

FN211

Why Study Financial Markets and Institutions?

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1 Why Study Financial Markets?

Financial markets are crucial in our economy.

1. Channel funds from savers to investors, promoting economic efficiency
2. Market activity affects: personal wealth, business firms, and economy

Why Study Financial Markets?

- Well functioning financial markets are key factors in producing high economic growth
- We will briefly examine each of these markets, key statistics, and how we will examine them throughout this course

Why Study Financial Markets?

Debt Markets & Interest Rates

- Debt markets allow governments, corporations, and individuals to borrow
- Borrowers issue a security, called a bond, offering interest and principal over time
- The interest rate is the cost of borrowing

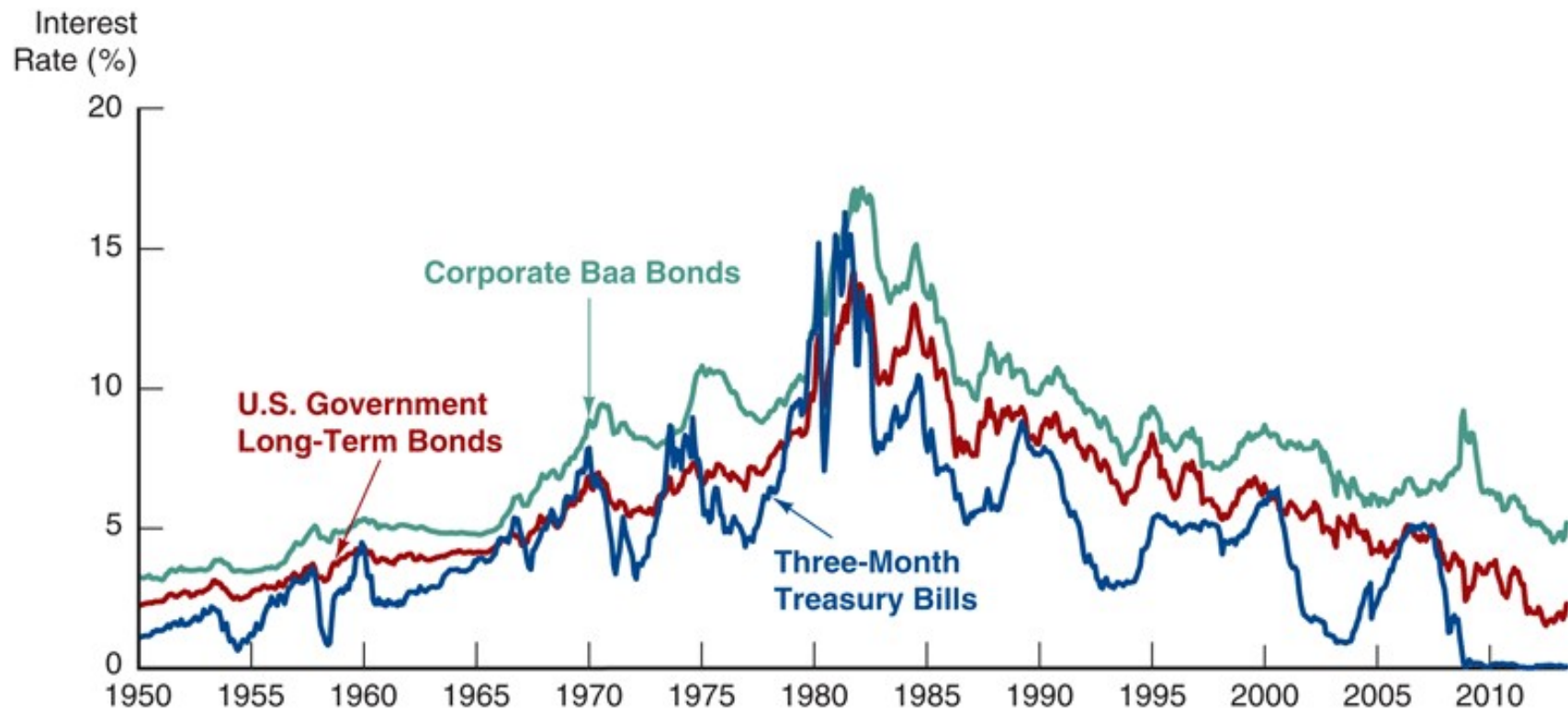
Why Study Financial Markets?

Debt Markets & Interest Rates

- Many types of market interest rates: mortgage rates, car loan rates, credit card rates, etc.
- The level of these rates are important. For example, mortgage rates in the early part of 1983 exceeded 13%
- Understanding the history of interest rates is beneficial
- We will study these further: types and characteristics of bonds; theories on how rates are determined

Bond Market and Interest Rates

Interest Rates on Selected Bonds, 1950–2013



Source: Federal Reserve Bank of St. Louis, FRED database: <http://research.stlouisfed.org/fred2/>.

Why Study Financial Markets?

The Stock Market

- The stock market is the market where common stock (or just stock) are traded
- Companies initially sell stock (in the primary market) to raise money. After that, the stock is traded among investors
- The stock market receives the most attention from the media

Why Study Financial Markets?

The Stock Market

Companies, not just individuals, also watch the market

- Often seeking additional funding
- The success of CEOs is dependent on the company's stock

We will examine the role of the stock market in the financial system

We will further look at how stock prices behave to information in the marketplace

Why Study Financial Markets?

The Foreign Exchange Market

- The foreign exchange market is where international currencies trade and exchange rates are set
- Although most people know little about this market, it has a **daily** volume nearing \$3 trillion!

Foreign Exchange Market

Exchange Rate of the U.S. Dollar, 1970–2013



Source: Federal Reserve Bank of St. Louis, FRED database: <http://research.stlouisfed.org/fred2/>.

2 Why Study Financial Institutions?

We will also spend considerable time discussing financial institutions - the corporations, organizations, and networks that operate the so-called “marketplaces.” We will look at:

1. Structure of the Financial System
 - Helps funds move from savers to investors
2. Central Banks and the Conduct of Monetary Policy
 - The role of the central bank, and foreign counterparts, in the management of interest rates and the money supply

Why Study Financial Institutions?

3. Banks and Other Financial Institutions

- Includes the role of insurance companies, mutual funds, pension funds, etc.

4. Managing Risk in Financial Institutions

- Focusing on risk management in the financial institution

Why Study Financial Institutions?

- Financial institutions are among the largest employers in many countries and often pay high salaries (of course, especially for those from finance, accounting, and economics majors!)
- Knowing how financial institutions are managed may help you better deal with them