

MACROECONOMIC STABILITY

Internal balance

Output is at full employment and inflation is low and stable

External balance

The current account can be financed in an orderly manner

e.g: factors impact the balances

- Too much or too little demand
- Uncertainty
- Inflation and exchange rate
- Assets price bubble
- ...

INSTABILITY AND CRISIS

Internal balance

CRISIS

External balance

e.g: possible consequences of the crisis

- Production falls
- Unemployment increases
- Banks fail
- Assets lose their value
- ...

BASIS OF FPP

Financial programming is the design of a set of macroeconomic policies aimed at achieving desired macroeconomic objectives

Accounts for the main sectors of the economy

4 SECTORS

All agents that perform similar economic functions

1

Real Sector:
producing units
within an economy

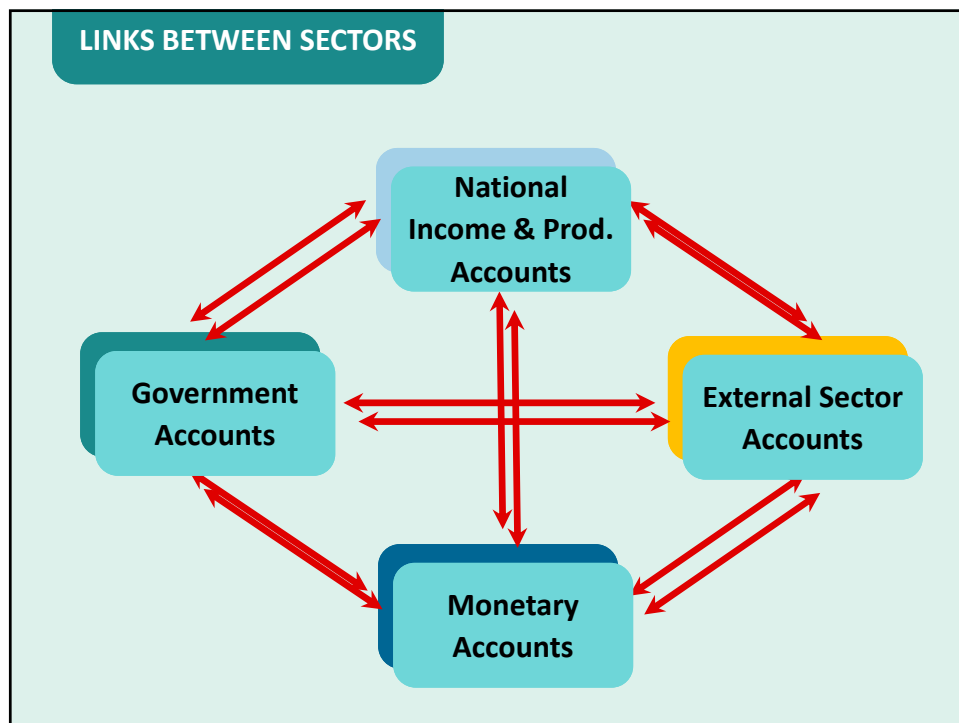
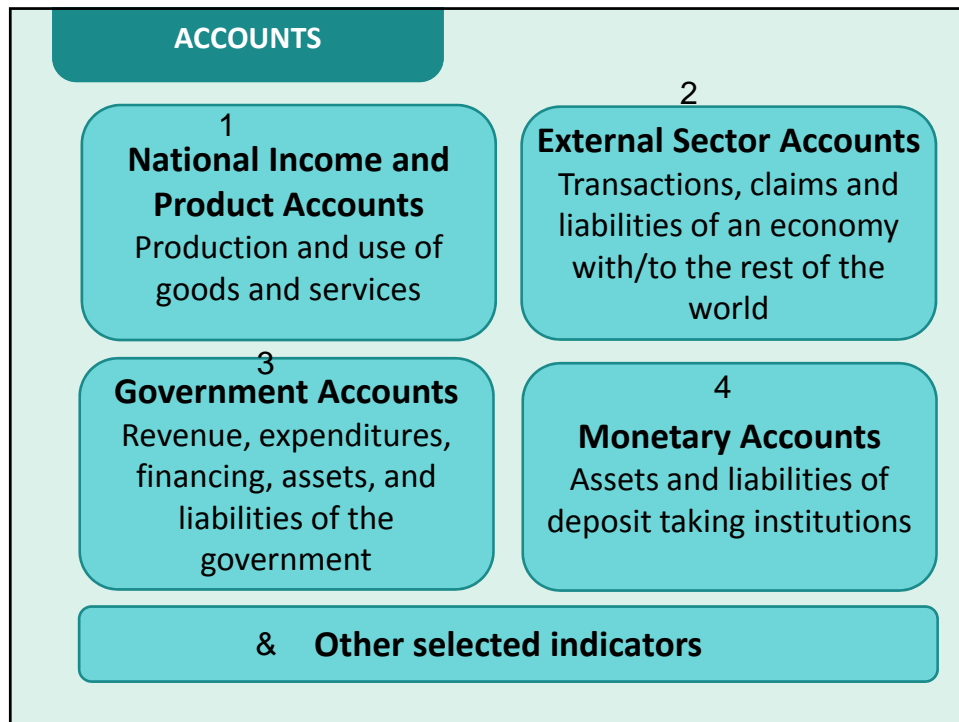
3 **Government
Sector**

4 **Monetary
Sector:
banks**

2

External Sector:
the rest of the
world

- transactions with other sectors
- assets and liabilities to other sectors



To bring together all 4 of the above accounts, accounting identities and behavioral relationships link the developments in these accounts consistently with the link that exists in reality b/w underlying sectors

1

ACCOUNTING IDENTITIES

Flows or positions involving

- agents in one sector and agents in other sector
 - agents of a sub-sector and the broader sector
- should be reflected equally in the respective accounts

The sum of certain aggregates should be the same as the sum of other aggregates, by construction

Examples:

- Monetary and the government accounts should report the same amount of bank lending to the government
- The supply of goods and services must be equal to the effective demand for goods and services

2

BEHAVIORAL RELATIONSHIPS

Behavioral relations link the development of variables of different accounts in an economic meaningful way

Examples:

- An increase in credit to the private sector may affect consumption and/or investment
- An increase in taxes and reduction in government expenditures may affect consumption, production, and imports

WHY ONLY 4 ACCOUNTS

The set of real, external, government, and monetary sector accounts is:

- Comprehensive (and captures fiscal and monetary policy)
- Generally available
- Periodic
- Timely
- Accurate

COMMON CONCEPTS

- Sectors
- Residence
- Stock, flows, and transactions
- Cash and accrual accounting
- Consolidation of accounts

RESIDENCE

Residence is based on center of predominant economic interest (not on citizenship)

- Households and individuals who live in an economy for a year or longer
- Enterprises that produce in the economy
- The government
- Non-profit organizations

STOCK, FLOWS, AND TRANSACTIONS

Stocks

The level at a point in time of the holdings of assets and/or liabilities

Flows

Changes in stocks during a period of time

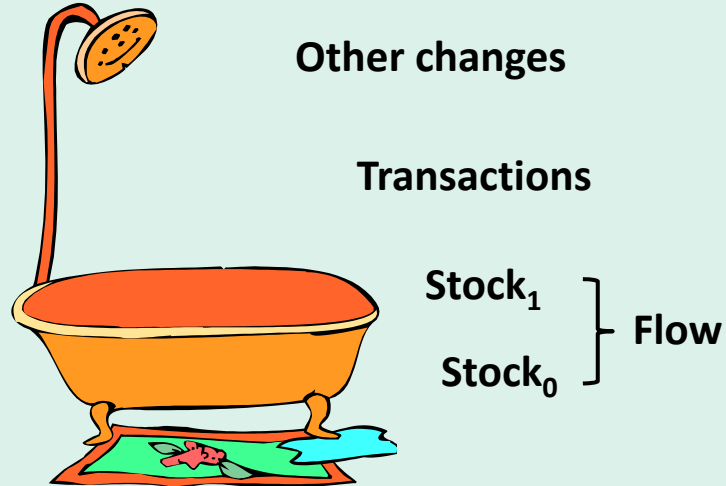
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Transactions

+

Other flows

STOCK, FLOWS, AND TRANSACTIONS



CASH AND ACCRUAL ACCOUNTING

Cash accounting

Transactions are attributed to the period when payment is made

Accrual accounting

Transactions are attributed to the period when they take place, irrespective of when payment is made

CONSOLIDATION OF ACCOUNTS

Eliminates all transactions and debtor-creditor relationships between units within the same sector.

Allows isolating the transactions and debtor-creditor relationships between a sector as a whole and other sectors.