

## Institutions and Markets

Economics 71a  
Gitman/Madura Chapter 2  
Lecture notes 2

## Goals

- Introducing
  - **Financial institutions**
  - Financial markets
  - Basic financial securities

## Institutions (the players)

1. Commercial banks
2. Mutual funds
3. Pension funds
4. Securities firms
5. Insurance companies
6. Others

## 1. Commercial Banks

- Consumers
  - Deposits/savings
  - Lending/transactions
    - Consumer loans
    - Home mortgages
    - Checking accounts
    - Credit cards
    - Debit cards

## Commercial Banks

- Firms
  - Cash management
  - Lines of credit
  - Bank loans

## Commercial Banks

- Intermediary roles
  - Between lenders and borrowers
  - Repackaging financial products
- Regulatory environment
  - Key aspect of monetary policy
  - Federal Deposit Insurance Corporation (FDIC)
  - Federal Reserve System

## 2. Mutual Funds

- Function
  - Consumer investments -> Firms
- Types
  - Stock (invest in stock market portfolios)
  - Money market (short term lending to firms)
  - Bond

## Mutual Funds

- Allow consumers to better **diversify**
- Gather and process investment information
- Fast growing sector

### 3. Pension Funds

- Manage/invest employee savings/pension plans
- Similar in spirit to mutual funds
- Hired by employer
- Retirement savings plans
  - Defined benefit (401K)
  - Defined contribution

### 4. Securities Firms

- Investment banks/brokerage firms
- Issue stock and bonds
  - (IPO: Initial public offering)
- Facilitate trades in securities
- Banks versus Investment Banks
  - The repeal of Glass-Steagall (1999)
  - Changing playing field

### 5. Insurance Companies

- Insure individual and corporate risks
- Receive payments (insurance premia)
  - Invest these
- Payout for losses
- New issues
  - Trading insurance policies
  - Derivatives
  - High tech risk management

### 6. Other Institutions

- Savings and loans
  - Savings -> home mortgages
- Credit unions
- Information and software services
  - Bloomberg
  - Quicken
  - Microsoft

## Changes

- Conglomeration
  - Banks buying others
    - Baybank -> Bank Boston -> Fleet
  - Number of banks will fall
  - Citigroup
    - Citibank
    - Travelers insurance
    - Salomon Smith Barney
- Globalization

## Goals

- Introducing
  - Financial institutions
  - **Financial markets**
  - **Basic financial securities**

## Markets

- Primary markets
  - New issues (IPO's, corporate and public debt)
- Secondary markets
  - Trading old stuff
  - In many cases most activity in secondary

## Money and Capital Markets

- Money markets
  - Short term securities (1 year or less)
- Capital markets
  - Longer term

## Money Market Securities

- Treasury bills
  - U.S. government debt
  - ¼, ½, 1 year lengths
- Commercial paper
  - Short term corporate borrowing
- Discount pricing
  - Buy for \$10, get paid \$11 in future
  - No interest payments

## Capital Market Securities

- Bonds (longer term borrowing)
  - U.S. Treasury
  - Municipal (tax free)
  - Corporate
  - More later

## Capital Market Securities

- Stocks
  - Common stock
  - Preferred stock
  - International
  - Stocks versus bonds
  - More later

## Trading and Markets

- Stock markets
- Bond markets
- Derivatives
- Foreign Exchange

## U.S. Stock Markets

- New York Stock Exchange (NYSE)
- National Association of Securities Dealers Automated Quotation (Nasdaq)
  - American Stock Exchange (AMEX)

## Stock Markets

	Market Capital	# Securities
NYSE	\$10.1 Trillion	3656
London LSE	2.4 Trillion	2997
Tokyo	2.3 Trillion	1802
NASDAQ	2 Trillion	6259

## Continuous Trading

- Market types
  - Specialist
  - Electronic dealer
  - Open outcry
- Order types
  - Market
  - Limit
  - More complicated

## Trading Volume NYSE

	Annual Volume	Turnover
1957	560 million shares	12%
1977	5,273	21%
1987	47,801	73% 1994=54
1997	133,312	69

## Trading Volume more

- What does this mean?
- Internet stocks
  - Turnover > 100% Day
- NYSE approx daily \$vol 10-500 billion
- Foreign exchange daily = \$1 Trillion

## Other Markets

- Futures/Options
- Foreign Exchange
  - Spot versus forward
- Bond