1. **Balance of Payment**
   - record of all monetary transactions between a country and the rest of the world over a certain period of time; statistical statement showing transactions in goods, services and assets between residents of a country (e.g. individuals, businesses and government) with rest of the word; helps in tracking the flow of funds in the economy
   - Maintained in form of double-entry book keeping system → any receipt from a foreigner is recorded as a credit and payments to foreigners are recorded as debits
   - Prepared by RBI as per IMF's manual BMP6 (Balance of Payments and International Investment Position Manual)
   - Components → Current Account & Capital Account (based on nature of transactions)

2. **Current Account**
   - It includes trade in goods and services, income and current transfers.
   - Further sub divided into → visibles (Merchandise Account/ Trade Account) & invisible account
   - Visibles (Merchandise Account/ Trade Account) → Trade in goods
   - Invisibles Account →
     - Trade in Services (e.g. Softwares, Business, Travel, Transport)
     - Factor incomes → compensation of employees and investment income (interests/dividend/profits)
     - Transfer Payments → Remittances, Gifts & Donation
   - Balance on Current Account = Balance of Trade + Balance on invisibles
     - Balance on Trade → difference between exports and imports of goods
     - Balance on invisibles → difference between exports and imports of invisibles (trade in services, factor incomes, transfer payments)
     - the current account balance shows the difference between the sum of exports of goods and services as well as income receivable, on the one hand, and the sum of imports and income payable on the other.
   - Balanced Current Account → receipts = payments
   - Current Account Surplus → Receipts > payments; a nation is lender to other countries
   - Current Account Deficit → Receipts < payments; a nation is borrower from other countries

3. **Capital Account**
   - record of all transactions which alter the external assets and/or liabilities of a country
   - It includes →
     - Investments (FDI, FPI etc.)
     - External Borrowings (ECB, short term debts, non residents deposits, government aid, intergovernmental, multilateral and bilateral loans etc.)
   - Balance on Capital Account →
     - Capital Account is in balance when capital inflows (like receipt of loans from abroad, sale of assets or shares in foreign companies) are equal to capital outflows (like repayment of loans, purchase of assets and shares in foreign countries
     - Capital Account Surplus → capital inflows > capital outflows
     - Capital Account Deficit → capital inflows < capital outflows

4. Balance of Payments – Surplus and Deficits

- Balance on current account and balance on capital account are interrelated.
  - any deficit in the current account must be settled by a surplus on the capital account.
  - any surplus in the current account must be matched by a deficit on the capital account.
- BOP account is always in equilibrium → Current account + Capital account = 0
- BOP deficits → can be financed using reserve of foreign exchanges (when capital inflows are insufficient to cover the CAD)
- The decrease (increase) in official Forex reserves is called the overall balance of payment deficits (surplus)

5. Errors and Omissions

- It is difficult to record all international transactions accurately; thus errors and omissions are used as balancing item
- BoP = Current Account + Capital Account + errors and omissions