The Power of Money – How Integrating Real Sector Accounts with Financial Accounts Can Improve the Understanding of the Swedish Business Cycle

Karl Johan Bergström
Statistics Sweden

Paper Abstract: This paper presents an approach to understanding business cycle dynamics by integrating real sector and financial accounts through the concept of financial savings. Starting from the expenditure side GDP identity, a financial savings identity is derived stating that the sum of financial savings among the business sector, households, the public sector and the foreign sector is equal to zero. This identity is then filled with sector information from the real and financial accounts, using the fact that financial savings is equal whether calculated from the real or financial side of the economy. After dividing the Swedish business cycle into positive and negative phases and looking at the dynamic financial savings pattern in both phases, the conclusion is drawn that non-financial corporations drive business cycles via shifts in expectations of future investments. In positive business cycle phases, non-financial corporations expand investments more than income showing up as a decrease in financial savings (the opposite holds true in negative phases). For this to be made possible funding is needed providing center stage to the balance sheet. It is found that short-term and long-term loans are the most important funding source for Swedish non-financial corporations. It is concluded that money, derived to have a direct link to financial savings, is endogenous thus serving the funding needs of non-financial corporations. Funding hinges on the will of non-financial corporations to shift their spending expectations relative to income. Given such expectations, a lender has the choice to approve or reject funding requests. If the request is approved money plays the role of enabling spending expectations to be realized. If it is rejected then expectations will not be realized. The former means that nominal growth comes about, the latter means no nominal growth. It is within this context the power of money in business cycle terms needs to be understood.