

# MONEY AND BANKING

## LECTURE 1: INTRODUCTION TO FINANCIAL SYSTEM

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- 3 WHAT IS FINANCIAL SYSTEM?
- 4 THE IMPORTANCE OF FINANCIAL SYSTEM
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- Instructor: Gu, Xin, PhD in Economics from School of Economics and Asia-Pacific Economic Cooperation Research Center, Nankai University.



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- Office: Room 840, School of Finance, the Main Executive Building.
- The course web site is <https://github.com/richardgu26zh/Money-and-Banking-Fall-Semester-2018>.

# CONNECTIONS WITH WHAT WE HAVE LEARNED

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- Money and Banking is considered as an extension of *Macroeconomics*.
- How do you define *economics* in your own words?
- Rational agents optimize their decisions given resource constraints.
- In *Macroeconomics*, we study the optimization of households, producers, and government decision jointly.

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- Financial infrastructure is the set of institutions that enable effective operation of financial intermediaries.
- It includes such elements as *payment systems, credit information bureaus and collateral registries*. It also includes legal and regulatory framework for financial sector operations.

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- Major investment banks around the world include Barclays, Bank of America Merrill Lynch, Goldman Sachs, Deutsche Bank, Morgan Stanley, UBS, Credit Suisse, and Citibank.

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- The world most influential central banks are the Federal Reserve (U.S.A), the People's Bank of China, the European Central Bank, and Bank of Japan.

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- Securities Exchange Committee, on the other hand, oversees securities markets.
- It puzzles many that why financial system is probably the most regulated sector in the economy. To answer this question, we need to investigate the importance of financial system.

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  - ② debt investors - fixed interest rates periodically and lump-sum repayment at maturity date (either bank loans or bonds).

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- Indirect finance - banks which grants you business loans.

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- When you in an attempt to raise funds by your own, you will acknowledge the time and energy that you need to invest in this financing process.

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- For example, Lee prefers a fixed interest rate of 6% per year; Richy might like 5,000 RMB to become an owner, although you don't think he knows anything about computer stuff.
- By comparison, we find out that raising funds through financial intermediaries is time-saving. What more does financial system do for us?

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- Besides, you don't need to line up in banks to buy mutual funds or fund wire.

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- Banks, in this case, pool funds from various entities (e.g., households and corporations), and then to distribute to units which are in need.

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- e.g. insurance companies and pension funds would give investors contingency payment and retirement annuities.



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- If you wanted to sell it quickly, you would choose investment banks, for instance.

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- It is a typical problem in economics, known as **asymmetric information**.

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- For more readings, please consult Bodie, Z, and Merton, R.C. (1995). *A Conceptual Framework for Analyzing the Financial System*, Chapter 1 to 8, Harvard Business School Press.

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- The amount of monetary assets and non-monetary assets (e.g., stocks and bonds) are affected by the central bank. On the asset side, the central bank holds government securities; on the liability side, it produces base money.

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- Decisions of either fund demanders, banks, or investment banks are highly influenced by decisions of the central banks.
- Decisions of the central bank are implemented by *monetary policy tools*, and generate influence on the economy through *monetary transmission channels*.

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- In *Understanding Interest Rates*, we will introduce a *plain vanilla bond*, interest rate measurement - *yield to maturity*, techniques of *present value*, and *calculation of rate of return*.