and spending control aggregate demand

## Key tensions:

-  Growth vs inflation
-  Stimulus vs debt sustainability
-  Competitiveness vs price stability





# Tourism Through Every Macro Lens

Macro concept	Tourism connection
<b>GDP</b>	Tourism receipts from abroad = export of services, part of NX
<b>Inflation</b>	Hotel/restaurant CPI tracked directly; cost competitiveness
<b>Unemployment</b>	Tourism creates 9%+ of Portuguese employment
<b>Monetary policy</b>	Low rates → investment boom; high rates → investment pause
<b>Fiscal policy</b>	Tourist taxes; COVID subsidies; VAT on hospitality
<b>Current account</b>	Tourism = Portugal's largest service export; key to external balance
<b>Exchange rates</b>	Euro strength vs £ and \$ directly affects inbound visitor numbers





👉 Tourism is not just an industry — it is a **macroeconomic phenomenon** that appears in every major indicator we have studied.

# Course Wrap-Up

## What you can now do:

-  Apply **microeconomic reasoning** — consumer choice, producer decisions, market equilibrium
-  Think **strategically** — game theory, Nash equilibrium, backward induction
-  Read **macroeconomic data** — GDP, inflation, current account, policy stances
-  Connect it all to **tourism** — the industry you are training for

## What comes next:

-  **Test 2** — May 28th  
Covers: Producer theory (Lectures 11–17) + Macroeconomics (Lectures 20–26)
-  **Group Presentations** — May 29th
-  For the **final exam**: the whole course
-  You've covered more economics in one semester than most business graduates do in a full year. Well done.

# Exercises



# Exercise 1 — Multiple Choice

A British travel company brings 5,000 tourists to Portugal each summer, each spending an average of €1,200 in the country. From the perspective of Portugal's Balance of Payments, how are these transactions classified?

- (A) As imports of services in Portugal's current account — Portugal is buying tourism from the UK
- (B) As exports of services in Portugal's current account — Portugal is providing tourism services to foreigners
- (C) As Foreign Direct Investment in Portugal's financial account — British money entering the Portuguese economy
- (D) As secondary income in Portugal's current account — it represents a transfer from the UK to Portugal

**Correct answer: (B).**

When foreigners spend money on services provided in Portugal, it is an **export of services** — Portugal is “selling” tourism to the UK. This creates a **credit** in the services component of the current account, improving Portugal's current account balance. Option A confuses the direction. Option C would apply if the British company was buying a Portuguese hotel. Option D (secondary income) covers transfers like remittances, not market transactions.



## Exercise 2 — Multiple Choice

In 2016, the UK voted to leave the EU (Brexit). The British pound immediately depreciated approximately 15% against the euro. Which of the following best describes the likely short-run effect on Portugal's tourism sector?

- (A) Positive — British tourists now find Portugal 15% cheaper, increasing inbound demand
- (B) Negative — British tourists find Portugal 15% more expensive, reducing inbound demand
- (C) Neutral — exchange rate changes do not affect tourism as prices are set in local currency
- (D) Positive — a weaker pound means Portuguese tourists can holiday more cheaply in the UK, boosting Portugal's imports

**Correct answer: (B).**

A GBP depreciation means each pound buys fewer euros. From a British tourist's perspective, Portuguese prices (in euros) now cost more pounds. A €100 hotel night that cost £85 before depreciation now costs £100. This reduces the real purchasing power of British visitors in Portugal, lowering demand for Portuguese tourism. Option A gets the direction backwards. Option D describes an increase in Portuguese imports (outbound tourism), which worsens Portugal's current account — the opposite of helping the tourism sector.



## Exercise 3 — Open Question

The table below shows simplified Balance of Payments data for Portugal in a given year (€ billion):

Item	Value (€bn)
Goods exports	65
Goods imports	-85
Services exports (incl. tourism)	45
Services imports	-22
Primary income (net)	-8
Secondary income (net)	+4
Capital account (net)	+3
Financial account (net)	?

- (a) Calculate the **trade in goods balance**, the **trade in services balance**, and the **current account balance**.
- (b) Using the fundamental BoP identity, calculate the **financial account balance**.
- (c) Tourism receipts account for **€28bn** of the services exports figure. Calculate tourism's share of total goods and services exports, and briefly explain what this implies for Portugal's economic vulnerability.

# Solution

(a)

Trade in goods balance =  $65 - 85 = -\text{€}20\text{bn}$  (goods deficit)

Trade in services balance =  $45 - 22 = +\text{€}23\text{bn}$  (services surplus)

Current account =  $(65-85) + (45-22) + (-8) + 4 = -20 + 23 - 8 + 4 = -\text{€}1\text{bn}$  (small deficit)

(b)

BoP identity: Current Account + Capital Account + Financial Account = 0

$-1 + 3 + \text{Financial Account} = 0 \rightarrow \text{Financial Account} = -\text{€}2\text{bn}$

(A negative financial account = net capital outflow, meaning Portugal is acquiring more foreign assets than foreigners are acquiring Portuguese assets — consistent with a small current account deficit.)

(c)

Total goods + services exports =  $65 + 45 = \text{€}110\text{bn}$

Tourism share =  $28 / 110 \times 100 = 25.5\%$

This implies significant **concentration risk**: a quarter of all export earnings comes from a single sector that is highly sensitive to external shocks (pandemics, exchange rates, terrorism, climate). When tourism collapses (as in 2020), Portugal's current account deteriorates sharply and the economy loses a critical income source. Diversifying the export base — developing manufacturing, tech, and other services — would reduce this vulnerability.

# Summary

## Today we covered:

- ✓ The **Balance of Payments** — a complete record of all international economic transactions
- ✓ Three accounts: **Current** (goods, services, income), **Capital** (grants, transfers), **Financial** (investment flows)
- ✓ The **fundamental identity**:  $CA + KA + FA = 0$
- ✓ **Tourism as an export of services** — foreign spending in Portugal = credit in current account
- ✓ Portugal's **current account history** — chronic deficit pre-2013, adjustment via tourism growth
- ✓ **Exchange rates** — EUR/GBP and EUR/USD directly affect inbound tourism competitiveness
- ✓ Brexit as a live example of exchange rate risk for tourism
- 🏆 **The macro block is complete!**

**Thank You — and Good Luck!** 🙌 🍀

**Test 2: May 28th**

Producer theory (Lectures 11–17) + Macroeconomics (Lectures 20–26)

**Group Presentations: May 29th**

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