

Topic 1 : Financial Assets and Overview of Financial Market

EE431/438

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

July 2013

- 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 people to specialize in what they do.
 - Unit of account
 - It reduces transaction cost by reducing the number of prices that need to be considered

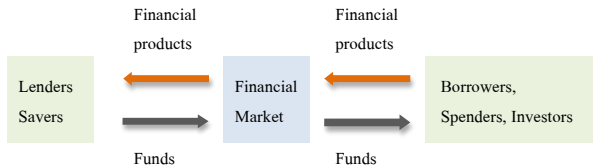
- Store of value
 - Money is used as a way to store purchasing power over time
 - This function is useful as we do not always want to spend our income immediately upon receiving it
 - It provides more liquidity (the relative ease with which an asset can be converted into a medium of exchange than other 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, an asset that derives value because of a contractual claim.
 - 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
 - “rate of return”, unit = percent
 - Stock A, price = \$100, expected to rise by \$10, Stock B, price = \$10, expected to rise by \$2
- 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

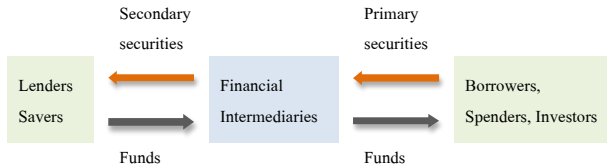
- Characteristics of financial assets : Topic 2 - 3
- Asymmetric information in the financial market : Topic 4 - 7
- Asymmetric information → market failure → role of financial intermediation and financial regulations
- Transaction in financial market promotes "saving" and "investment" : flow of funds 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

- 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, investors)
 - Secondary market: all sellers and buyers are(savers, investors)
 - 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 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 → 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

“IF THE banks won’t lend you money, might a stranger? Probably not, to judge by recent data from Prosper, an American peer-to-peer lending marketplace (a place where people can lend their own money to other people).

Peer-to-peer lending, the website, which lets lenders bid against each other on the interest rates they are prepared to offer to specific borrowers, has seen an increase in demand from subprime borrowers as access to bank credit has tightened.”

Source: Economist (2007)

Explain the difference between direct finance and indirect finance.

What is the method for direct financing mentioned in the news: bank lending, peer-to-peer financing or none?

News 1. “The Stock Exchange of Thailand Index hit a new 18-year high, ahead of the Bank of Thailand’s policy rate meeting today. The Thai bourse ended the morning session at 1,540.12 points, gaining 8.05 from the previous closing. The index further rallied in the afternoon, despite foreign net-sells this month, to end the day at 1,546.64 points on turnover of Bt63 billion.” Source: The Nation (February 20, 2013)

News 2. “Supalai Public Company Limited (SPALI) is offering a 5-year unsecured debentures with the issue size of THB 745 million. The coupon rate has been determined at 3.73 per cent per annum. The interest is payable semi-annually.” Source: ThaiBMA

- Specify which piece of news talks about primary market and which piece of news talks about secondary market.
- Specify which piece of news talks about debt market and which piece of news talks about equity market.