

# [Causes and effects of stronger and weaker peso](https://assignbuster.com/causes-and-effects-of-stronger-and-weaker-peso/)

The money and capital markets are at the economic centre of the industrial and commercial world. Both firms and individuals rely upon the efficient operation of these markets for obtaining capital for investment purposes or money to meet their short-term financial needs. Over the last fifty years the operation of the money and capital markets has been progressively ‘ globalised’ both to finance international trade but also to support multinational business and governments finance their activities. This globalisation has been facilitated by a number of political, economic and technological developments.

In this chapter, we explore the financial markets with an outline of their history and their development in modern globalised economies. We devote some time to the concept of a security as a negotiable claim and the phenomenon of securitisation. We outline the structure of the financial markets and, in particular, how the money and capital markets interact. We then turn to the equity market as the primary risk market and discuss the role of information in the pricing of securities and the concept of information efficiency.

Although we take a bias towards market efficiency, some anomalous evidence will also be described. Risk and return are then defined and an intuitive appreciation given of the concept of diversification and risk partitioning. The risk–return trade-off is then discussed, leading to an informal discussion of the capital asset pricing model. Finally, topics in the fixed interest market are then discussed before closing with a section on the sources of long- and short-term finance. Financial markets transfer funds from those who have excess funds to those who need funds.

They enable college students to obtain student loans, families to obtain mortgages, businesses to finance their growth, and governments to finance their expenditures. Without financial markets, many students could not go to college, many families could not purchase a home, corporations could not grow, and the government could not provide as many public services. Household and businesses that supply funds to financial markets ear a return on their investment; the return is necessary to ensure that funds are supplied to the financial markets.

If funds were not supplied, the financial markets would not be able to transfer funds to those who need them. Those participants who receive more money than they spend are referred to as surplus units. They provide their net savings to the financial markets. Those participants who spend more money than they receive are referred to as deficit units. They access funds from financial markets so that they can spend more money than they receive. Many individuals provide funds to financial markets in some periods and access funds in other period.

Types of Financial Markets Each financial market is created to satisfy particular preferences of market participants. For example, some participants may want to invest funds for a short-term period, whereas others want to invest for a long-term period. Some participants are willing to tolerate a high level of risk when investing, whereas others need to avoid risk. Some participants that need funds prefer to borrow, whereas others prefer to issue stock.

There are many different types of financial markets, and each market can be distinguished by the maturity structure and trading structure of its securities. Types of Financial Market Structures Exist Auction markets An auction market is some form of centralized facility (or clearing house) by which buyers and sellers, through their commissioned agents (brokers), execute trades in an open and competitive bidding process. The " centralized facility" is not necessarily a place where buyers and sellers physically meet.

Rather, it is any institution that provides buyers and sellers with a centralized access to the bidding process. All of the needed information about offers to buy (bid prices) and offers to sell (asked prices) is centralized in one location which is readily accessible to all would-be buyers and sellers, e. g. , through a computer network. No private exchanges between individual buyers and sellers are made outside of the centralized facility. An auction market is typically a public market in the sense that it open to all agents who wish to participate.

Auction markets can either be call markets -- such as art auctions -- for which bid and asked prices are all posted at one time, or continuous markets -- such as stock exchanges and real estate markets -- for which bid and asked prices can be posted at any time the market is open and exchanges take place on a continual basis. Experimental economists have devoted a tremendous amount of attention in recent years to auction markets. Many auction markets traded in relatively homogeneous assets (e. g. , Treasury bills, notes, and bonds) to cut down on information costs.

Alternatively, some auction markets (e. g. in second-hand jewellery, furniture, paintings etc. ) allow would-be buyers to inspect the goods to be sold prior to the opening of the actual bidding process. This inspection can take the form of a warehouse tour, a catalogue issued with pictures and descriptions of items to be sold, or (in televised auctions) a time during which assets are simply displayed one by one to viewers prior to bidding. Auction markets depend on participation for any one type of asset not being too " thin. " The costs of collecting information about any one type of asset are sunk costs independent of the volume of trading in that asset.

Consequently, auction markets depend on volume to spread these costs over a wide number of participants. Over-the-Counter Markets An over-the-counter market has no centralized mechanism or facility for trading. Instead, the market is a public market consisting of a number of dealers spread across a region, a country, or indeed the world, who make the market in some type of asset. That is, the dealers themselves post bid and asked prices for this asset and then stand ready to buy or sell units of this asset with anyone who chooses to trade at these posted prices.

The dealers provide customers more flexibility in trading than brokers, because dealers can offset imbalances in the demand and supply of assets by trading out of their own accounts. Many well-known common stocks are traded over-the-counter in the United States through NASDAQ (National Association of secures Dealers' Automated Quotation System). Intermediation Financial Markets An intermediation financial market is a financial market in which financial intermediaries help transfer funds from savers to borrowers by issuing certain types of financial assets to savers and receiving other types of financial assets from borrowers.

The financial assets issued to savers are claims against the financial intermediaries, hence liabilities of the financial intermediaries, whereas the financial assets received from borrowers are claims against the borrowers, hence assets of the financial intermediaries. (See the diagrammatic illustration of a financial intermediary presented earlier in these notes. ) Additional Distinctions among Securities Markets Money versus Capital Markets The financial markets that facilitate the transfer of debt securities are commonly classified by the maturity of the securities.

Those financial markets that facilitate the flow of short-term funds (with maturity of one year or less) are known as money markets, while those that facilitate the flow of long-term funds are known as capital markets. Primary versus Secondary Markets Whether referring to money market securities or capital market securities, it is necessary to distinguish between transactions in the primary market and transactions in the secondary market. Primary markets facilitate the issuance of new securities.

Secondary markets facilitate the trading of existing securities, which allows for a change in the ownership of the securities. Primary market transactions provide funds to the initial issuer of securities; secondary market transactions do not. The issuance of new corporate stock or new treasury securities is a primary market transaction, while the sale of existing corporate stock or treasury security holdings by one investor to another is a secondary market transaction.

An important characteristic of securities that are traded is secondary market is liquidity, which is the degree to which securities can easily be liquidated (sold) without a loss of value. Some securities have an active secondary market, meaning that there are many willing buyers and sellers of the security at a given point in time. Investors prefer liquid securities so that they can easily sell the securities whenever they want (without a loss in value).

If a security is illiquid, investors may not be able to find a willing buyer for it in the secondary market and may have to sell the security at a large discount just to attract a buyer. Debt versus Equity Markets Debt instruments are particular types of securities that require the issuer (the borrower) to pay the holder (the lender) certain fixed dollar amounts at regularly scheduled intervals until a specified time (the maturity date) is reached, regardless of the success or failure of any investment projects for which the borrowed funds are used.

A debt instrument holder only participates in the management of the debt instrument issuer if the issuer goes bankrupt. An example of a debt instrument is a 30-year mortgage. In contrast, equity is a security that confers on the holder an ownership interest in the issuer. There are two general categories of equities: " preferred stock" and " common stock. "

Common stock shares issued by a corporation are claims to a share of the assets of a corporation as well as to a share of the corporation's net income -- i. . , the corporation's income after subtraction of taxes and other expenses, including the payment of any debt obligations. This implies that the return that holders of common stock receive depends on the economic performance of the issuing corporation. Holders of a corporation's common stock typically participate in any upside performance of the corporation in two ways: by receiving a share of net income in the form of dividends; and by enjoying an appreciation in the price of their stock shares.

However, the payment of dividends is not a contractual or legal requirement. Even if net earnings are positive, a corporation is not obliged to distribute dividends to shareholders. For example, a corporation might instead choose to keep its profits as retained earnings to be used for new capital investment (self-financing of investment rather than debt or equity financing). On the other hand, corporations cannot charge losses to their common stock shareholders.

Consequently, these shareholders at most risk losing the purchase price of their shares, a situation which arises if the market price of their shares declines to zero for any reason. An example of a common stock share is a share of IBM. In contrast, preferred stock shares are usually issued with a par value (e. g. , $100) and pay a fixed dividend expressed as a percentage of par value. Preferred stock is a claim against a corporation's cash flow that is prior to the claims of its common stock holders but is generally subordinate to the claims of its debt holders.

In addition, like debt holders but unlike common stock holders, preferred stock holders generally do not participate in the management of issuers through voting or other means unless the issuer is in extreme financial distress (e. g. , insolvency). Consequently, preferred stock combines some of the basic attributes of both debt and common stock and is often referred to as a hybrid security. Domestic Versus Global Financial Markets Eurocurrencies are currencies deposited in banks outside the country of issue.

For example, Eurodollars, a major form of Eurocurrency, are U. S. dollars deposited in foreign banks outside the U. S. or in foreign branches of U. S. banks. That is, Eurodollars are dollar-denominated bank deposits held in banks outside the U. S. An international bond is a bond available for sale outside the country of its issuer. Example of an International Bond: a bond issued by a U. S. firm that is available for sale both in the U. S. and abroad. A foreign bond is an international bond issued by a country that is denominated in a foreign currency and that is for sale exclusively in the country of that foreign currency.

Example of a Foreign Bond: a bond issued by a U. S. firm that is denominated in Japanese yen and that is for sale exclusively in Japan. A Eurobond is an international bond denominated in a currency other than that of the country in which it is sold. More precisely, it is issued by a borrower in one country, denominated in the borrower's currency, and sold outside the borrower's country. Example of a Eurobond: Bonds sold by the U. S. government to Japan that are denominated in U. S. dollars.