Lecture 1

The financial system

Corporate financing – business finanances

Asset pricing – value of financial instruments

Financial markets – banking jobs

Behavioural finance – suggests biases that influence prices (overconfidence etc.) what influences prices

Money – store of value
Currency – government decreed value (money relies on trust)

Textbook

Financial system provides marketplace for money

Lender-savers (e.g. households) (SSU's)

Borrower-spenders (e.g. companies, governments) (DSU's)

Commercial banks are intermediaries (indirect financing)

Large corporations use financial markets (shares, investors, bonds)

Small companies will use indirect as well

Determinants of Interest Rate Levels

DEMAND of funds: Return on investment (Greater/lesser opportunities influence real rate)
SUPPLY of funds: Time Preference (low rates of interest, incentive to buy now)

real rate of interest (r)

-inflation adjusted (absence of inflation)

Fisher Equation

Real rate of interest = r
Nominal rate of interest = i
Change in general level of prices = ΔP_e

$i = r + \Delta P_e + r\Delta P_e$