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 03/08/2011 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 probabilites (risk) used by the buyer to determine the terms of the purchase agreement are no longer accurate.*

Thank you for your attention