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Public Accounts, Interest Rates and Inflation as Determinants of Financial Stability

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In an economic and politically interdependent world the stability tend to be increasingly determined by international development rather than solely by domestic factors. The international financial market is a result of this reality, promoted by trade openness and allows convergence in interest rates and also in inflation rates. This way of economic intervention is an incentive to global stability which is a lever to the sustainability between monetary and real economy in order to prevent, or at least reduces, financial crisis being them monetary, banking or debt. First, we identify public accounts and trade balance as engines to support the domestic financial stability that tend to be pressured increasingly by other economies, namely those that growth stronger and quickly. Second, we emphasize the economic advantageous of financial stability through the convergence in interest rates. Third, we highlight the role of lower inflation rates as a determinant of stability, including as vehicle of short-term economic relationship stabilization and, increasingly, as key factor for international monetary confidence. In this sense, we also underline the need to control the instability provoked by financial inflation. We conclude that monetary and financial policies can be good examples of public policies where sustainability must also assume its role, namely, as defend (Woodford, 2008), when monetary policy has a long run target level of inflation rate as basis of its decisions. This is particularly important when the sources of economic crises and its dimensions showing us an uncertainty time.

Field of Research: Macroeconomics and Monetary Economics, Financial Economics

1. Introduction

The technological evolution promotes new economic transactions. All people are closer and the economic and social phenomena more interdependent, recommending also to solve problems jointly. This reality is a motivation for this paper where we emphasize the economic problems that can be fewer by reducing disparities between economic components, making healthier economies. Nowadays, is a time where we share not only climate disturbances and scarce resources, but also political interventions, mainly public policies as is the case of monetary and financial policies. In these sense, the financial globalization is a contribution to the convergence in interest rates, a vehicle to international trade in goods and services, and also creates better conditions to reduce speculative international financial services.

Our task here is to clarify the relationship between main economic components in order to a better management. We will focus on the disequilibrium in public accounts as a source of instability, mainly within countries with convergence criteria, and also the interest rates as cost of capital and factor of lower capital mobility. First, we pay attention to the real economy and its sustainability emphasizing the role of public accounts and trade balance. Second, we analyse the convergence in interest rates and inflation rates as an instrument

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of economic growth and well-being. We give particularly attention to EU countries as a lever to reach the global stability and enlarge its benefits to other parts of the globe. We use data about short terms interest rates in 2005, 2006 and 2007 that allows us to compare the values between EU countries, showing the dimension of disparities. We also highlight the role of inflation rates as a vehicle of short-term economic relationship stabilization and, increasingly, as key factor for international monetary confidence given the context of instability provoked by financial inflation. We conclude that monetary and financial policies can be good examples of public policies where sustainability must also assume its role, namely, as defend (Woodford, 2008), when monetary policy has a long run target level of inflation rate as basis of its decisions. This is particularly important when the sources of economic crises and its dimensions showing us an uncertainty time.

2. Real Economy and Its Sustainability

Nowadays there is a big effort to search excellence results using efficient ways. The markets play its role in private goods as voting in the market for public goods (Mueller, 2007). Both create positive externalities, but not the same level of efficiency. The monopolistic decisions can offer inefficient services even public services. First, consumers try to reach a quantity of these services until marginal utility be equals zero (MgU=0) because the price (taxes) are not equally supported by citizens as suggest Knut Wiecksell model. Second, the social benefits can be lower than social costs. The monetary and financial policies can be good examples of public policies where the sustainability must also assume its role, namely when monetary policy has a long run target level of inflation rate as basis of its decisions (Woodford, 2008).

The theoretical contributions to macroeconomic convergence through the monetarist, new classical and real business cycle, are together a good support in order to find new ideas for common problems. The sources of economic crises and its dimensions drive us to an uncertain time. The different types of financial crisis been in currencies, banks or debt, creates a need to a better control in real side in order to get economic sustainability, namely, through employment and growth. Technological development reduces the traditional employs and creates new ones with more skills in order to ensure new productive processes. Mankiw and Scarth pay attention to economic growth referring the following: “Long-run economic growth is the single most important determinant of the economic well-being of the nation´s citizens. Everything else that macroeconomists study - unemployment, inflation, trade deficits, and so on - pales in comparison” (Mankiw and Scarth, 2008:266).

The mobility of capital is a result of a higher proximity and interdependency between the economies that today enlarge its effects to the global economy. This fact creates opportunity to new approaches for daily questions in a global market. There is an effort of Keynesians in finding government policies as monetary and fiscal for a reduction in economic fluctuations provoked by real disturbances or even purely monetary disturbances. The dynamic stochastic general equilibrium (DSGE) models measures the evolution of real marginal cost (as wages) to explain variation in inflation rate. This analysis, gives life to the Phillips curve. However, while DSGE models assume short-run departures from equilibrium or natural level of real activity, in fact, the natural rate of output is not a smooth trend, because it suffers real disturbances, and also monetary disturbances. In this sense, monetary policy assumes an important task, especially, as means of inflation control where financial inflation plays an increasing role. This goal is important for control of real and monetary disturbances and both are determinants for

long-run economic growth. Another important component of sustainability of the long-run economic growth is the international trade. In an era of globalization the openness of an economy is a need that tends to be higher for economies with lower dimensions. The openness of an economy to the international market offers other ways to support and sustain the output and employment through financial conditions that also get their main sources of sustainability in real economy. By this way, an increasing in real output though a competitive way and lower level in unemployment rates, gives a very important support to the real economy. The well known relationship between unemployment and output supported by the Okun Law gives also relevance to Phillips curve and, indirectly, put in evidence the role of inflation control and growth in economic sustainability, reducing a need for government expenditures with social cost provoked by unemployment, which implies instability in public accounts.

The economic globalization with a strong real side increase output growth and must be complemented with other macroeconomic variables in order to promote a competitive economy. But an economic sustainability supported by monetary side is not enough and creates more vulnerability in the currency that will impose more social cost. At the same time, can reduce economic activity and then lower public revenues essentially, pressured by competition in corporate tax rates. The result can creates crowding out effects that can provoke disturbances in a sustainable economic growth. Summarizing we can say that growth is a result. The control in unemployment, inflation and trade are ways to get it. Nowadays, it is also required more efficiency in public policies, namely monetary policy, that must be attended the needs of real economy which has its dynamics pressured increasingly, not only by monetary market but also by financial market. These last two markets tend to be more dynamic, inducing real market to become a loser of its own sustainability.

3. The Sustainability of Public Accounts and Trade Balance

The economic and social evolution sometimes occurs in adverse economic environments. Economic growth and economic recession times promote these situations. The economic intervention must be different in each one of these occasions. With economic growth the revenue of government increases and gives opportunity to promote government expenditures. By the opposite, the economic recession creates a need of public investment in order to promote economic activity, even provoking a budget disequilibrium. The positive correlation between economic activity and government expenditures commonly measured by share of public sector in GDP (G/GDP), show us this tendency, namely, in EU countries. Babihuga shows relevant information about the dimension of governments and concludes that all regions growth their dimension between 1980 and 2003, with Europe as the region that grows more (Babihuga, 2006). Other contributions show that from 1970 until 2000 there is an increasing in share of total public sector in EU15 countries. Poorer countries as Portugal, Spain and Greece increase more: about 20%; and Germany, Netherland and Ireland register lower variation: around 5% (Pereira, Afonso, Arcanjo and Santos, 2009). In last decade there is a big convergence where, in 2008, the minimum value is 39.8% registered in Luxemburg and the maximum 53.6%, in Sweden. Sweden is the Member State that also registered much higher values, mainly during 1990`s years whose values registered were more than 70%. The competition and an uncertain environment need each more attention of government in order to save economic and social protection of their citizens suggesting new public answers. Adolph Wagner gives a contribution to public expenditures, arguing that government expenditures growth more than proportional to the economy. A convenient attitude, is an increasing in

taxes when there is growth, in the time of prosperity (allowing more revenues), and enlarge expenditures in time of recession. By this way, the politics must incentive economic activity promoting visible hand of the government to drives the invisible hand of the market. Additionally, regulation is a complementary way to increase the level of intervention in economic activity. Within a global context, the recent international financial crises show us these movements.

The EU countries with convergence criteria as is the case of the euro zone countries, particularly, those with instability in public accounts as is the case of budget deficit and public debt, has more restrictions in their economic activity, mainly, in recession periods. The dimension of the budget deficit and the level of the debt registered in recent period, namely in big economies like Germany and France, show us some difficulty in this world recession time. The values of the deficit and debt are much higher than those recommended by European Commission: 3% and 60%, respectively. The euro as a strong international currency creates an additional difficulty to trade balance. The trade balance is an important component of GDP. Exports and Imports disequilibrium also creates a need of liquidity, as well as public accounts disequilibrium. The openness of the economies promotes other opportunities to export and import increasing its dimension as a component of aggregate demand. A positive result of trade balance is a good financial instrument for the real economy, but the opposite situation, a negative trade balance, imposes additional financial needs that can be a source of instability, mainly when there also is disequilibrium in budget (budget deficit).

These two financial needs (budget and trade) is not compatible with a future sustainable growth, mainly in a strong taxes competitiveness environment as we can see when we compared the average in EU15 with the average in10 new Member States, as we can see in table 1.

Table 1: Corporate Tax Rates in EU

	2000	2005	Δ (variation)
EU15	35.3	30.4	Δ^- 6.6
New MS10	24.8	18.2	Δ^- 4.9

Source: Nicodeme 2006, TUTWPE nº 182 and our contribution

Table 1 show us the average corporate taxes rates comparing the EU15 with new Member States (New MS10), in 2000 and 2005. The decreasing in new MS_{10} is higher than in EU15, 6.6 and 4.9, respectively. This additional divergence provokes a disincentive to economic growth in EU15. The foreign direct investment (FDI), and, by this way, the international trade are also promoted through decreasing corporate taxes rates. Peacock defends that there is doubt surrounding the definition of the limits to public sector growth, as well as in associated changes in taxation (Peacock, 2006). However, we know that there is a negative correlation between higher taxes and private investment. Musgrave emphasizes three dimensions of the budget: allocation, distribution and stabilization and also refer that fiscal practice would be simplified (Musgrave, 2006). We can conclude that public accounts and trade balance are two important economic issues that require our attention in order to reduce other instability factors such as interest and inflation rates as we will see in the followings sections.

4. Interest Rates and Its Convergence

The real interest rates is equal to zero if inflation is equal to nominal interest rates that can be, traditionally, represented by the equation: $r = \pi - i$; where *r* is the real interest rate, π is the inflation rate and *i* the nominal interest rates. If we look to nominal interest rates as revenue of capital, that is, as financial income, we can lose our income when $r = 0$, which implies nominal interest rate equal to inflation rate. By the other side, when we consider the interest rates as a cost of capital factor, it is important its lower price that introduce an incentive to investment. Nowadays, the interest rate is also a monetary policy instruments allowing monetary authorities to concentrate their attentions in order to reach more economic stability.

By this reason the long-run interest rates of Government bonds have an increasingly role in economy, mainly in countries with additional responsibilities in convergence criteria. Until now, the main budget problems were solved without this type of responsibility and, the option was to supply more money and supported more inflation. However, nowadays there are restrictions which are assumed by countries with a common currency, as is the case of the euro zone countries. The problems related with public accounts disequilibrium tend to be transferred for the future generations through the public budget financing and induce inappropriate public policies. However, global economic and financial crisis implies more financial efficiency in management of public financial returns and allows a reduction in variance of the long-run interest rates of Government bonds, as we can confirm with European countries, particularly, within the euro zone countries, but also is true within other international currencies. We concentrate our attention in short-term interest rates.

Table 2 shows the short-term interest rates registered in three sequential periods: 2005, 2006 and 2007. We analyse the efforts in convergence of interest rates as an instrument of government finance and well-being. The 27 European Countries are considered in our analysis. Comparing the convergence between EU27 and US, we can see that is higher than between Japan. In 2005 registered 2.9%; 3.6% and 0.1%, respectively. In 2006, there is an increase in all values 3.5%; 5.2% and 0.3%, respectively. The US registers the higher variation with 1.6%, following EU27 only with 0.6%.

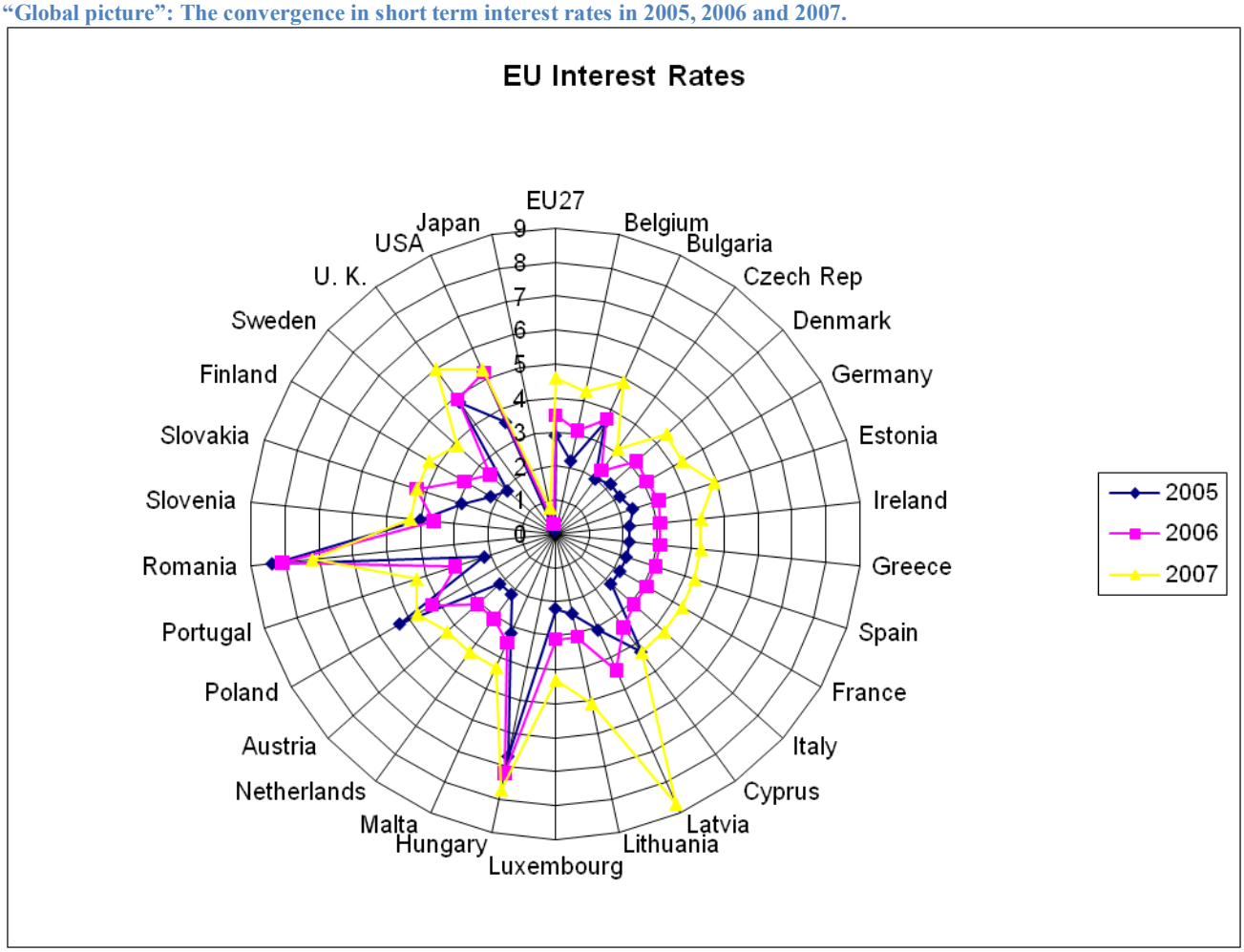
In 2007, the values registered are 4.6%; 5.3% and 0.8%, respectively. There also is an increasing movement compared with 2006, particularly to EU27 and Japan. This last country registered, once more, the lower value (0.8%), but is the higher positive variation, more than double between 2005 and 2007: moves from 0.3% to 0.8%. Not less important is UK that registers the higher value in interest rate: 6%, in 2007. It is also relevant to say that UK registers the same variation as EU27: 1.1%, from 2006 to 2007.

Table 2: Short term interest rates

	2005	2006	2007
EU27	**2,9**	**3,5**	**4,6**
Belgium	2,2	3,1	4,3
Bulgaria	3,6	3,7	4,9
Czech Rep	2	2,3	3,1
Denmark	2,2	3,2	4,4
Germany	2,2	3,1	4,3
Estonia	2,4	3,2	4,9
Ireland	2,2	3,1	4,3
Greece	2,2	3,1	4,3
Spain	2,2	3,1	4,3
France	2,2	3,1	4,3
Italy	2,2	3,1	4,3
Cyprus	4,3	3,4	4,3
Latvia	3,1	4,4	8,7
Lithuania	2,4	3,1	5,1
Luxembourg	2,2	3,1	4,3
Hungary	6,7	7,2	7,7
Malta	3,2	3,5	4,3
Netherlands	2,2	3,1	4,3
Austria	2,2	3,1	4,3
Poland	5,3	4,2	4,7
Portugal	2,2	3,1	4,3
Romania	8,4	8,1	7,2
Slovenia	4	3,6	4,3
Slovakia	2,9	4,3	4,3
Finland	2,2	3,1	4,3
Sweden	1,9	2,6	3,9
U. K.	4,8	4,9	6
USA	3,6	5,2	5,3
Japan	0,1	0,3	0,8

Source: CESifo World Economic Survey, 2009.

"Global picture": The convergence in short term interest rates in 2005, 2006 and 2007.



All this information about short terms interest rates in 2005, 2006 and 2007 allows us to compare the values in time and between countries showing the dimension of disparities, particularly in Romania, Hungary and Latvia as we can see through the "globe picture". The black line shows the first year of analyse 2005, the brown line shows information in 2006 and the grey line reports the year 2007. The higher distance from the centre proves us an increasing of the short term interest rate in this period of analysis: from 2005 to 2007. All countries increased their interest rates in this sample. The euro zone countries registered, in all periods of analysis, lower values than EU27, as a whole. In 2007, EU27 register 4.6 % and euro zone 4.3%. By this reason, it is a time to share precautions of political interventions and enlarge common policies to other regions, as is the case of monetary policy. We conclude that financial globalization allows more convergence in interest rates, as we mentioned before. Furthermore, it facilitates international trade in goods and services, and also, reduces speculative international financial services. Financial innovation has been a big contribution to this reality.

5. Inflation Control and Stable Currencies

The inflation as permanent increasing in level of prices is a phenomenon that affects all people. The scarce of resources and differences in productivity due to less adequate technologies, and human capital or inappropriate management, induce permanent variations in prices. There is no country, region, or citizen protected from this economic and social problem.

Within euro area, the Central Bank has responsibility in inflation control. By this reason the price stability is its main goal and convinces us in the advantage to reduce the turbulences provoked by the high inflations. By this way stabilize purchasing power and help to sustain the value of the currency. The tendency to increase the level of prices is natural, but sometimes varies substantially, stimulated by an improvement in demand or a reduction in natural resources, as happened with oil prices. However, the technological progress allows a reduction in prices, as well as a promotion of productivity through an improvement in human capital. Both reasons can explain recent control or even a reduction in prices of real economy, and the same happen with financial innovation to financial prices, as is the case of interest rates. Not less important, is also the monetary integration within EU context, which creates conditions to a better control in monetary side, being a very important contribution to inflation control through the interest rates.

The inflation is a good economic indicator that provides an opportunity to get useful information in the long–run as a growth stable factor, and also to a deep short-run analysis, as the Phillips curve suggest. The implications of inflation are so big, so makes sense a better understanding of its main sources. We retain the following contribution: “To understand inflation, therefore, we must understand money – what it is, what affects its supply and demand, and what influence it has on the economy” (Mankiw and Scarth, 2008: 81). But we think that there is a new dimension of inflation that is the financial inflation that we will pay attention ahead.

5.1 Inflation Control as a Financial Stable Factor

A stable currency is a fundamental issue for macroeconomic convergence and is also a result of an inflation rate controlled. A high inflation rate is a factor of monetary depreciation and then, it is important to control its quantity in order to ensure its quality. The inflation rate as an increase in the average level of prices includes also the price of money (interest rates) which is particularly relevant in real side as production factor and, also, in monetary side as source of monetary stability through monetary market and capital market. Being the currency a good generally accepted with maximum liquidity, the management of its printing (and creation by the commercial banks), imposes a big responsibility to Central Banks for its issuance and trading. More recently, with development of financial markets, increases sources of financing by money creation, also in euro area, which raises the possibility to finance public debt, increasing future financial responsibilities. With these fundaments makes sense the governments to reinforce their attention in quantity of money available in the financial system, reducing also its insufficiency, but at the same time, considering that the quantity of money determines its price level which effects on economic growth and level of inflation are always relevant. These means, that real side through scarce resources and increasing in demand determine the price levels, but the monetary side has also strong responsibility in inflation control. The revenue saved by government through printing money, getting inflation tax, can provoke an uncontrolled inflation rate that creates instability in all economic agents: families, enterprises and government. These interactions make this topic as an important one to study, and, more important, to be controlled by monetary authorities.

More dynamics economies, also with an efficient capital market, have an additional protection of higher inflation rates risk. The capital market appears as an alternative to financing enterprise, but also governments through the issuance of public debt, through the government bonds: a way that imply to pay interest and then, to be more efficient in the expenditures through the responsibility in management of public accounts. When tax

inflation finance public investment and money creation finance public and private investment, all attentions are necessary. In terms of returns they tend to be higher and stable, mainly, when private investments are used to create new employments by firms that will pay more income taxes and also corporate taxes. If not, there will be a reduction in public investments, at least a pressure in price of the currency: with higher interest rates, namely in international currencies. These reasons explain why inflation is an important problem to pay attention, being price stability the main goal of the ECB. The importance of the interrelation between real and monetary economy are stressed by Akerlof that emphasize the following: "*Probably the single most important macroeconomic relationship is the Phillip curve*", in (Mankiw and Scarth, 2008:408). By this way, there is a pressure in human capital to get new better employs and an increasing in productivity. Within the context of principles and public policy decisions, as is the case of monetary policy, Woodford highlight: «Such a principle prescribes a particular way of balancing two important goals of monetary stabilization policy, corresponding to the dual objectives of "price stability" and "maximum employment" specified in the Federal Reserve Act» (Woodford, 2008: 16). The direction is to reach the better of these two worlds.

It is common to find contributions that emphasize inflation by real side and also by monetary side, mainly put in evidence two important goals of monetary stabilization policy: price stability and employment. Herein, we include other relevant point of this issue that it is necessary to consider; it is the inflation that results of the financial market. Then makes sense to introduce a new concept: financial inflation. Now we assume an enlargement of the concept of inflation including three dimensions: real side, monetary side and financial side. Nowadays is common to find an increasing number of families whose wages are not the only one income. They can add other income that result from financial returns. In these sense, some contributions introduce the issue and related topics as: monetary policy, velocity and the equity premium (Gust and López-Salido, 2009). They concluded that the household with a developed capital market enlarge their income. The household purchases equities issued by the firms and *bonds* issued also by the government, used as new opportunity to apply their savings whose returns tend to increase. The income depends also of the decision to optimize portfolio which is "state depend" rather than "time dependent" (Gust and López-Salido, 2009). This is the reason that explains the decision of families to use financial market not only to apply their savings, but also to speculate, in order to optimize their portfolio. These types of revenues are, particularly important in economies with lesser welfare state, like US. In these economies, households transfer funds from her checking account to her brokerage account during work life and to reverse this flow at her expected retirement data, becoming her primary source of cash for consumption. In the US market, about 30 percent of the households participate in financial market, and about 70 percent of them rarely rebalance their portfolio in order to get higher equity premium. This gives an important stability to the financial market as we can see through the following conclusion: "households that rarely rebalance never chose to hold excess cash in their checking accounts …, while households that frequently rebalance only rarely hold excess cash in their checking accounts" (Gust and López-Salido, 2009). We emphasize a new dimension of inflation in the following point.

5.2 Tax Inflation and Financial Inflation Control

The control of tax inflation by Central Banks can imply other way to get financing through bonds issuance by governments that also contribute to an increase in financial dynamic that provokes higher interest rates. However, the interest rates volatility includes not only its internal prices (interest rates), but also its external price: the exchange rate mainly,

between the international currencies. Additionally, the equity premium is an income of households, but is also a factor of financial inflation which depends of stock prices. In these sense we have also recent contributions, such as (Gust and López-Salido, 2009), that paid attention to the three components of the stock prices that was identified by Bernanke and Kuttner (2005) as a broad index of stock prices, which includes:

♦ changes in current and expected future dividends,
♦ changes in current and expected future real interest rates and
♦ changes in current and expected future excess equity returns or equity premia.

Considering these three dimensions of stock price volatility, here we would like to emphasize the last one concluding that, changes in equity premia or perceived riskiness of stocks are an important channel of increases in stock prices contribute by this way to inflation, as source of financial inflation. This last dimension is related with capital market and the first two dimensions are more related with monetary market. We can justify this argument due to interest rate and, consequently, dividends depended, indirectly, of the Central Bank in order to reach price stability and economic growth. In this context we can say that it is important to identify a new dimension of inflation, as is the cases of financial inflation. Traditionally, we have monetary inflation provoked by inflation tax, but nowadays with a centralized monetary policy remain space to develop the financial inflation promoted by stock premium and returns from public debt. These two new sources of income require more attention by monetary authorities for a better controlling of price stability, in order to get stability in real inflation, monetary inflation and also financial inflation. Dividends, interest rates and equity premia are together increasing sources of no wage income. The volatility of the last one, equity premium, is associated to the risk premium that is converse with stability between two first. Combining this fact with the US market where about 20 percent of household investors rebalance their portfolio in order to get higher equity premium, make sense to assume a pressure over price level in financial assets. The interdependence between each component of index proposed by Bernanke and Kuttner (2005) is strong and was demonstrated by them, concluding that a 25 basis point cut in the nominal rate raises equity prices at least 0.75 percent, but can reach 1.5 percent. However, the rise in the equity prices reflects a decline in equity premium. The start point of a similar process like this can be a result of raises in money growth by Central Bank. In this case, a decreasing in price of money (interest rate), drive investors to try and attenuate their returns and then, take more risk investing in stock market. The result is an increasing in equity prices and a decline in equity premium which imply the household to rebalance their assets. The final effect provoked by the monetary injection is no effect on output but has an important redistributive effect; firms have access to capital at lower prices and households reduce their financial income, reducing by this way the financial inflation pressured as consumer, getting less equity premium. Only those that rebalance their financial assets must stay more protected. This explanation shows us the volatility in consumption provoked by fluctuation in equity premium contributing by this way to increase the inflation rate by financial inflation. To complement this approach is relevant to retain the following conclusion "… the deterministic increase in money growth leads to equilibrium with both higher consumption of active rebalancers and a higher fraction of rebalancers" (Gust and López-Salido, 2009: 26). Not less important is also to say that at near initial equilibrium, a small monetary shock induces relatively large increases consumption, and larger shocks lead to smaller effects on consumption. Linking two phenomena provoked by two inter-related monetary and financial decisions: tax inflation and financial inflation; the first occurred more in developing countries, due to enough correspondence between growth rates and monetary shocks and the second, a more recent phenomena, can occur particularly in more developed countries when they use the

capital market as an alternative to finance the economy. This last way, nowadays is a common way to finance and is analysed as an extension of a neoclassical framework in which asset and goods markets are segmented from each other (Gust and López-Salido, 2009) that is, modelling a production economy with equity returns. Then, it can coexist sequentially in the economy the possibility to get the average excess returns on equity (namely, through public sector enterprises), movements in risk that increase with higher returns and a monetary easing lead to a decline in the equity premium (through for better accessing to banking financing). We can summarize that face these monetary and financial movements the monetary authorities must contribute to a better control of the equity premium and by this way to diminish the effects on consumption, in order to reduce the fluctuations in inflation rate provoked by financial returns. This conclusion allows us to consider financial side (assets prices) also managed by authorities through monetary growth. Each monetary shock should makes deposits less attractive induce to rebalance and then, less equity premium.

6. Conclusion

We conclude for an important role of three dimensions of inflation: real inflation (prices in goods and services), monetary inflation (tax inflation) and financial inflation (assets returns), in order to get stability that necessarily includes the real, monetary and financial sides of an economy. It is possible to see each asset issued as financial good in real economy that need to be corresponded with currency in monetary side. In this case, we can see the financial market not only as an alternative to finance, but essentially, as a complementary market of goods that also must to be financed. Furthermore, more developed financial markets need to be complemented with printing money, in order to control the returns and provoking lower price in the currency, and consequently, cheaper assets prices.

Looking to financial capital as an extension of the traditional capital factor and also to see human capital as an extension of the labour supply that promotes real market and create more dynamic business cycles, then, both these reasons justify a more active monetary policy. If the extension of neoclassic framework, look to the assets and goods markets as ramifications of the same segment, as well as human capital and labour supply; we have an improvement in neoclassical model, more dynamic business cycles, which justify a market with better regulation for a better management. By this way, we can improve the dynamic of the markets and also reduce the number and level of fluctuations in interest and inflation rates. These reasons also required more efficiency in public policies, namely in monetary policy, that must be attended to the needs of real economy which has its dynamic increasingly pressured not only by the monetary market but also by the financial market. These last two markets tend to be more dynamic, inducing real market to become a loser of its own sustainability.

We can conclude that face to these monetary and financial movements the monetary authorities must contribute to a better control of the equity premium and, by this way, to reduce the effects on consumption, in order to diminish the fluctuations in inflation rate provoked by financial returns. This conclusion allows us to consider financial side (assets prices) to be also managed by authorities through monetary growth. Each monetary shock should makes deposits less attractive induce to rebalance and then less equity premium.

Thinking globally, and considering the contributions that defines financial stability as its ability to facilitate and enhance economic processes, manage risk and absorb shocks as defends (Garry 2004), we can conclude that with our analysis through public accounts, interest rates and inflation we have an important theoretical infrastructure to reanalyse financial stability. We suggest an emphasize in real economy with participation of private and public sectors, articulated through a consistent institutional and market structure, as important issues to future research.

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