Financialization (II): Financial markets & households

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The household perspective

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How *businesses* raise **$$$** for their expansion plans is only *half* the story.

The other half is what *households and individuals* do to **supply** those funds.

Savings

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It only makes *sense* for individuals to be in financial markets if there are *savings*.

> *Savings* constitute the share of disposable (after-tax) income that is *not* spent on *consumption* of goods and services.

$$\text{Savings} = \text{Disposable income} - \text{Consumption}$$

Savings

- *What to do with savings?*

Some options:

- Cash
- Savings account
- Government bonds
- Stocks
- Housing
- Gold
- Other financial assets

Savings

The fundamental *difference* between *cash* and other *financial assets*:

- *Liquidity*

Savings

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Liquidity, return, & risk

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When separating oneself from *liquidity*, *three* things to consider:

1. *How much* I will be paid?
2. Will I be paid more or less than *expected*?
3. How *easily* can I get rid of this asset?

Liquidity, return, & risk

When separating oneself from *liquidity*, *three* things to consider:

1. *How much* I will be paid? = *Return*
2. Will I be paid more or less than *expected*? = *Risk*
3. How *easily* can I get rid of this asset? = *Liquidity*

Liquidity, return, & risk

- A financial asset's ***rate of return*** is the ***reward*** for parting ways with cash.
- ***Risk*** is the possibility (odds) that expected projects ***may not work***.
- An asset's ***liquidity*** refers to how ***easily*** one can exchange it for cash.

When businesses and individuals shake hands

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Businesses incur in *debt* in order to expand and increase *profits.*

- In other words, businesses *demand* cash.

Households/Individuals who can *save* want a return from parting ways with cash.

- Given certain *risk, return, and liquidity* conditions, individuals *supply* cash.

Next time: Financial assets, in detail