Chapter 1

Outcomes

- **Explain the meaning of financial instruments and financial markets.**
- What is a financial market?
- What are bonds and stocks?
- What is the meaning of interest rates on securities?
- What is the role of a financial institution?
- Why and how do we measure the stock of money, aggregate income and price level?
- The meaning and the purpose of monetary policy?

- What is a financial market?

A market where funds are transferred from those who have it and don't use it to those who don't have and want to use it.

- What are bonds and stocks?

A security is a claim on someone's future income. A Bond is a debt security, which ensures periodic payments from the other party for a specified period of time.

Stocks represent a share of the assets or earnings of a company. These can be traded and sold for money. The holder of the stock has the claim. Corporations issue stocks to raise capital.

- What is the meaning of interest rates on securities?

The interest rate is the cost of using funds that you do not own. A security is a claim on someone's future income, while the interest rate on the security is the amount by which this claim will increase to compensate for the use of the funds by the person who does not own it.

- What is the role of a financial institution?

Financial facilitate the relationships between the lender and the borrower. They move the funds from those who save to the others.

- Why and how do we measure the stock of money, aggregate income and price level?

Money is anything that is generally accepted as a means of payment for goods services or debt.

We measure the stock of money because it is instrumental in the success of the economy. Money growth feeds the economy, when the money stock growth slows we usually witness a depression.

Aggregate income is measured as the total income of the factors of production which is similar to the aggregate output since all payments for final goods and services (GDP aggregate output) flows to owners of the goods in the form of income.

Aggregate price level is the average level of prices. Continuous increase of it is called inflation. Inflation is strongly linked to a growth in money supply.
This can be measure by GDP deflator Ndgp/Rgdp=(1.%) inflation since base to know.
Or CPI

- The meaning and the purpose of monetary policy?

Monetary policy is the government's policy with regards to REPO rates and reserve levels, by which they change the amount of money supply in an economy. The purpose is to ensure economic stability and growth by changing these variables to change money supply.

Changes in the REPO rate affect the money supply and economy as a whole as it changes the aggregate demand and price level.

Monetary control is needed since banks are profit focused, and act on their own behalf to the detriment of society as a whole.

Security ISSUER (borrower): Wants to borrow money. Then promises future payments to the holder. He then gets cash from the PURCHASER (lender).

True false
1-5.F, T, F, T, F CORRECT
6-13 T, T, T, T, T, T, T, T

Explain briefly and in general terms the meaning of a security and how it facilitates lending and borrowing? (5)

A security is document that gives the holder a claim to the future income or assets of the issuer of the security. By means of a security an entity with excess funds and no uses for them can lend these funds to an entity with a shortage of funds and opportunities to use these funds.

What is common stock, what purpose does it serve and how does it affect the investment decisions of a business? (4)

This is a claim of ownership to a part of a firm's assets or earnings. It allows firms to raise capital to fund their activities and investments. Firms aim at increasing their share value because a higher share price means that firms can raise more capital by issuing shares to the public.

List 2 ways in which the quantity of money can affect the economy? (2)

Increased Money Supply can lead to increased output and higher employment.
Increased Money Supply can lead to higher prices.

Explain the difference between nominal and real GDP and when to use which? (4)

The real GDP shows the total output of the economy based on finished goods that is adjusted to remove the inflation effects. This value should be used to compare to the GDP of other periods. Nominal GDP is not often used for any other reason but to indicate the increase in the prices of the generated goods.

List and define three common measures of the aggregate price level? (6)

CPI. The consumer price index is a measure of the prices at which a common basic basket of items can be purchased in a given year. These values are compared to a base value that indicates the general increase in prices.

GDP deflator. NGDP/RGDP=1.11 indicates that since the base year the inflation rate has been 1.11-1 *100 %.

The PCE personal consumption expenditure measures the nominal PCE/ real PCE to give you the PCE deflator.