ECONOMICS OF FINANCIAL MARKETS

Course Outline

Office Location: BAC 347
Office Telephone: (902) 585 1511
Email Address: moussa@acadiau.ca
Office Hours: Tuesday and Thursday: 10:30 a.m-12:30 p.m.

Introduction

Welcome to this course on the economics of financial markets. Financial markets are an integral part of an economic system based on markets and laisser faire. Financial markets allow specialization to take place. They support economic activity and growth. They allow the payment system to function efficiently. They also allow the transfer of purchasing power from those who save to those who invest in physical capital to produce goods and services without necessarily securing the prior approval of those who save. Often, the transfer involves more than those two parties using a very old mechanism money, which was invented long before the emergence of modern financial markets.

Because financial markets deal in future claims and use money, which is a very imprecise mechanism by its very nature, those participants who save and those who produce face up to a substantial amount of risk and uncertainty. The risk and uncertainty are inherent in dynamic economic activity and they are amplified by the operation of financial markets since free entry and exit in these markets allows non-producers of goods and services and non-savers to intervene in these markets.

Risk and uncertainty are reduced with collection and processing of relevant information and through pooling and mixing of independent economic activities. Thus, participants other than those who save and produce goods and services do the collection and processing of relevant information. They profit by helping those who save and those who produce to make the most appropriate economic decisions and so does the economic system. The existence of profit with no capital required attracts into financial markets people who do not collect information and or process it correctly but they want to cash in on economic profit by placing small bets that win huge returns with a small probability. Those participants that collected and process the correct information properly need to advance small amounts of capital. Those who are attracted by profit to place bets need close to nothing in terms of capita. These facts make it possible for financial markets to satisfy the free entry and exit condition of competitive markets.

The collection, processing, and use of relevant information on time help participants in financial markets including savers and producers to operate efficiently. Since there is free entry and exit into and from financial markets, any new and relevant information is put to use immediately. Economists refer to this kind of markets as efficient markets. Unfortunately, many misuse this concept claiming that real world financial markets are efficient. In fact they are not since they are subject to actions by participants who venture to enter without relevant information but enter to gamble. Some of these did and will make huge fortunes; many did not and will not. However, poorly informed participants hoping for huge gains by merely placing bets increase uncertainty, cause unnecessary costs, and create inefficiencies such as we see from time to time in the form of financial crisis, and boom and busts of stock markets and financial markets in general.

Participants in financial markets created instruments to deal with risk and to transfer purchasing power and risk. In this course, we study the financial instruments and the financial markets where those instruments are traded including money markets, credit markets, bond markets, stock markets, and currency markets. We also study the main group of operators in those markets: banks, pension funds, brokers and brokerage firms. Finally, we study the risks faced by participants in financial markets and the instruments created to transfer purchasing power, diversify risk, and transfer risk. Our ultimate goal is to understand how such instruments are used to help financial markets perform their tasks as efficiently as possible and help the economy achieve an efficient allocation of resources.

Recommended Textbook: F. S. Mishkin and A. Serletis, "The Economics of Money, Banking and Financial Markets", Pearson Fifth Canadian Edition

Topics Schedule

	Topic	Mishkin
Week 1: Sept 7- Sep 9	Introduction, The financial system	Chs. 1, 2
Week 2: Sept 12- Sep 16	Money	Ch. 3
Week 3: Sep 19 - Sep 23	Interest rates	Ch. 4
Week 4: Sep 26- Sep 30	Understanding Risk	
Week 5: Oct 3 - Oct 7	Behavior of Interest rates	Ch. 5
Week 6: Oct 10 - Oct 14	Risk and term structure of interest rates	Ch. 6
Week 7: Oct 17 - Oct 21	Risk and term structure of interest rates	Ch. 6
Week 8: Oct 24 - Oct 28	Stock Market	Ch.7
Week 9: Oct 31 – Nov 4	Derivatives	Ch. 13
Week 10: Nov 7- Nov 11	Derivatives	Ch. 13
Week 11: Nov 14-Nov 18	Foreign exchange market	Ch. 18
Week 12: Nov 21- Nov 25	International Financial system	Ch. 19
Week 13: Nov 28- Dec 2	International Financial System	
Dec 5	Review	

Marking system

	Date	Grading System
Test 1	September 30, 2016	5
Test 2	November 30. 2016	5
Midterm Exam	October 12, 2016	32
Assignments	See Schedule below	15
Final Exam	See Registrar's Schedule	35
Paper		8

Assignment Schedule

Assignment	Date of Distribution	Due date
1	September, 21 2016	September 28, 2016
2	September 28, 2016	October 7, 2016
3	November 14, 2016	November 23, 2016

Assignments must be handed in at the beginning of the class of the due date day.