

People's Guide to Economics

Kwa Zulu Natal Department of Economic Development

March 2009

Volume 1, Issue 1

Special points of interest:

- What is the BOP?
- What is a bubble?
- What is Stagflation
- What is the Futures Market?
- What is a Bourse?
- Who are the G8/G20
- What are credit rating agencies?



Definitions That You Need to Know

BALANCE OF PAYMENTS (BOP)

The total of all the money coming into a country from abroad less all of the money going out of the country during the same period. This is usually broken down into the current account and the capital account. The current account includes:

- Visible Trade, which is the value of exports and imports of physical goods;

- Invisible Trade, which is receipts and payments for services, such as banking or advertising, and other intangible goods, such as copyrights, as well as cross-border dividend and interest payments;

The capital account includes:

- Long-term capital flows, such as money invested in foreign firms, and profits made by selling those investments and bringing the money home;

- Short-term capital flows, such as money invested in foreign currencies by international speculators, and funds moved around the world for business purposes by multinational companies. These short-term flows can lead to sharp movements in exchange rates

BUBBLE

When the price of an asset rises far higher than can be explained by fundamentals. *The Chicago Tribune* of April 13th 1890, writing about the then mania in real-estate prices, described "men who bought property at prices they knew perfectly well were fictitious, but who were prepared to pay such prices simply because they knew that some still greater fool could be depended on to take the property off their hands and leave them with a profit". Such behaviour is a feature of all bubbles.

Economists argue about whether bubbles are the result of irrational crowd behaviour or, instead are the result of rational decisions by people who have only limited information about the fundamental value of an asset. Whatever their cause, bubbles do not last forever and often end not with a pop but with a crash.

STAGFLATION

A period of slow economic growth and high unemployment (stagnation) while prices rise (inflation).

Stagflation occurs when the economy isn't growing but prices are, which is not a good situation for a country to be in. This happened to a great extent during the 1970s, when world oil prices rose dramatically, fueling sharp inflation in developed countries. For these countries, including the U.S. stagnation increased the inflationary effects.

FUTURES MARKETS

Futures markets trade futures contracts, which specify that the underlying index, currency, or commodity will be bought or sold for a specific price on a specific date in the future (known as the expiration date). Traders trade futures contracts to make a profit on the difference between the buying price and the selling price, rather than to ever actually own the underlying commodity. Examples of the types of commodities traded in futures markets are coffee, tea, sugar, and gold and copper.

Kwa Zulu Natal Department of Economic Development

Contact

Liesel Beires

033 2642729 (Tel)

071 116 4160

Beiresl@kznded.gov.za

Websites to Visit

<http://durbanportal.net>

www.kznded.gov.za



CREDIT RATING AGENCY (CRA)

Is a company that assigns credit ratings for issuers of certain types of debt obligations as well as the debt instruments themselves. In some cases, the servicers of the underlying debt are also given ratings. In most cases, the issuers of securities are companies, state and local governments, non-profit organisations or national governments issuing debt-like securities (i.e., bonds) that can be traded on a secondary market. A credit rating for an issuer takes into consideration the issuer's credit worthiness (i.e., its ability to pay back a loan), and affects the interest rate applied to the particular security being issued. Examples of such companies are Moody's and Standard & Poor's.

G7/G8

At its beginnings, the G7 was an informal gathering of heads of state and governments of the world's most advanced economies (Canada, France, Germany, Italy, Japan, the United Kingdom and the United States). It started at Rambouillet in 1975 at the initiative of French President Valéry Giscard d'Estaing and German Chancellor Helmut Schmidt.

In 1998 Russia joined what then became the G8. Since 2005, the G8 has been holding dialogues with the major emerging economies of Brazil, China, India, Mexico and South Africa. The G7/8 deals with such issues as: global economic outlook and macroeconomic management, international trade, energy, climate change, and relations with developing countries. Recently, the summit agenda has broadened considerably to include a host of political-security issues ranging from human rights through regional security to arms control.

G20

The G20 is an informal forum that promotes open and constructive discussion between industrial and emerging-market countries on key issues related to global economic stability. It was created as a response both to the financial crises of the late 1990s and a growing recognition that key emerging-market countries were not adequately represented at the core of global economic discussion and governance.

The members of the G20 are the finance ministers and central bank governors of 19 countries: Argentina, Australia, Brazil, Canada, China, France, Germany, India, Indonesia, Italy, Japan, Mexico, Russia, Saudi Arabia, South Africa, South Korea, Turkey, the United Kingdom and the United States of America. The European Union is also a member, represented by the rotating Council Presidency and the European Central Bank.

GDP

Gross domestic product, a measure of economic activity in a country in a period of a year. It is calculated by adding the total value of a country's annual output of goods and services. $GDP = \text{private consumption} + \text{investment} + \text{public spending} + \text{the change in inventories} + (\text{exports} - \text{imports})$. It is usually valued at market prices.

BOURSE

Is the European way of saying "Stock exchange"; by extension it has come to mean any non-American market for the trading of stocks and bonds:

LIQUIDITY

How easily an asset can be spent, if so desired. Cash is wholly liquid. The liquidity of other assets is usually less; how much less may be measured by the ease with which they can be exchanged for cash (that is, liquidated). Public financial markets try to maximise the liquidity of assets such as bonds and equities by providing a central meeting place (the exchange) in which would-be buyers and sellers can easily find each other.

SHARES

Financial securities, each granting part ownership of a company. In return for risking their capital by giving it to the company's management to develop the business, shareholders get the right to a slice of whatever is left of the firm's revenue after it has met all its other obligations. This money is paid as a dividend. Shareholders have voting rights, including the right to vote in the election of the company's board of directors. Shares are also known as equities. They can be traded in the public financial markets or held as private equity.