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Clarification C26
Currency unions

FOR INFORMATION

TREATMENT OF CURRENCY UNIONS

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Treatment of Currency Unions

EXECUTIVE SUMMARY

1. The Currency Union Technical Expert group (CUTEG) was established in December 2003 under the aegis of the IMF Committee on Balance of Payments Statistics (BOPCOM) to advise on balance of payments statistical issues relating to currency unions (CU) in the context of the revision of the *Balance of Payments Manual (5th edition)*. It includes representatives from the existing currency unions and three prospective currency unions. At its June 2005 meeting, the Committee welcomed CUTEG's report on the issues it was asked to address. BOPCOM was in general agreement with the outcomes presented, with the remaining issues to be addressed in the drafting of the new Manual. The issues and the outcomes are presented in Appendix I.

2. Despite their growing role in economic arrangements globally, currency unions are barely discussed in the *1993 SNA* and *BPM5*. In paragraphs 90 and 14.34 of *BPM5* and *1993 SNA* respectively, there is the definition of a regional central bank, and recommendations on how to treat the assets and liabilities of these institutions. Developments since the *1993 SNA* was finalized, particularly the establishment of the Eurosystem, has undermined the current advice.¹

3. As is evident from Appendix I, the work of CUTEG has been to develop a comprehensive body of draft definitions and conceptual advice on currency unions to include in the international methodologies.

4. The major features of this work can be summarized as follows:

- **Definitional issues related to regional arrangements**
 - *Definition of a Currency Union (CU)*: essentially characterized by the existence of a central decision making body (commonly a Currency Union Central Bank (CUCB)), of a single monetary policy and a single currency, on the basis of a formal legal agreement. This excludes other forms of monetary arrangements (dollarisation or other “-isation”), which do not present specific balance of payments issues;
 - *Definition of an Economic Union (EcUn)*, where the emphasis is on the free movement of goods, services, capital and persons;
 - *Definition of the territory of a CU*, comprising the territories of the member states, plus the CUCB. The latter is a resident of the CU, and a non-resident of

¹ The Eurosystem comprises the European Central Bank and the national central banks of the EU Member States that have adopted the euro.

any member state. The same applies to any other regional organizations comprising the same, or a subset of the same, economies;

- *Definition of the territory of an EcUn*, consisting of the territory of the EcUn's economies and the relevant regional organizations;
- *Definition of a domestic currency in a CU*, which, at national level in member states, can also be an external asset/liability when issued/held by other member states;
- **Statistical treatment of the CUCB**
 - CUTEG agreed that the CUCB is to be considered as an institution in its own right, holding its own assets and liabilities, and resident in the currency union but nonresident from the point of view of individual member countries.
 - This treatment of the CUCB would represent a change from the current treatment recommended in the *1993 SNA* and *BPM5*, and particularly affects the balance of payments/international investment position of countries that are members of so-called centralized currency unions (East Caribbean Central Bank (ECCB), Central Bank of West African States (BCEAO), Bank of Central African States (BEAC), West African Monetary Institute) (see Appendix II – which notes however that these countries do not in practice follow the current recommended treatment);
- **Treatment of reserve assets in a currency union**
 - Only those foreign assets that meet the criteria of reserve assets at the CU level can be considered as reserve assets at the national level (i.e. claims on non-residents of the CU).
- **Other methodological issues**
 - These arise from the operational aspects of a CU, such as issuance and circulation of banknotes, initial subscriptions to the capital of the CUCB, initial transfer of reserve assets and treatment of intra-CU assets and liabilities.
 - Also, CUTEG agreed that the Balance of Payments and International Investment Position (BOP/IIP) of a CU (and EcUn) cannot result from the simple aggregation of national data since cross-border transactions and positions within the area must be excluded. The geographic allocation of flows/positions thus becomes fundamental for the compilation of a CU BOP/IIP. At national level, transactions/positions with residents of other countries of the CU are still eligible for the national BOP/IIP. At CU level, these become resident transactions (or positions) and need to be treated as such in SNA institutional sector accounts relating to the CU (and EcUn).

Other issues

5. During the BOPCOM's discussions, three other issues were raised:
- The treatment of seigniorage in the balance of payments of the member states of a CU. This issue relates to the attribution of monetary income among CUCB members. The intention is to apply *BPM5/1993 SNA* concepts to the treatment of this income, possibly regarding it as a current transfer.
 - The allocation of the output of a CU central bank back to the member states: as an international organization, a CUCB is non-resident of the country in which it is located; accordingly, its output is not part of the output of that economy, but the compensation of employees is part of the income account of the countries where the employees reside.² Accordingly a discrepancy arises between the output and income accounts of individual member countries and of the area as a whole. This is not an issue peculiar to CUs/EcUns but a consequence of the statistical treatment of international organizations.
 - Whether monetary and currency unions are synonymous. While from the definition it is clear that a monetary union is integral to a currency union, is it possible for monetary unions to exist that “fall short” of a currency union, where a number of sovereign countries adopt a single currency? For instance, common monetary areas, where there is co-existence of national currencies, are sometimes referred to as monetary unions. In drafting the guidance for the updated BPM, the text will make clear that it is focusing on currency union (a type of monetary union) because this situation raises specific issues (definition of a domestic currency, residence of the monetary authorities, treatment of reserve assets etc.).

Box 1. Working Arrangements for the Review of Methodological issues related to Currency Unions and Other Regional Arrangements for the Revision of BPM5

The CUTEg was created in 2004 by the IMF as an expert group to elaborate further on the limited guidance provided by BPM5 with regard to regional balance of payments/international investment position statistics. CUTEg held two meetings (June 2004 in Washington, D.C. and December 2004 in Frankfurt). CUTEg remains in existence and will review the text of the proposed appendix for the updated BPM.

The CUTEg comprises representatives of the IMF, Eurostat, European Central Bank (ECB), East Caribbean Central Bank (ECCB), Central Bank of West African States (BCEAO), Bank of Central African States (BEAC), West African Monetary Institute (WAMI), Saudi Arabian Monetary Authority (for the Gulf Cooperation Council), Czech National Bank, National Bank of Belarus, and Ufficio Italiano dei Cambi.

² The question of the output of a central bank is the subject of another paper before the AEG.

CUTEG's conclusions and recommendations were submitted for consideration of the BOPCOM at its June 2005 meeting. CUTEG's issues and outcome papers are published on the IMF's external website at <http://www.imf.org/external/np/sta/bop/cuteg.htm>

CURRENCY UNIONS

Deliberations of the CUTEG on the main issues discussed ³

<i>Issue</i>	<i>Outcome</i>	<i>Comments</i>
Definition of a Currency Union	For statistical purposes, a currency union (CU) is a union to which two or more economies belong and that has a central decision making body, commonly a currency union central bank (CUCB), endowed with the legal authority to conduct a single monetary policy and issue the single currency of the union. A CU is established by means of a formal intergovernmental legal agreement (e.g. a Treaty).	To belong to a CU, the economy must be a member of the central decision making body, have a representative that participates in its regular monetary policy decision making process, and be subject to its monetary policy decisions No implication for SNA
Definition of an Economic Union	For statistical purposes, an Economic Union (EcUn) is a union to which two or more economies belong. EcUns are established by means of a formal intergovernmental legal agreement among sovereign countries/jurisdictions with the intention of fostering greater economic integration. In an economic union some of the elements associated with a national economic territory are shared among the different countries/jurisdictions. These elements include (1) the free movement of goods and services within the EcUn and a common tax regime for imports from non-EcUn countries (free-trade zone); (2) the free movement of capital within the EcUn; (3) the free movement of (individual and legal) persons within the EcUn. Also in an EcUn, specific regional organizations are created to support the functioning of the EcUn under points (1) to (3). Some form of cooperation/coordination in fiscal and monetary policy usually exists within an EcUn.	No implication for SNA.
Territory of a Currency Union	A Currency Union (CU) territory consists of the geographical territory of the CU economies that comprise the CU, plus the CUCB, where appropriate. Any other regional organizations that comprise the same or a subset of the same economies are included in the CU.	Some updating of the SNA possibly needed.
Territory of an Economic Union	An Economic Union (EcUn) territory consists of the geographical territory of the economies that	Some updating of the SNA possibly needed.

³ The issues surrounding the treatment of the allocation of transactions of a CUCB in a centralized currency union are dealt with in Appendix II.

	comprise the EcUn, and the regional organizations that comprise the same or a subset of the same economies and are set up to manage the functioning of the EcUn.	
Definition of a regional organization	Regional organizations are a subcategory of international organizations; they can be financial or non financial institutions. They consist of those supranational institutions whose members are governments or monetary authorities of economies that are located in a specific region of the world. Regional organizations, which include Currency Union Central Banks (CUCB), are created for many purposes including supporting, guiding, and even governing aspects of the economic relationships or integration processes among the region's economies. Regional organizations are established by means of a formal intergovernmental legal arrangement (e.g. a Treaty).	Some updating of the SNA possibly needed, as no reference is made to regional organizations in paragraph 4.164.
Definition of a Currency Union Central Bank	The Currency Union Central Bank (CUCB) is a financial institution that acts as the common central bank for the member economies of the CU.	A CU does not necessarily imply the existence of a CUCB. The only requirement is the existence of a central decision making body. Changes would be needed in the SNA (paragraph 14.34)
Residence status of regional organization	Regional organizations (including the CUCB), that has the same membership, or a subset of the same membership, as the CU, or economic union, are residents of the union, but not resident in any individual member country of the union.	The CUCB will be considered as an institution in its own right, holding assets and liabilities. Changes would be needed in the SNA (paragraph 14.34).
Residence of multiterritory enterprises	Union-wide incorporation for multiterritory enterprises might create problems in determining the residence of units and the allocation of activities across member states in which the company has operations, and so present difficulties for national statistics.	There is no clear evidence yet that such cases cannot be dealt with under the existing methodology, but this issue might require close monitoring.
Geographical allocation of flows	In principle, financial flows and stocks in CU, EcUn and other regional BOP/IIP statements are to be allocated along the creditor/debtor approach.	As the BOP/IIP of a CU (and EcUn) cannot result from the simple aggregation of national data, the compilation of the BOP/IIP statement of a CU (and EcUn) has implications for the collection of data at the national level. No implication for SNA.

Geographic classification of goods imports and exports from a national and economic/currency union perspective	The present recommendation in the <i>Balance of Payments Compilation Guide</i> to use the country of consignment concept should be reconsidered given the 1998 revision in the UN's International Trade Statistics Manual.	No implication for SNA.
Sector allocation of flows	The sector (and, where relevant, subsectoral) classification of regional organizations that are nonresident of member countries but resident of the CU or EcUn should be decided on a case by case basis.	No implication for SNA. The group recommended that present guidance for sectorizing international (and now, regional) organizations could be reviewed (e.g. distinction between monetary and non-monetary organizations).
Definition of a domestic and a foreign currency in a CU	The currency issued in a CU should always be considered a domestic currency from the viewpoint of each member country, even though this currency can be issued by a nonresident institution (either another CU National Central Bank (CUNCB) or the CUCB). The definition of domestic currency in the <i>External Debt Guide</i> (paragraph 6.12) was confirmed.	SNA needs some updating (paragraph 11.70).
Definition of reserve assets in a CU	Reserve assets shown in the BOP/IIP of CU member countries should include only those assets that (1) represent claims on nonresidents of the CU and (2) are considered as reserve assets of the CU as a whole, meeting the criteria in <i>BPM5</i> .	The standard definition of reserve assets is to be adapted in the context of a CU. No implication for SNA.
Initial transfer of reserve assets	Claims arising from the initial transfer of reserve assets to the CUCB are to be classified as <i>other investment</i> , either under <i>currency and deposits</i> or under <i>other assets</i> .	No implication for SNA.
Initial subscription to the capital of the CUCB	Two possibilities: either to record this transaction under <i>Direct Investment (equity capital)</i> , or to record it under <i>Other Investment / Assets / Other assets/ Monetary Authority</i> in the national data.	During the CUTEG work, a consensus seemed to emerge in favor of the latter option, as it is in line with the current <i>BPM5</i> recommendation (paragraph 422) but this classification issue will be resolved in the drafting phase of the new Manual. No implication for SNA.
Intra CU-CUNCBs claims and liabilities	Transactions and positions corresponding to the balances of CUNCBs/CUCB resulting from their participation in the CU clearing and settlement arrangements possibly to be recorded under <i>Other Investment / Currency and Deposits / Monetary Authorities</i> in the national data.	Final resolution of both issues in the drafting phase of the new Manual.

	<p>Remuneration of intra-CUNCBs balances (including those arising from settlement and clearing arrangements) possibly to be recorded as income on a gross basis under <i>Current account / investment income / income</i> on other investment in the national data.</p>	<p>No implication for SNA.</p>
<p>Issuance and migration of banknotes within the CU</p>	<p>From a national perspective, the CU banknotes issued by another CU central bank (CUCB or CUNCB) are domestic currency and an external asset at the same time. If the issuer of the banknotes can be identified, the present balance of payments methodology can be applied in the national data (e.g., recording transactions in foreign banknotes). However, when the issuer cannot be identified, as in the Eurosystem, and in the absence of data on currency in circulation, this methodology cannot be applied.</p>	<p>In a decentralized CU, this is primarily a national compilation issue, as it is almost impossible to distinguish between the two sources of changes in intra CU claims and liabilities—change in domestic circulation of banknotes (not to be recorded in the BOP) and migration of banknotes (to be recorded)—unless there is distinctive markings on the banknotes that can allow the issuer to be identified.</p> <p>No implication for SNA.</p>

CHANGE IN PRESENT GUIDANCE FOR REGIONAL CENTRAL BANKS

1. From among the issues reviewed by the CUTEG, AEG members may wish to be particularly aware of CUTEG's proposals for the treatment of regional central banks, renamed by CUTEG as Currency Union Central Bank (CUCB), in a centralized Currency Union (CU). These proposals change the existing *1993 SNA* and *BPM5* treatment.

Background

2. As background, two kinds of CU can be identified. In one model (ECCB, BCEAO, BEAC), the CU has a CU central bank (CUCB) owned by the governments of the member countries. The common currency is issued by the CUCB and central bank operations in each country are carried out by branches or agencies of the CUCB. This model can be referred to as a centralized model. In a second model ("Eurosystème"), the CU comprises a CUCB and CU national central banks (NCBs) of the member countries. The CUCB is owned by the CU NCBs, and not by the Governments. Decisions on the single monetary policy and foreign exchange operations are taken by the decision making bodies of the CUCB, which also coordinates the implementation of the decisions which are primarily carried out by the CU NCBs. This model can be referred to as a decentralized model.

Current international guidance

3. The methodology of *1993 SNA* and *BPM5* recommends that the assets and liabilities of the regional central bank be allocated among national offices in proportion to the claims that such offices have over the bank's collective assets. The reasoning behind this treatment is that "the national office acts as the central bank for that country" (*SNA93*, paragraph 14.34, and 4.164d), which means that BOP statistics should identify for each member country of a CU a monetary authority distinct from other CU member countries. This methodology was set out at a time when there were only centralized CUs in existence and is not applicable to a decentralized model. Indeed, it turns out that in practice even the centralized models do not follow this advice.

4. The existence of a decentralized type of CU (the Eurosystème) was first acknowledged in the *Monetary and Financial Statistics Manual (MFSM 2000)*, which recommended that two different methodologies be applied, depending on the nature of the CU: implementation of the *SNA93/BPM5* methodology for the centralized CU, and imputation of assets and liabilities on a strict residence basis for all agencies forming part of a decentralized CU.

5. The *External Debt Statistics: Guide for Compilers and Users* (paragraph 2.21) does not distinguish between the two models. It states that the CUCB should be considered as "an international organization, and thus a non-resident from the perspective of the national central bank (i.e. national office acting as central bank)". In other words, if a CUCB issues debt in its own right, the claim of the creditor is on the CUCB.

Proposed new international guidance

6. CUTEG came to the conclusion that, whatever the form of the CU, the CUCB should be considered as an international organization, i.e. an institutional unit in its own right, owning assets and liabilities of its own, and non-resident of any member country (see paragraph 19 of Appendix I). This represents a change from *BPM5* and *1993 SNA* methodology, but not from current practices, as in all existing centralized CUs, some parts of the reserve assets have remained unallocated.

7. CUTEG's view raises potential problems in centralized CUs, in which member countries do not have national central banks. In particular, under these circumstances, the issue arose as to whether all transactions of the CUCB with member countries should be recorded in the BOP/IIP of these countries. CUTEG took the view that:

- As in *1993 SNA/BPM5*, each national office acts as the central bank for that country. If no national branch or agency exists in the country, a notional unit should be established for statistical purposes (i.e. as long as national BOP/IIP statistics have to be compiled); this is the implicit recommendation in *1993 SNA* and *BPM5*, as these manuals assume that national agencies exist in all CU countries, and so de facto represents no change in methodology.
- Domestic transactions settled through the CUCB should be attributed to the national office.
- Transactions with non-residents settled through the CUCB are to be recorded in the national balance of payments according to the nature of the transaction, with the counter-entry in the relevant financing item attributed by the CUCB, e.g. reserve assets. A numerical example to illustrate this approach is attached.
- Transactions of residents with the CUCB, where the CUCB is the bilateral counterparty, should be recorded according to the nature of the transaction.

Also from a national perspective, if the issuer of the banknotes can be identified, as is the case with the present centralized CUs (BCEAO, BEAC and ECCB), the present balance of payments methodology can be applied in the national data (i.e., recording transactions in foreign banknotes)⁴.

⁴ In the Eurosystem, issuers of banknotes cannot be identified, making the measurement of transactions in banknotes across borders very difficult. A practical issue arises as to whether existing BOP methodology can be applied in such circumstances.

Evidence of consensus about need for change and recommendations

8. These recommendations, agreed within the CUTEG, were endorsed by the BOPCOM. Indeed, these recommendations to a large extent codify and refine existing practice, as it appears that CUCBs in centralized CUs already keep records of individual member countries positions vis-à-vis the CUCB. Thus the change in methodological approach brings it closer to current practice. The BOPCOM noted that the new methodology has no impact on the calculation of GDP.

BALANCE OF PAYMENTS TRANSACTIONS/POSITIONS IN THE NATIONAL DATA FOR A MEMBER COUNTRY OF A CENTRALIZED CURRENCY UNION: NUMERICAL EXAMPLE

A. Opening period

Let us assume that A and B are the only members of the CU and that the opening position is as follows:

CUCB balance sheet

Assets		Liabilities	
Foreign assets (reserve assets)	500	Banknotes	1600
Claims on CU residents	1500	Deposits of CU banks	400
Total	2000	Total	2000

The creation of a notional monetary authority in each country entails the attribution of domestic assets (credit to governments and banks) and liabilities (banknotes) to each country as follows:

National Agency balance sheet

Country A

Assets		Liabilities	
Net claim on CUCB (reserve assets)	300	Banknotes	1000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	250
Total	1250	Total	1250

National Agency balance sheet

Country B

Assets		Liabilities	
Net claim on CUCB (reserve assets)	200	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	150
Total	750	Total	750

The CUCB has foreign assets of 500, which in this instance are all reserve assets, the total reserves for the union. In turn, the net claim⁵ of the national monetary authority on the CUCB represents the foreign assets (again all reserve assets in this instance) of the country: A and B have reserve assets of 300 and 200, respectively.

In this example, it is assumed that the CUCB has no assets and liabilities on “own account” i.e., no assets or liabilities that do not reflect positions with the national economies.

During the time periods 1, 2, and 3, the following operations take place :

⁵ Net is meant in terms of the difference between the assets and liabilities.

B. Period 1

A imports 100 of goods from Spain (not a member of the CU) which are paid in foreign exchange (euros)

Typically, the resident of A will acquire the foreign currencies he needs from the CUCB, through his domestic bank. The transactions are as follows:

- The bank account at the importer's resident commercial bank is debited (100) and the importer acquires foreign currency (100).
- The commercial bank acquires foreign currency from the CUCB (100) and the commercial bank's account at the CUCB is debited (from 250 to 150). For statistical purpose, it will be assumed that the national agency in country A holds the account of the commercial bank, and that in turn the national agency acquires the foreign currency from the CUCB.
- The CUCB draws down its reserve assets (from 500 to 400), and the account of the national agency is debited in the books of the CUCB.
- Net claims of country A on the CUCB decline due to the debiting of the national agency's account. This decline in net claims reflects transactions in reserve assets (from 300 to 200).

So under the proposed treatment, imports increase with the counter-entry in reserve assets. The BOP transactions and the balance sheet of country A would be as follows :

BOP country A

	Credit	Debit
<i>Current Account</i>		
Goods		100
<i>Financial Account</i>		
Reserve assets	100	

National agency balance sheet

Country A

Assets		Liabilities	
Net claim on CUCB (reserve assets)	200	Banknotes	1000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	150
Total	1150	Total	1150

C. Period 2

A exports the same goods to B for an amount of 120 domestic currency

The transaction is settled in domestic currency through the banking system. The transactions are as follows:

- The resident importer's bank in B settles in domestic currency with the exporter's bank through their accounts at the CUCB. So B's commercial bank account at the CUCB is debited (from 150 to 30) while A's commercial bank account is credited (from 150 to 270). As in period 1, for statistical purpose, it is assumed that the accounts of the commercial banks are held in their respective national agencies.
- Net claims of country A on the CUCB increase (from 200 to 320) due to the crediting of the national agency's account and net claims of B decline (from 200 to 80) due to the debiting of the national agency's account.
- The transaction is neutral for the CUCB as a whole, but does affect the intra-CU composition of net claims on the CUCB, which in this instance is reflected in changes in reserve assets.

In the proposed treatment of the BOPs of A and B, the entries would be as follows :

	<i>BOP country A</i>		<i>BOP country B</i>	
	Credit	Debit	Credit	Debit
<i>Current Account</i>				
Goods	120			120
<i>Financial Account</i>				
Reserve assets		120	120	

<i>National Agency balance sheet</i>				<i>National Agency balance sheet</i>			
<i>Country A</i>				<i>Country B</i>			
Assets		Liabilities		Assets		Liabilities	
Net claim on CUCB (reserve assets)	320	Banknotes	1000	Net claim on CUCB (reserve assets)	80	Banknotes	600
Domestic assets (residents of A)	950	Bank deposits (residents of A)	270	Domestic assets (residents of B)	550	Bank deposits (residents of B)	30
Total	1270	Total	1270	Total	630	Total	630

D. Period 3

B exports the same goods to Nigeria (not a member of the CU) for the amount of 150

The transaction is settled in foreign currency.

- Then the resident of B sells the foreign exchange receipts to his resident commercial bank in B and his account is credited (150).
- The commercial bank sells foreign currency to the CUCB (150) and the commercial bank's account at the CUCB is credited (from 30 to 180). As in periods 1 and 2, for statistical purpose, it is assumed that the national agency holds the account of the commercial bank.
- The CUCB increases its reserve assets (from 400 to 550), and the account of the national agency is credited in the books of the CUCB.
- Net claims of country B on the CUCB increase due to the crediting of the national agency's account.

So, under the proposed treatment, exports increase with the counter-entry in reserve assets. The BOP transactions and the balance sheet of country B would be as follows:

BOP country B

	Credit	Debit
<i>Current Account</i>		
Goods	150	
<i>Financial Account</i>		
Reserve assets		150

National agency balance sheet

Country B

Assets		Liabilities	
Net claim on CUCB (reserve assets)	230	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	180
Total	780	Total	780

E. CONCLUSION

At the end of period 3, the balance of payments of A and B show the following entries :

	<i>Country A</i>		<i>Country B</i>	
	Credit	Debit	Credit	Debit
<i>Current Account</i>	120	100	150	120
<i>Financial Account</i>				
Reserve assets		20		30

These transactions result in an increase of the reserve assets of the CUCB of 50 and its balance sheet has changed as follows :

CUCB balance sheet

Assets		Liabilities	
Foreign assets (reserve assets)	550	Banknotes	1600
Claims on CU residents	1500	Deposits of CU banks	450
Total	2050	Total	2050

National Agency balance sheet

Country A		Country B	
Assets		Liabilities	
Net claim on CUCB (reserve assets)	320	Banknotes	1000
Domestic assets (residents of A)	950	Bank deposits (residents of A)	270
Total	1270	Total	1270

National Agency balance sheet

Country B		Country A	
Assets		Liabilities	
Net claim on CUCB (reserve assets)	230	Banknotes	600
Domestic assets (residents of B)	550	Bank deposits (residents of B)	180
Total	780	Total	780