

Balance Sheets – Assets v Liabilities

- Whose Balance sheets
 - Firms and Banks
 - Households
 - Rest of the World
- What Dominates
 - Assets or Liabilities?
 - Firms, Banks, Households, RoW?

Balance Sheet Structure

- Financing Profiles are really expectational profiles
- Hedge – income expectation certain – production dominates
- Speculative – financing expectation also certain
- Ponzi – income expectation certain (negative)
financing expectation uncertain
 - finance dominates

Ponzi accounting

Interpretations – Cushions of Safety

How Good are Balance Sheet Statistics

- Firms --
 - Ponzi Accounting
 - No longer simple bank loans, bonds and equity --New Financial Architecture
- Banks –
 - No Assets – Fee and Commissions, Prop Trading
- Non-Bank Financial Institutions – Ponzi Traders
- No good measures of leverage – no good measures of cushions of safety
- Discount window no longer works to support asset prices

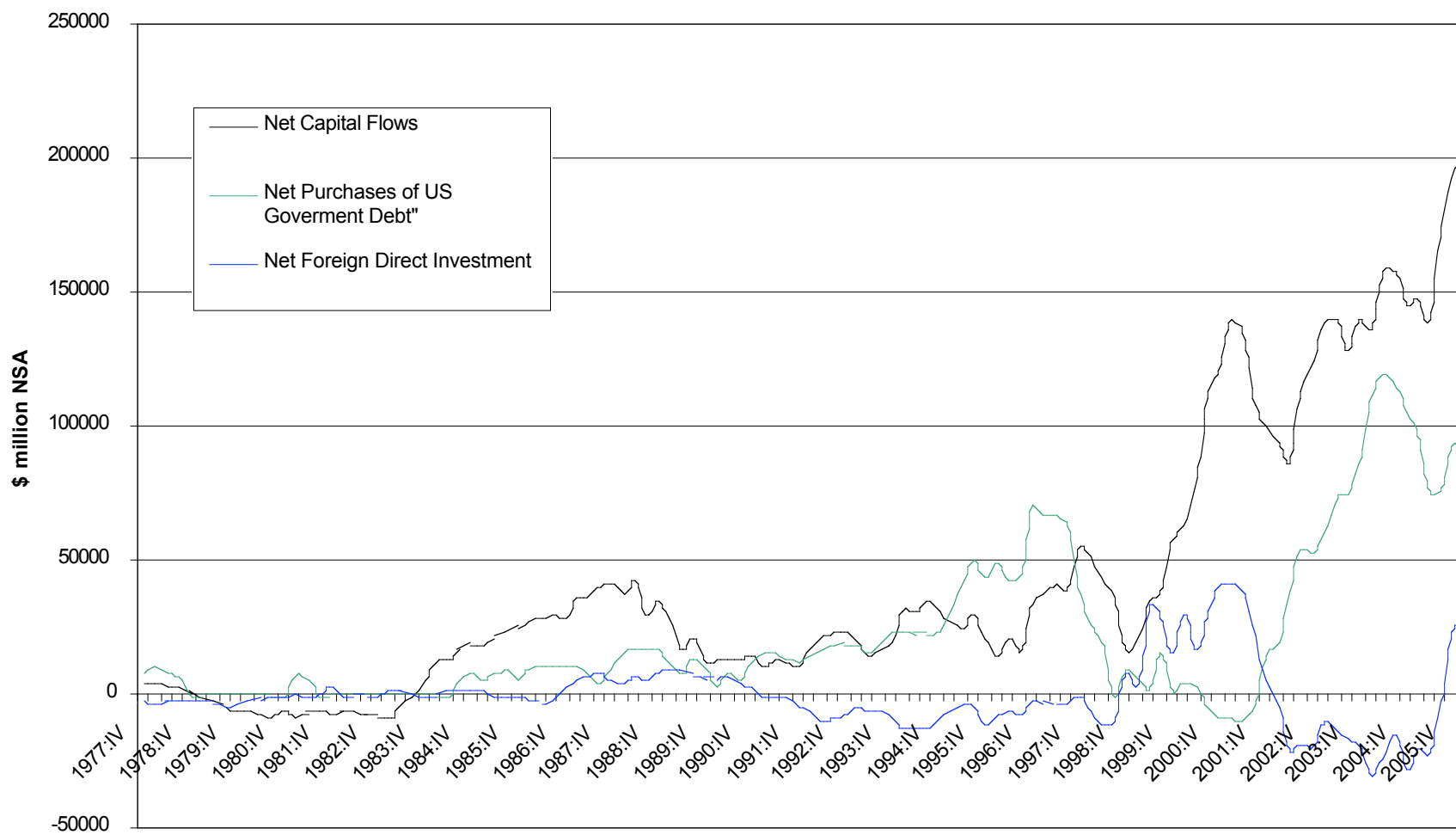
How Good Are Balance Sheets

- RoW –Balance of Payments Stats
 - Created for a Fixed Exchange Rate Regime
 - Low Capital Flows
 - Vertically Integrated Domestic Production
- Factor Services Account
- Exchange Rate Revaluations of Foreign Assets
- Sales of Subsidiaries –
 - German Firms sell more from US subs than from Exports to the US market

Reading Balance Sheets

- Finance now dominates domestic production
- International Finance now dominates Trade
- Rest of World now as important as Domestic
- Need to look at Sectoral Balance sheets in the RoW to Understand International Imbalances

Figure 2 US International Transactions 1977-2006Q1
Quarterly Data 4 Q Moving Averages



Three Basic Points

- Imbalances are normal, part of development process
 - Currently it is the size – due to capital liberalisation and horizontal production
- Determined by Development Policy Decisions
- What appear to be “hedge” structures are indeed Ponzi structures

Development Policy

- Positive Net Resource Flows
 - Trade deficit, capital flows from developed to developing
- Negative Net Resource Flows
 - Trade Surplus, capital flows from developing to Developed Countries
 - Self-Insurance Reserve Accumulation
- Europe and OPEC Developing Asia All Use NNRF Policies for Different Domestic Objectives
 - Asia – employment
 - Europe – price stability
 - OPEC – domestic industrialisation – geopolitical factors

Figure 1 US Balance on Goods Trade
Quarterly Data 4Q moving averages 1978-2005

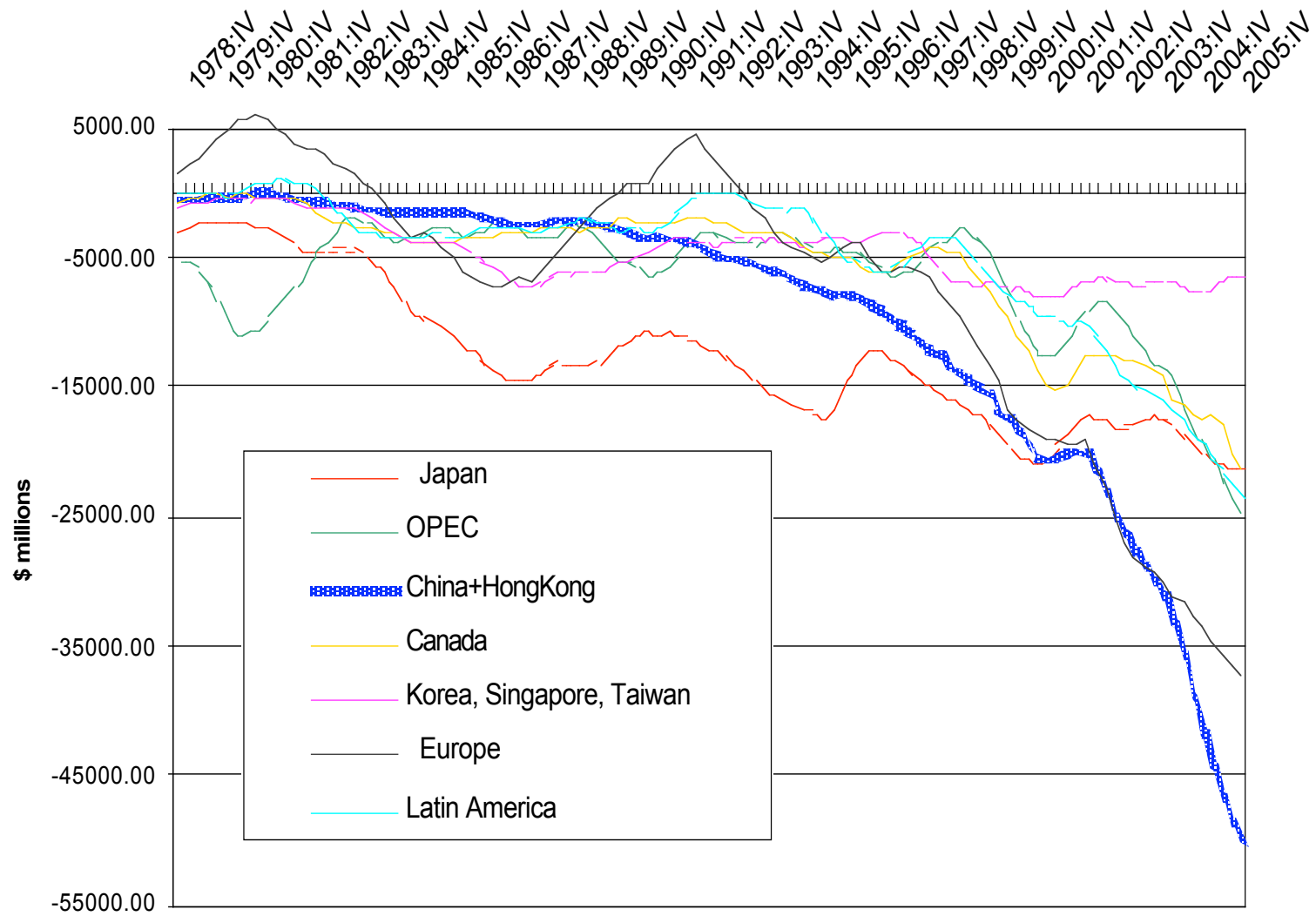
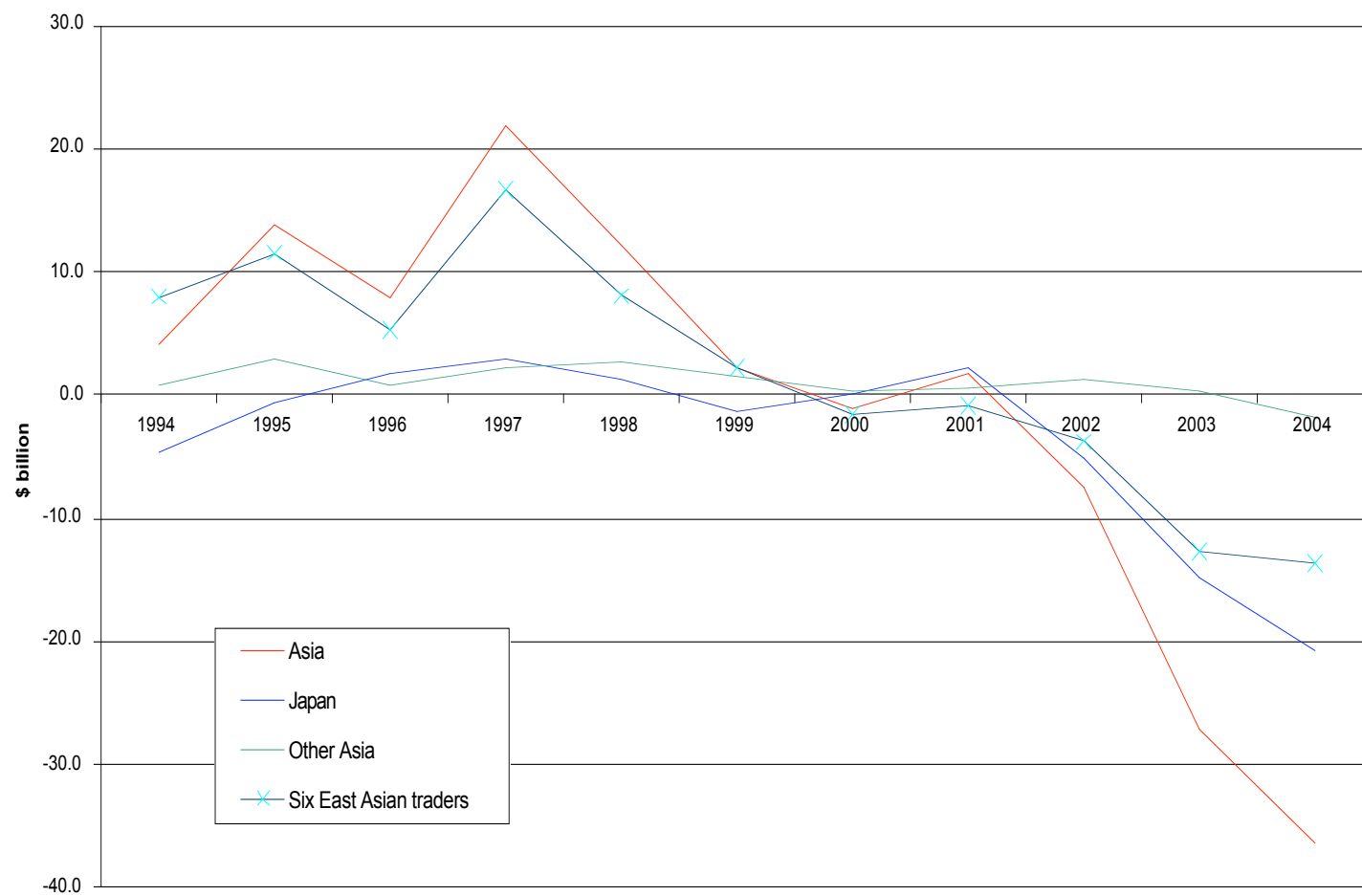


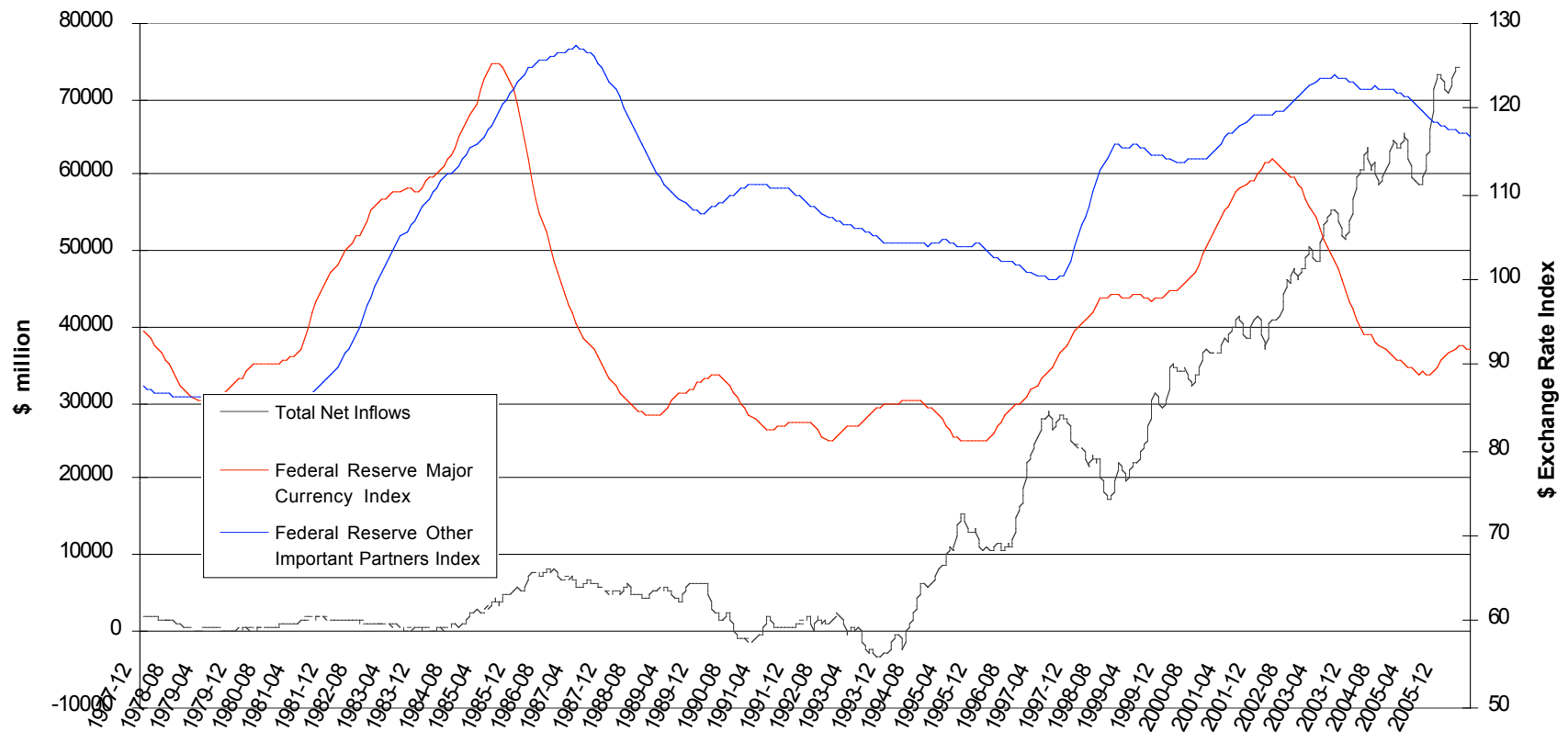
Figure 3 China's Asian Trade Balance



NNRF as a Hedge Profile

- Export earnings cover imports and debt service
- Foreign Exchange Reserves Cover Capital Reversals
- No Risk of Financial Crisis
- Adjustment via Trade Flows and Exchange Rates

Figure 4
Net Foreign Acquisition of US Long Term Securities and Exchange Rates
1977-04/2006 monthly data 12 mo moving averages



US Net FDI Flows 4 Q Moving Averages NSA 1995-2005Q3

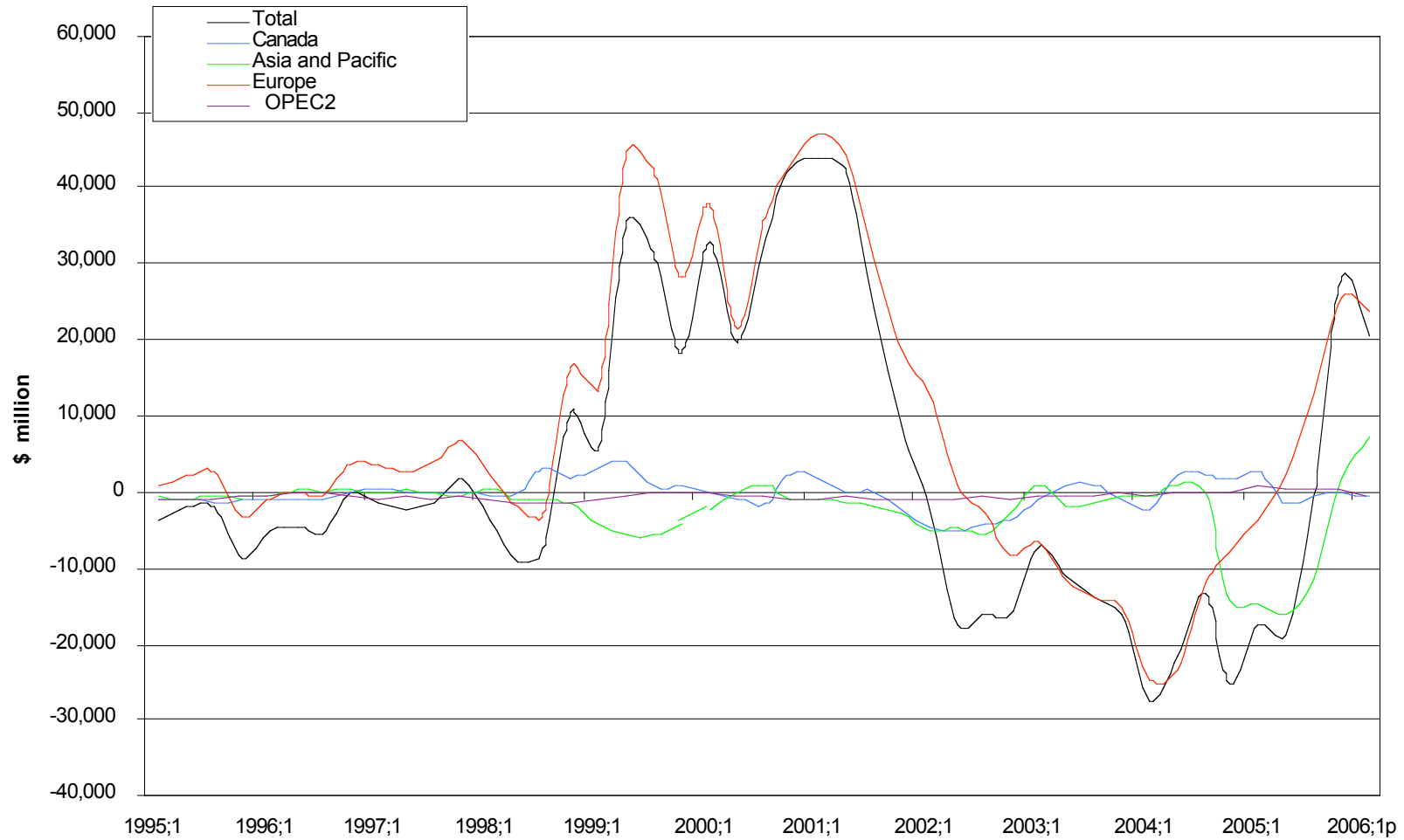
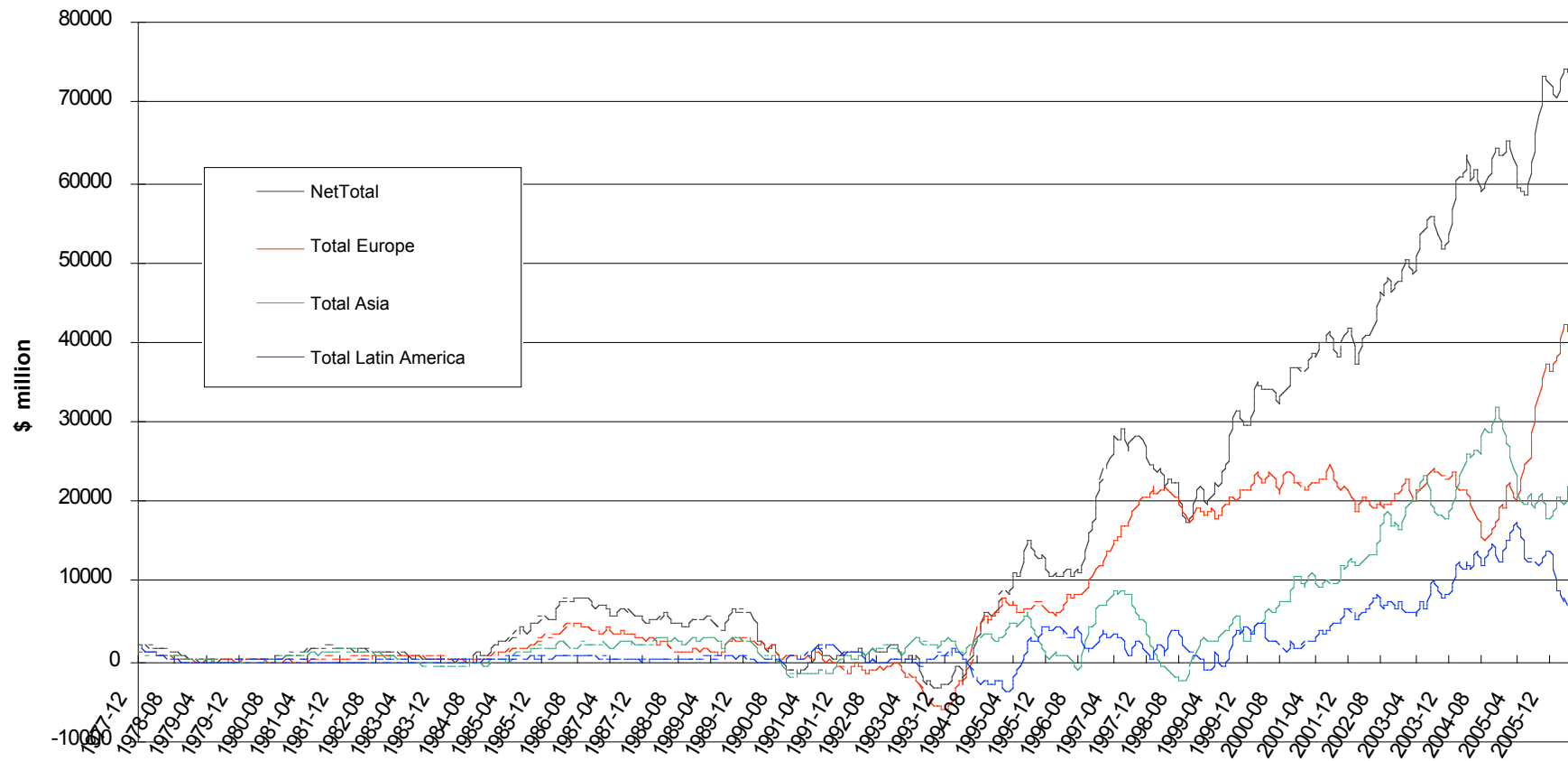


Figure 8 Net Non-Resident Acquisition of US Long-Term Securities
1977-04/2006 monthly data 12 mo moving averages



Asset – Liability Stability

- Domar on Domestic and Foreign Debt Sustainability
- NNRF is stable if rate of increase in foreign lending is equal or greater than the rate of interest on foreign assets – cet par (exchange rate).
- This is the definition of a: ??

Ponzi Financing Scheme

- It is Financial Fragile
- What will trigger Instability?
 - Sectoral Balance sheets
 - Interest Rates