Financial markets and services: introduction and overview assignment

Business

Characteristics of a financial market Can you think of some other markets? Physical or virtual? It may be a or a of buyers and sellers who deal with each other over the telephone or computer screen Financial institutions Firms that provide financial services to Us and Duds; the most important financial institutions are financial Financial Intermediaries Financial institutions that borrow from Us for the purpose of lending to Duds. 1. 2 Economic function of financial markets

Economic activity is characterized by many exchange transactions which involve the buying and selling of goods, services and productive resources. Distinction made between ” ” and ” l” aspects of these transactions. E. G. In a sales transaction, a buyer takes physical possession of goods in exchange for a payment of money or a promise to pay in the future. The former aspect of the transaction is “ real” and the latter “ financial” with the goods categorized as “ real assets” and the payment is with a “ financial asset”.

In a barter system, there is an absence of the “ financial” element to economic transactions The financial system includes both markets for financial instruments and those institutions concerned with financial transactions, Just as the “ real” component of the economic system includes both markets for goods and services and the institutions The financial system is thus a vital component of the total economic system to increase the capacity to satisfy the needs and wants of individuals for goods.

The economic role of the financial system can be mainly characterized as one of facilitating real and financial transactions. The simple economic system consists of a and a . In terms of real flows, the cuisines sector produces goods and services which are purchased by the household sector for consumption. The household sector provides other necessary productive inputs to the business sector in exchange for sector collects and other compensation.

The government from the household and the business sectors and uses the receipts to buy goods, services and productive inputs which are used to supply government services (infrastructure, law and order enforcement etc) to the other sectors Diagram 2 (Exchange Flows in an economic system) depicts the relationship between the financial system and various real and financial flows in the economy.

Exchange Flows in an economic system The Financial System Financial obligations (Markets, instruments Financial assets Loaned funds & Borrowed funds (Investments) institutions) (Savings) Goods and services Tax payments Household Business Government services Sector Government Sector Productive inputs (labor etc) Payments for inputs (wages, salaries etc) Turning to the role of the financial system, it is interposed between flows of saving, investment and financial instruments (financial assets of savers and financial obligations of investors).

The flows reflect the exchanges of resources use over time rather than exchanges of ell resources at points in time. Exchange of resource uses over time (lending and borrowing) is made possible by some economic participants’ forgoing current consumption in favor of future consumption. The postponement of consumption or saving is encouraged by the prospect that future consumption opportunities can be enlarged as the result of the productive use of the current resources made available for investment purposes.

The existence of opportunity for the business sector to in an economic system provides the . Households use saved receipts to lend to business firms or to purchase equity in business firms. Such transfers of purchasing power supply the business sector with the financial resources that enable firms to gather and use real resources for investment and thereby increase output for goods and services.

The investment of these funds in turn provides the by means of paying a return on savings – in the case of loaned funds in the case of purchase of ownership shares. Economic units whether in the household, business or government sectors that spend less than their net receipts are called surplus economic/spending units. This excess of net receipts over expenditures for a period of time is called hen it occurs in the household sector, in the business sector in the government sector.

An economic unit which elects to spend more than its net receipts by drawing on spending units. Which economic units are generally Duds? Any economic unit can be Doss 1. 3 Ways to Transfer Funds Transfer of funds can be accomplished by an US lending money to and accepting an IOW from a DSL An IOW – written promise to pay a specific sum of money (principal) plus fee (interest rate) for the privilege of borrowing money over a period of time (maturity of loan) Souse are financial claims. Claims against someone else's money at a true date.

Financial Liabilities or Claims Too ADS, financial claim is a liability Too US, financial claim is an asset US may hold it till maturity or sell it in the markets A deficit spending unit may borrow from a surplus unit by exchanging a financial instrument (a promise to make future payments) for the latter's saved funds. The issuer of the instrument (borrower) thus incurs a recipient of the instrument (lender) obtains a Exchanges of saved funds for financial assets are accomplished in financial markets.

The Important contribution to this process is made by the third component of the uncial system – financial institutions in their role as between lenders and borrowers. Diagram 3: Transfer of funds from Surplus to Deficit Spending Units Dollars Purchasing power flows one way Legal obligations flow back The transfer of funds from Doss to Us in the most efficient manner either for investment or for consumption can be done via 1. Direct financing Direct financing involves lending directly to Duds.

Exchange of money and financial claims direct where Doss issue on themselves and sell them for money to Us and the Us hold the financial claims in their portfolios as interest bearing assets. Financial claims are bought and sold in financial markets such as the Examples of direct financing include 2. Indirect financing or commonly known as intermediation financing Indirect financing involves lending to a financial intermediary that borrows from Us to reeled to Duds.

Financial intermediaries transform financial claims to make them more attractive to the ultimate investor where direct claims (Souse) are purchased from Doss and transformed into with a different set of characteristics to sell to the US. Us residual claim is against financial institution rather than the ADS. Examples of Indirect financing include Financial intermediaries such as commercial banks tailor financial claims to meet the investment needs of Us while simultaneously buying a variety of financial claims from Duds.

In the direct credit markets, Us buy whatever type of claims Doss sell. Summary This lecture introduces the students to the concept of the financial system, financial markets and the economic roles which it plays. The markets serve as a conduit for the transfer of funds from surplus to deficit spending units with transfers taking place directly or indirectly.