ECS301D: STUDY UNIT 1

What is a security? Explain briefly what is a bond

1.1 **pp.3-4** **(4)**

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 specific period of time.

1.2 **p.5** **(3)**

A common stock represents a share of ownership in a corporation. Corporations raise funds to finance their activities by issuing stock and selling it to the public. The stock market is an important factor in business investment decision, because the price of shares affects the amount of funds that can be raised by selling newly issued stock to finance investment spending.

List 2 ways in how the amount of money may affect the economy.

1.3 **pp.8-11** **(2)**

Money plays an important role in generating business cycles. Continual increases in the money supply are correlated with inflation. Money also plays a role in interest-rate fluctuations.

1.4 **pp.20-21** **(4)**

GDP (gross domestic product) is the market value of all final goods and services produced in a country during a certain period (usually a year). Nominal GDP is measured in current prices, while real GDP is measured in constant or fixed prices.

1.5 **p.21** **(5)**

GDP deflator: Defined as nominal GDP divided by real GDP.

PCE deflator: Defined as nominal personal consumption expenditures (PCE) divided by real PCE.

Consumer price index (CPI): Measured by pricing a basket of goods and services bought by a typical household.

2.1 **pp. 7, 23-25, 35** **(5)**

Financial markets perform the essential economic function of channelling funds from households, firms and governments that have saved surplus funds by spending less than their income (lender-savers) to those that have a shortage of funds because they wish to spend more than their income (borrower-spenders). Financial markets allow funds to move from people who lack productive investment opportunities to people who have such opportunities.

In direct finance, borrowers borrow funds directly from lenders in financial markets by selling them securities, while indirect finance involves a financial intermediary that stands between the lender-savers and borrower-spenders and helps transfer funds from one to the other.

Financial intermediaries are institutions that borrow funds from people who have saved and in turn makes loans to others.

2.2 **pp.25-27** **(10)**

Debt instruments are offered in debt markets, while equities (or stocks) are offered in equity markets. A debt instrument is a contractual agreement by the borrower to pay the holder of the instruments fixed amounts at regular intervals until a specified date, upon which a final payment is made. Stocks are claims to the share in the net income and the assets of a business.

A primary market is a financial market in which new issues of a security are sold, while a secondary market is a financial market in which securities that have been previously issued can be resold.

Exchanges are centralized locations where buyers and sellers of securities meet to conduct trades. An over-the-counter (OTC) market is market in which dealers at different locations have an inventory of securities ready to buy and sell "over the counter" to anyone who comes to them and is willing to accept their prices.

The money market is the financial market in which only short-term debt instruments are traded. The capital markets is the financial market in which longer-term debt and equity instruments are traded.

2.3 **see pp.28-30** **(15)**

2.4 **see pp.31-32** **(12)**

2.5 **pp.35-39** **(8)**

Lower transaction costs: Transaction costs are time and money spent in carrying out financial transactions. Financial intermediaries can lower transaction costs by taking advantage of economies of scale. They have also developed expertise in lowering transaction costs.

Reduce exposure to risk: Financial intermediaries do this through risk sharing. Through the process of asset transformation, risky assets are turned into safer assets for investors. Diversification also allows individuals to invest in a portfolio of assets whose returns do not always move together.

Reduce problems related to asymmetric information: Financial intermediaries are better equipped to screen out bad credit risks from good ones. They also have developed expertise in monitoring the parties they do lend to.

2.6 **pp.43-45** **(6)**

By increasing the amount of information available to investors, regulation aims to reduce the problems of moral hazard and adverse selection. This can also contribute to the soundness of financial intermediaries and the financial system.

Government regulation can include any of the following: Restrictions on entry; Disclosure; Restrictions on assets and activities; Deposit insurance; Limits on competition; Restrictions on interest rates.

3.1 **pp.49, 14-17 (SG)** **(5)**

Money is anything that is generally accepted in payment for goods or services or in the repayment of debts.

The money stock is measured by estimating various monetary aggregates, including M1A, M1, M2 and M3. Each of these measures are based on the relationship $M=C+D$ and differ as to which type of deposits are included in D.

Currency + cheque Deposits

3.2 **pp.49-50** **(4)**

stock variable measured at a point in time

Flow of earnings over

Money is a stock variable, that is a certain amount at a given point in time. Income is a flow variable, that is a flow of earnings over time.

Wealth is the total collection of pieces of property that serve to store value. Wealth includes money, but also other assets such as bonds, stocks, land, cars and houses.

3.3 **pp.50-52** (MUS **(6)**

Money is a medium of exchange: It is used to pay for goods and services. Money promotes economic efficiency by eliminating much of the time spent exchanging goods and services.

Money is a unit of account: It is used to measure value in the economy.

Money is a store of value: It is a repository of purchasing power over time.

3.4 **pp.53-55** FEECC **(15)**

Commodity money: This is money made up of precious metals or another valuable commodity. Commodity money has intrinsic value, but is heavy and difficult to transport.

Fiat money: Fiat money is paper currency decreed by governments as legal tender. It is much lighter than commodity money, but it is expensive to transport in bulk. It is also vulnerable to counterfeiting. To be accepted as medium of exchange it requires trust in the authorities who issue it.

Cheques: A check is an instruction from you to your bank to transfer money from your account to someone else's when he deposits the cheque. Cheques allow transactions to take place without the need to carry around large amounts of currency and reduce transaction costs. It takes time to get cheques from one location to another, and all the paper shuffling required to process cheques can be quite costly.

Electronic payments: Payments are made electronically using the Web. Electronic payments are quick and easy.

E-money: Electronic money is money that exists only in electronic form such as debit cards, smart cards and e-cash. E-money is much faster than cash and reduces the need to carry around large amounts of currency.

3.5 **p.17 (SG)** **(8)**

M1A	=	cash/currency
	+	cheque and transmission deposits
M1	=	cash/currency
	+	cheque and transmission deposits
	+	demand deposits ✓
M2	=	cash/currency
	+	cheque and transmission deposits
	+	demand deposits
	+	other short- and medium-term deposits ✓
M3	=	cash/currency
	+	cheque and transmission deposits
	+	demand deposits
	+	other short- and medium-term deposits
	+	other long-term deposits