

Finance (Basic)

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Financial markets

Definition:

Financial markets provide channels for allocation of savings to investment.


Functions of FM

- Borrowing and Lending
- Price determination
- Information Aggregation and Coordination
- Risk Sharing
- Liquidity
- Efficiency

Interest rate

Type of interest:

Simple interest x Compound interest

Inflation  Nominal x Real IR

Major components of FM

- ❑ Money market (T-Bills,)
- ❑ Capital market (Stocks, ...)

Practical examples

The client saved to the bank from 08/03/2011 to 05/05/2011 an amount of 15,000.00 to an annual interest rate of 8%. How much was the interest during this period?

The client saved for two years 10,000.00 to the bank. The interest rate was 6% per annum. The inflation was in this period 2%. How much got the client from the bank in two years? What was his real gain?

Subtypes of FMs

CM:

FEM

IM

FM

DM

CM

MM

Capital markets

- Primary markets

- Secondary markets

Secondary market

Spot market

Forward market

The major players in FMs

- ❑ Brokers
- ❑ Dealers
- ❑ Investment Banks
- ❑ Financial Intermediaries

Financial market structures

OTC

CE

ECN

Index

Definition:

□ Types of indices:

Efficient-market hypothesis

FMs are informationally efficient.

- ❑ Three version of the hypothesis:
 - ❑ Weak
 - ❑ Semi-strong
 - ❑ Strong

Asymmetric Information in FMs

AI means...

Two types of AI

Adverse selection *is a problem that arises for a buyer of goods, services, or assets when the buyer has difficulty assessing the quality of these items in advance of purchase. (Loan Markets)*

Moral Hazard *exists in a market if, after the signing of a purchase agreement between the buyer and seller (of asset) the seller changes his behavior in such a way that the probabilities (risk) used by the buyer to determine the terms of the purchase agreement are no longer accurate.*

Thank you for your attention
