

# 09-16 ECON 345

Wednesday, September 16, 2015

5:02 PM

- Problem Set 1 on MyLab due Thursday, Sept 24 at 11:59PM (Directions to access MyLab on Connect)
- Only permitted to use a simple calculator (non-graphing, non-financial) for the exams

## Intro

- Feds Funds Rate has been as high as 20% in the 1980's
- Almost down to 0% in the recent years
- Last Fed Funds Rate Hike was in June 2006

## Structure of Financial Markets

*Primary Market* for a security (stock or bonds) - used for IPOs. Where a new security is sold to the first buyers (usually commercial banks or chartered banks). In the primary market, those with excess funds interact with those with insufficient funds. Major banks acts in primary market (not individuals).

They value and discount the initial placement of the government paper. Government can be only placed in the primary market.

*Secondary Market* for a security - where securities that were previously issued are bought and sold (through brokers or dealers). Central bank can only buy the bond/govt. paper in the secondary market. Central bank is independent from the central bank. Private sector determines the market rate for the bonds. The secondary market does not direct funds from savers to borrowers (not providing funds for investment purposes). The existence of the secondary market makes the primary market more liquid. Secondary market does play a role in financing the primary market (acts as a backup)

Secondary markets is composed of Exchanges and Overt-the-Counter (OTC) markets

Exchanges: Toronto Stock Exchanges, NYSE

OTC Markets: Dealers at different locations buy and sell with no

supervision of an exchange. Good way for brokers to expand their business.

Face to face transactions between financial intermediaries. It can be very time consuming.

### Money Markets and Capital Markets

The Money Market trades short-term debt instruments (contracts that mature within 1-year)

The Capital Market trades longer-term debt and equity instruments (maturity > 1 year)

#### Money Market Instruments:

- Government of Canada Treasury Bills
- Certificates of Deposits
- Commercial Paper - short term corporate debt (not collateralized / lent based on the credit worthiness of the company / no security)
- Repurchase Agreements - in and out deal - sell an asset and buy it back within a period (up to 1 year)
- Overnight Funds - monitor the overnight interest rate - lending funds between commercial banks; this information is monitored by the central banks (the rate is between 15 to 25 basis points); Overnight interest rate is very accurate (8 to 9 decimal places to the interest rate)
- Outstanding value of Commercial Paper increased upto 2000, but dropped after, whereas short-term debt in terms of treasury bills has always been on the rise; Commercial Paper market has shrunk because of a credit crunch

#### Capital Market Instruments:

- Mortgages and mortgage-backed securities (MBS)  
Mortgage is a loan that is secured by an asset (for homes)
- Corporate Bonds (longer periods of time than Commercial Paper)  
Corporate bonds have been on the rise unlike commercial paper (moving to a longer maturity horizon)
- Canadian (federal) government bonds = bonds are longer than a year unlike bills

- year 2010-2015
- Canada Savings Board
- Provincial and municipal government bonds
- Consumer Loans
- Commercial and Farm Mortgages

## Financial Intermediaries

Depository Institutions [to make deposits - highly regulated in Canada]

Chartered Banks (similar to US commercial banks)

Trust and Mortgage Loan Companies

Credit Unions

Contractual Savings Institutions

Life Insurance Companies (where you pay premium - similar to deposits)

Property and Casual Insurance Companies (auto, home insurance companies)

Pension Funds and Government Retirement Funds

Investment Intermediaries

Finance Companies: Sears, GE lend to their intermediaries

Mutual Funds