EE 431: Economics of Financial Markets and Institutions

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Office Hours: Tues, Thurs 8.00 – 9.30

Course Description

Money and capital markets; Financial assets; Financial risks and financial risks bearing; Asset pricing; the CAPM and APT models; Interest rate structure; Bond and equity instruments; Financial derivatives; Asymmetric information in financial market; Financial institutions; Risk management of financial institutions; Monitoring and controlling of financial institutions; The deposit insurance system

Introduction

- We use ***money*** in our daily life.
- Why do we use money?
  - Without money, we would go back to barter trade, which is very inefficient.
  - We may use money to store our wealth as well.
- We will see that money affects our lives in various aspects.

1. Why study financial markets?

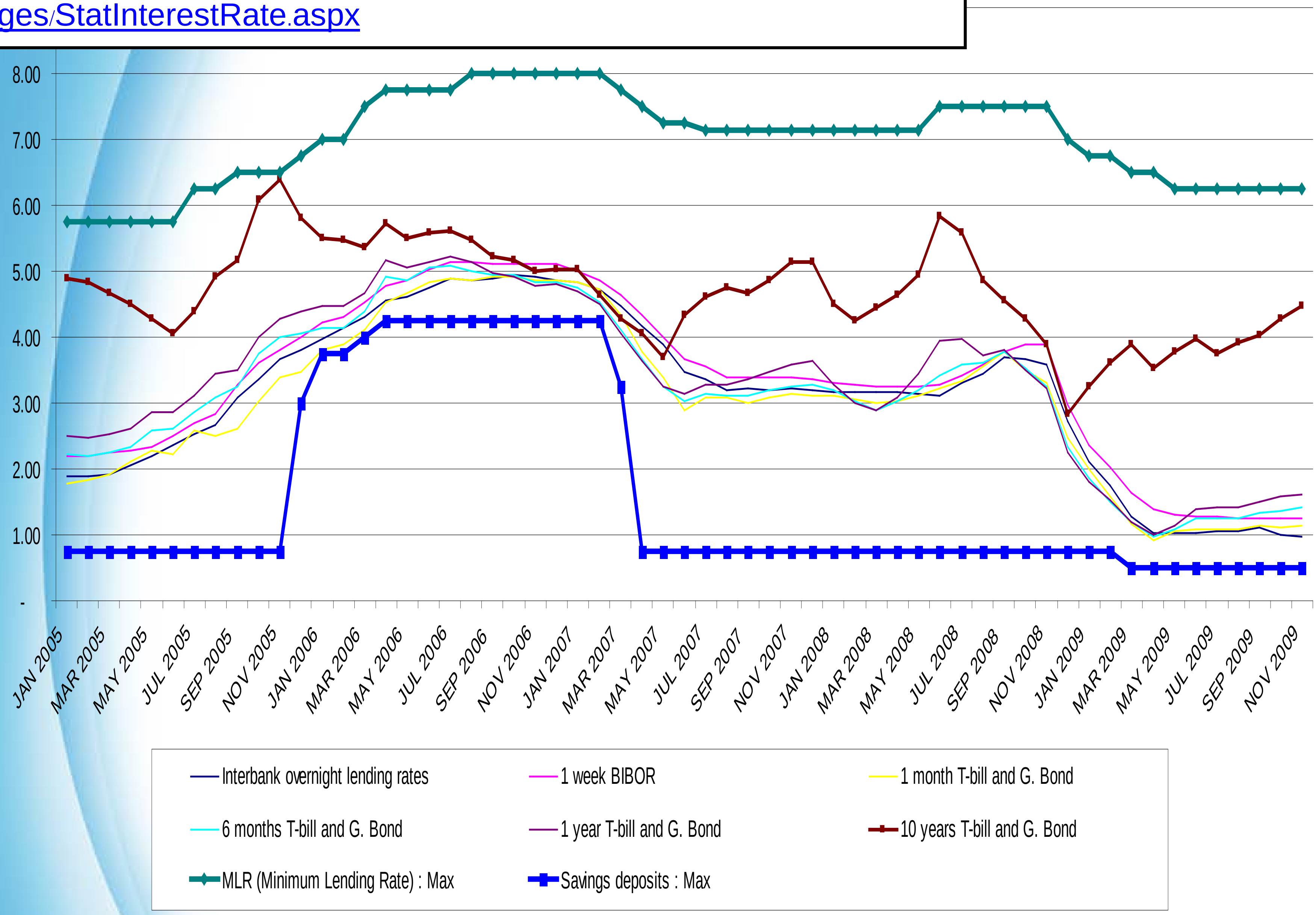
- Since we use money for efficiency, financial markets become important.
- We, economists, think that ***financial markets*** transfer funds from people who have an excess of funds to people who have a shortage.
- This promotes economic efficiency as well.

1.1 Bond Market

- A ***security*** is a claim on the issuer's future income or assets.
- A ***bond*** is a debt security that promises to make payments periodically for a specified period of time.
- An ***interest rate*** is the cost of borrowing for the rental of funds.

Thai Government Bond

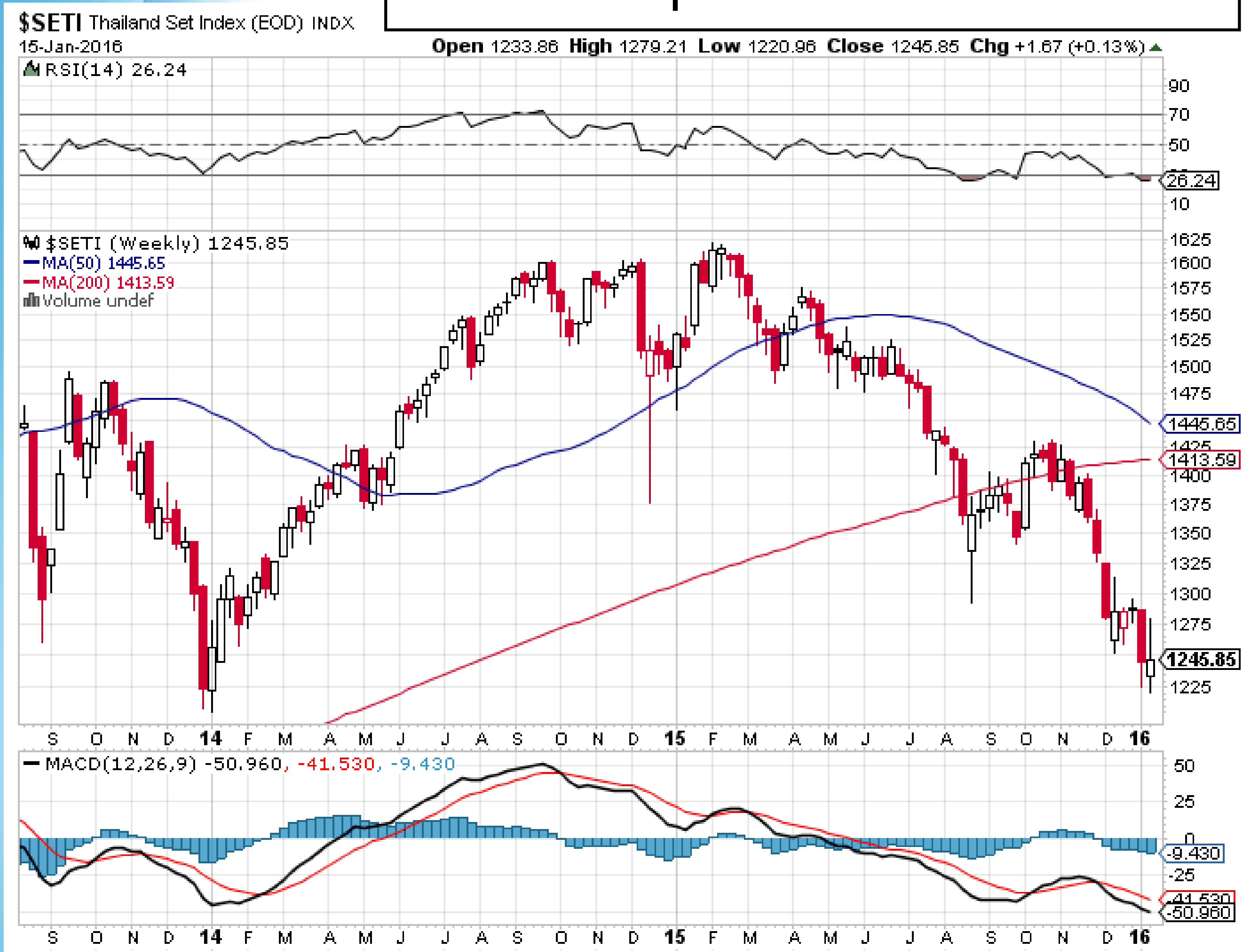
Source:
http://www.bot.or.th/English/Statistics/FinancialMarkets/InterestRate/Pages/StatInterestRate.aspx



1.2 Stock Market

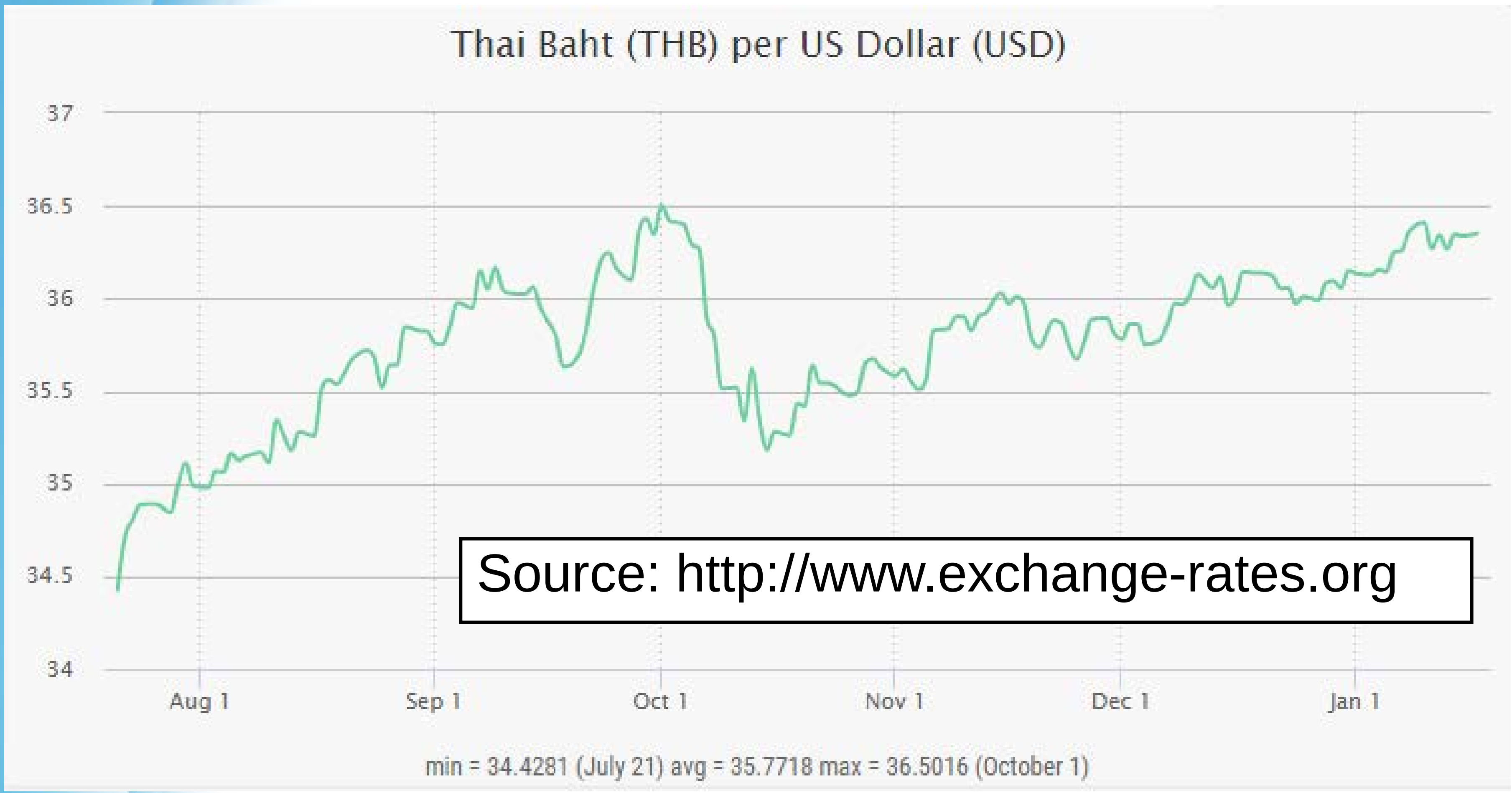
- There are 2 main types of stock: common and preferred.
- A ***common stock*** represents a share of ownership in a corporation. It is a security that claims on the earnings and assets of a corporation.***
- ***Preferred stock*** generally does not have voting rights, but has a higher claim on assets and earnings than the common shares.

Source: http://stockcharts.com



1.3 Foreign Exchange Market

- The ***foreign exchange market*** is where people convert between domestic currency and foreign currencies.
- The ***foreign exchange rate*** is the price of one country’s currency in terms of another country’s.


Thai Baht (THB) per US Dollar (USD)
37
36.5
36
35.5
35
34.5
34
Aug 1
Sep 1
Oct 1
Nov 1
Dec 1
Jan 1
Source: http://www.exchange-rates.org
min = 34.4281 (July 21) avg = 35.7718 max = 36.5016 (October 1)

2. Why study banking and financial institutions?

- This is an important channel (maybe the most important channel in Thailand) in transferring funds.
- We will see the functions and operations of these financial intermediaries in this course.

2.1 Banks

- ***Banks*** are financial institutions that accept deposits and make loans.
- They are the financial intermediaries that the average person interacts with most frequently.

2.2 Other financial institutions.

- These include, for example, insurance, finance companies, mutual funds, government financial intermediation, and investment banks.

3. Why study the central bank?

- We, economists, think that changes in money supply can affect our daily lives.
- We also think that monetary policy is important for stabilizing our economy.
- The Bank of Thailand, our central bank, takes care of monetary policy in Thailand.

3.1 Crises and Financial Sector

- Financial sector plays an important role to create or amplify many crises in the past.
- We, as economists, need to understand the relationship between financial sector and crises to solve or prevent the problems in the future.

3.2 Central Bank and the Financial Regulator

- The Bank of Thailand plays an important part in regulating financial sector.

- Deposit Protection Agency (DPA)
- Basel II
- Counter-cyclical regulations

Course objectives

Eventually, students of this course would be able to:

- Understand the functions of money and the financial system
- See the connection between financial sector and real sector
- Have basic knowledge on various components of the financial system
- Get some ideas of financial development
- Understand the main problems of financial transactions
- Practice research and presentation skills
- Apply theoretical ideas to the real world

Evaluation

• Class participation	5%
• Reports	10%
• Presentation	20%
• Mid-term examination	25%
(**Tuesday, March 8, 8.00 – 9.30 hrs.**)	
• Final examination	40%
(**Wednesday, May 25, 9.00 – 12.00 hrs.**)	

Financial games (1)

- There will be 3 financial games in this class, which are
  1) Best Life Insurance
  2) Value Investor
  3) Strong Commercial Bank

- Students should arrange into 10 groups

Financial games (2)

- Presentations (2/group)
  1) Best Life Insurance – Every group
  2) Value Investor – First 5 groups
  3) Strong Commercial Bank – Last 5 groups
- Reports (3/group)
  – Printed report, not exceeding 8 pages
  – Electronic file must be submitted
  – In case of presentation, electronic copy of the presentation file as well

Other policies

- The lecturer retains his right to give a final grade basing on his criteria.
- Topics covered may be adjusted.
- There will ***not*** be any supplementary exams. Hence, you should stay happy and healthy throughout the class.