Topic 1 : Financial Assets and Overview of Financial Market

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Federic Mishkin, The Economics of Money, Banking and Financial Markets Chapter 1 - 3, HG173 .M57 2007

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- Money is not, properly speaking, one of the subjects of commerce; but only the instrument which men have agreed upon to facilitate the exchange of one commodity for another. It is not the wheels of trade: It is the oil which renders the wheels more smooth and easy." David Hume, Of Money , 1752.
- Money is anything that is accepted in payment for goods and services or in the repayments of debts.
- Functions of Money:
  - Medium of exchange
    - This promotes economic efficiency as it reduces transaction costs and it also allows
  - Unit of account
    - It reduces transaction cost by reducing the number of prices that need to be considered

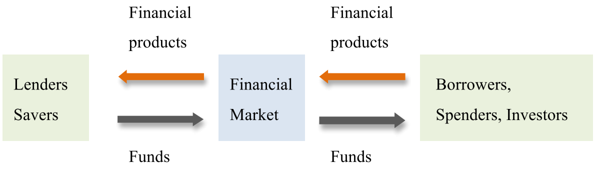
- Store of value
  - Money is used as a way to store purchasing power over time
    - This function is useful as we do not always want to spend our income immediately upon receiving it
    - It provides more liquidity (the relative ease with which as asset can be converted into a medium of exchange than other assets
  - Standard of deferred payment
- Money, Wealth and Income

- Financial market is a market for financial assets
  - Market is the interaction between buyers and sellers
- Financial asset is promise to repay cash (or any valuables) in the future
  - Other words, financial products, financial claims, securities
  - Financial asset is a kind of “goods and services”
  - Financial asset is different from general goods and services
  - its price depends on “future return” “risk” and “liquidity
- Information Theory
  - Search goods: their quality is known ex ante
  - Experience goods :their quality is known ex post
  - Credence goods: their quality may never be established, even ex post

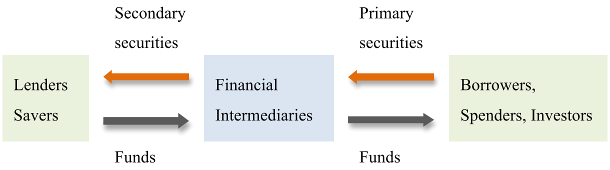
- Characteristics of financial assets : Topic 2 - 3
- Asymmetric information in the financial market : Topic 4 - 7
- Asymmetric information $\rightarrow$ market failure $\rightarrow$ role of financial intermediation and financial regulations
- Transaction in financial market promotes "saving" and "investment" : flow of funds from savers to investors
- saving is goods for future consumption
- investment is an increment in the stock of capital goods
- direct investment VS. indirect investment
- economic investment VS financial investment

- Flow of funds : borrowers = deficit spending unit, lenders = surplus spending unit

1. Direct Finance : borrowers borrow funds directly from the lenders by selling them securities



2. Indirect Finance : Financial intermediary stands between the lenders and the borrowers and help transfer funds from one to the other



Example : Direct (D) or Indirect (I) finance

- deposit money into a bank
- buy a newly issued bond from PTT PLC. at Kasikorn Bank
- buy a government bond at BOT
- buy an insurance plan from an insurance company
- give your friend a loan
- your friends put money into your business and both of you share in the profits (or losses) of the business

Structure of financial markets

- Primary and secondary market(classified by seasoning of the claims) :
  - New securities are sold to initial buyers : Primary market
  - Security that have been previously issued are resold: Secondary market
  - Primary market: flow of funds from .... to .... (savers, investers)
  - Secondary market: all sellers and buyers are ....(savers, investers)
  - In Economics, is primary market more important than secondary market?
  - Importance of secondary market: promote liquidity, provide information necessary for the financial asset price determination in the primary market
  - Notice that most theories focus on behaviour in secondary market

- Money and capital market (classified by maturity)
  - Short-Term (maturity < 1 year) Money Market
  - LongTerm (maturity > 1 year) Capital Market
- Debt and equity market (classified by the nature of the claims)

	Debt	Equity
Role		
Return		
Risk		
Maturity		
example		

- Derivative market
  - A derivative is a financial instrument whose value depends on (or derives from) the value of other, more basic underlying assets.
  - Forward contract : a contract to buy or sell a specified amount of a designated asset at a date known in the future, is not traded on organised exchanges
  - Futures contract : a contract to buy or sell a specified amount of a designated asset at a date known in the future, is not traded on organised exchanges ; traded on organised exchanges
  - Swap contract: a contract between two parties to exchange cash flows in the future according to some prearranged formula
  - Option: contract that gives the owner the right but not obligation to buy or sell a specified asset at a stipulated price

Examples of financial assets

- Treasury bills : a short term instruments the government issued to finance its budget deficits
- Certificate of deposits : a financial contract sold by a bank that pays annual interest of a given amount and at maturity pays back the original purchase price
- Repurchase agreements: a contract to purchase a government security back at a specified price $\rightarrow$ loans in which a government security serve as collateral
- Corporate bonds: long-term bonds issued by corporations
- Government bonds: long-term bonds issued by the government
- Mutual funds shares: a share in mutual funds
- Common stocks : a share of ownership in a corporation