

## WEEK 1: THE FINANCIAL SYSTEM

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### 1. Finance – a context

- Current global and domestic economic conditions and indicators
- Money is a store of value (maintains its intrinsic value)
- Currency is a government decreed 'form of money' and is a medium of exchange but not a good store of value

### 2. The Financial System – marketplace for money, enabling a transfer of purchasing power between market participants and present and future time

- Direct Financing:
  - Wholesale markets – minimum transactions > \$1 m
  - Main participants – financial institutions namely superannuation funds, mutual funds, insurance companies – creditworthy companies have best access to finance
- Indirect Financing:
  - Accessing finance through an intermediary
  - Most small companies confined to obtaining finance through a commercial bank: an intermediary

### 3. Determinants of Interest Rate Levels

- Real rate of interest: inflation adjusted rate.
- Determinants – Supply and demand
- **The Fisher Equation:**  $r = \frac{1+i}{1+\pi} - 1$
- **Approximate version:**  $r = i - \pi$

## WEEK 2: THE TIME VALUE OF MONEY (TVM)

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### 1. TVM – the difference in the value between a dollar in hand today and a dollar promised in the future

- Future Value: accumulated value
- Present Value: the equivalent value at an earlier date (i.e. today) of a future sum(s) of money
- Simple interest: interest earned on the original principle only
- Compound interest: interest earned on the original principle and on the interest earned
- Compounding: process by which interest earned on an investment is reinvested, so future periods interest is earned on the interest as well as the principle
- Discounting: process by which the present value of future cash flows is obtained
- **FV of a single amount (simple):**  $FV = PV(1 + i * n)$
- **FV of a single amount (compounding):**  $FV = PV \left(1 + \frac{i}{m}\right)^{m*n}$
- **PV of a single amount:**  $PV = FV \left(1 + \frac{i}{m}\right)^{-m*n}$

## WEEK 3: THE TIME VALUE OF MONEY (TVM) PART II

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### 1. Effective Annual Interest Rate (EAR) – the annual interest rate that reflects compounding within a year

- Nominal Interest Rate: the simple interest rate charged per period multiplied by the number of periods per year

