

Finance 4000

Money and Capital Markets

- Gerald P. Dwyer, Jr.
 - Vice President, Federal Reserve Bank of Atlanta
 - Professor of Economics, Clemson University (on leave)
 - 404-614-7095
 - dwyerg@clemson.edu

- Grading
 - Three Tests — two midterms and a final
 - midterms on 2/16 and 4/6 and final on 5/6
 - dates final
 - final comprehensive
 - Project
 - analysis of articles from the *Wall Street Journal* or a similar publication
 - apply principles learned in class to real issues
 - Relative importance
 - two midterm exams are 20 percent each
 - project is 25 percent
 - final is 35 percent
- Attendance and Homework

- Financial Markets

- Financial markets are markets in which funds are transferred from people who want to lend to those who want to borrow.

- Funds are transferred from those who want to purchase less than is possible with their current cash flow to those who want to purchase more than is possible with their current cash flow

- Examples are bond and stock markets

- Generic term is securities markets

- A security is a claim on the issuer's future cash flow or assets to make certain payments

- A bond is a security with a promise to make payments at certain times for some length of time

- generally issued as debt
- often quoted in terms of the interest rate
- Figure

- A stock is a security that represents an ownership claim on a corporation

- for individual stocks, quoted as price
- for "market", have index numbers — Figure

- Foreign Exchange markets
 - Markets in which participants buy and sell funds denominated in different currencies
 - For example, funds in United States dollars are traded for funds in British pounds sterling
 - A foreign exchange rate is the price of one country's currency for another country's currency
 - Figure

- Financial Institutions — Intermediaries
 - Financial intermediaries are firms that borrow funds from some and make loans to others
 - Indirect finance rather by borrower and lender dealing directly with each other
 - Examples
 - banks — accept deposits and make loans
 - insurance companies
 - finance companies
 - pension funds, mutual funds and investment banks
 - Financial innovations
 - derivatives
 - smart cards

- Functions of Financial Markets and Institutions — Figure
- Types of Securities
 - Type of claim
 - Debt — e.g. bond
 - Equity — e.g. stock
 - Type of market traded in
 - Primary
 - A primary market is a market in which new issues of securities are sold by the issuer to initial buyers
 - Secondary
 - A secondary market is a market in which previously issued (second-hand) securities are traded
 - We will focus on secondary markets.
 - Secondary markets are more liquid — cheaper to trade in — and more continuous.
 - Issuing price determined by expected price in secondary market.
 - Therefore, we'll focus on the secondary market.
 - Where traded

- Exchanges
- Over-the-counter market
 - dealers in different locations
- Issuer
 - Government
 - Private
- Term to maturity
 - short term — a year or less
 - longer-term
 - notes — two to seven years or so
 - bonds — longer term to maturity

- Financial Intermediaries
 - Why do people use financial intermediaries?
 - Transactions costs — economies of scale
 - Asymmetric information
 - Lower costs of acquiring information sufficient
- Asymmetric information
 - Asymmetric information is an inequality of information in which one party to a transaction has information about himself or herself that the other party does not have

- Implications of asymmetric information
 - Adverse selection
 - Who comes in the door?
 - Before transaction occurs
 - Can affect contract terms to weed out less desirable customers
 - e.g. life insurance
 - Moral hazard
 - Actions take because have loan, contract or insurance
 - A loan is like insurance because need not pay in case of bankruptcy
 - Have an incentive to take actions that are more likely to result in bad outcomes if they also are more likely to produce good outcomes
 - “Heads I win; Tails you lose.”
 - Banks can *monitor* lenders’ behavior in a way that financial markets do not

First Midterm is February 16