



EC/FI358 FINANCIAL MARKETS AND THE ECONOMY

IES Abroad Vienna

DESCRIPTION:

The objective of this course is to deepen students' understanding of the functions of financial markets in addition to key linkages between the real economy and the financial sector. This requires an understanding of the instruments traded on the key financial markets and their purpose, elements of security pricing, the most important institutions active on those markets and, finally, how governments attempt to steer the economy by means of policy measures which operate via financial markets. In addition, some of the structural weaknesses in the financial system will be explained, which constitute sources of financial and economic instability, and which can result in widespread market failure.

A core message the course will be that a modern economy cannot function without an efficient financial system; equally, the financial system must be tailored to the needs of the real economy and must not be allowed to become self-serving. By means of case studies, the recent experiences of Iceland, Ireland and Austria will be examined, with reference to other countries such as the United Kingdom and Greece.

After considering the structure of an economy and the interactions of its main sectors, attention will focus on how financial markets reconcile the needs of economic agents. Due to the progress of globalization, money markets are the most highly integrated financial markets, internationally; hence the need to examine the foreign exchange and Eurocurrency markets, in addition to instruments traded on "domestic" markets. Important considerations include payments imbalances, government borrowing and the activities of multinational banks. As the money market is the channel through which monetary policy operates, it assumes special importance in efforts to stabilize the economy.

Capital markets are also considered, emphasizing the financing needs of the corporate sector and the government. Innovative activity, from junk bonds to more recent innovation in securitization, has frequently ended in grief; nevertheless, has to be viewed as an essential development. Markets for derivative securities will not be dealt with extensively, and the emphasis here will be to understand how the growth of credit derivatives in recent years exacerbated a crisis which originated elsewhere.

The course will include a visit to the currency museum of the Austrian Central Bank.

CREDITS: 3 credits

CONTACT HOURS: 45 hours

LANGUAGE OF INSTRUCTION: English

PREREQUISITES:

- A course in economics, especially macroeconomics, is essential.
- Courses in finance, accounting and/or corporate finance would be advantageous.

METHOD OF PRESENTATION:

- Lectures, which will incorporate class discussion
- Group presentations on given topics (case study on banking issues)
- Class excursion to the Dorotheum, the world's oldest auction house including written evaluations of benefit

REQUIRED WORK AND FORM OF ASSESSMENT:

A recommended reading assignment is given for each week of class. Additional reading assignments will be given which go beyond the lecture content. Some of this literature is indicated in the 'additional reading' section (see below). These books are readable descriptions of "what happened" as opposed to textbooks. However, this will be moderate as the course reading is onerous. Group project on a case study and a presentation of findings, including a written summary hand out. Quizzes and exams.

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- Course participation and discussions - 10%
- Two quizzes – 20%
- Midterm Exam - 20%
- Final Exam - 30%
- Group work and presentation - 20%

Course Participation & Discussions

After inputs by the lecturer students are encouraged to deepen and check their understanding by asking questions, working on small cases and participate in discussions (of actual topics).

Quizzes

Single Choice quizzes: out of four possible answers one is to be chosen.

Midterm Exam

Made up of single choice-questions and problem cases, including some calculations.

Final Exam

Made up of single choice-questions and problem cases, including some calculations.

Group Work & Presentations

The research paper to be presented and discussed in class has to fulfill the scientific requirements as regards chosen methods, covered topic, style and formal aspects. It is a short paper based on a topic assigned by the lecturer, based on materials mainly provided by the lecturer and aiming at deepening the understanding of the topics covered in class or to approaching them from a different perspective.

LEARNING OUTCOMES:

By the end of the course students will be able to:

- Understand the role of the financial system in the domestic, as well as the global, economy, with special emphasis on the Eurozone and Austria. The USA will be used for comparative purposes, where appropriate.
- Understand the reasons for recurring financial and economic crises: In particular, how national governments do not comply with the constraints of globalization.
- Discuss the main instruments traded on financial markets, along with the roles of the principal markets, which are frequently discussed in the financial press.
- Discuss current trends and developments in the international financial system (e.g. exchange-rate regimes, globalization and economic integration, trade liberalization etc.) from a historical perspective.
- Evaluate critically the arguments of interest groups and culturally accepted prejudices concerning deregulation and free markets.

ATTENDANCE POLICY:

IES Vienna requires attendance at all class sessions, including field study excursions, internship meetings, scheduled rehearsals, and all tests and exams. Attendance will be taken for every class. If a student misses more than two classes without an excuse, the final grade will be reduced by one-third of a letter grade (for example, A- to B+) for every additional unexcused absence.

Excused absences are permitted only when:

- 1) a student is ill (health issues),
- 2) when class is held on a recognized religious holiday traditionally observed by the particular student, or
- 3) in the case of a grave incident affecting family members;
- 4) Exceptions may be made for conflicting academic commitments, but only in writing and only well in advance of missed class time.

Please refer to IES Vienna Attendance Policy for details on how to get your absences excused.

CONTENT:

Week	Content	Assignments
<p>Week 1</p>	<p>Overview of Financial Markets</p> <ol style="list-style-type: none"> 1. key concepts (liquidity, leverage, negotiability) 2. etc.) 3. financial intermediation between sectors (and other functions) 4. types of markets (direct and indirect markets etc.) 5. sectoral flows-of-funds 6. open economy considerations. 	<ul style="list-style-type: none"> • Howells & Bain chs. 1+12 (pp. 1 – 27 & 332 – 358) • Mishkin: ch. 2 (pp. 23 – 40) <p>Supplementary:</p> <ul style="list-style-type: none"> • Mishkin & Eakins chs. 1+2 (pp. 3 – 9 & 17 – 36)
<p>Week 2</p>	<p>Structure of the Economy</p> <ol style="list-style-type: none"> 1. aggregate supply-aggregate demand (AS-AD) model of the economy 2. balance of payments 3. real and financial sectors – transmission mechanisms 4. the economy of the Eurozone. 	<ul style="list-style-type: none"> • Blanchard ch. 7 (pp. 139 – 160) • Howells & Bain ch. 2 (pp. 29 – 47) • Krugman, Obstfeld, Melitz ch. 13 (pp. 323 – 345) <p>Supplementary:</p> <ul style="list-style-type: none"> • Mishkin & Eakins ch. 26 (Appendix ch. 14, available from www.prenticehall.com/mishkin_eakens) • ECB ch. 2 (pp. 29 – 39)
<p>Week 3</p>	<p>The Special Role of Interest Rates</p> <ol style="list-style-type: none"> 1. yield curves – spot and forward 2. theories of yield curves 3. economic importance of yield curves 4. essence of monetary policy. 	<ul style="list-style-type: none"> • Choudhry ch. 3 (pp. 67 - 92) • Howells & Bain ch. 7 (pp. 201 – 232) • Mishkin chs. 4 – 6 (pp. 61 – 78; 120 – 137) <p>Supplementary:</p> <ul style="list-style-type: none"> • Valdez & Molyneux ch. 6 (pp. 127 – 137)
<p>Week 4</p>	<p>Money Markets and Banking</p> <ol style="list-style-type: none"> 1. Money-market instruments (purpose, pricing) 2. Eurocurrency markets (origins, purpose, pricing, LIBOR, EURIBOR) 3. Banks v. non-banks 4. Bank balance sheets 5. Banking book and trading book 6. A/L management 	<ul style="list-style-type: none"> • Hull ch. 2 (pp. 21 – 38) • Howells & Bain ch. 10 (pp. 288 – 305) • Choudhry chs. 1+2 (pp. 1 – 20; 23 – 65) <p>Supplementary:</p> <ul style="list-style-type: none"> • Arnold ch. 9 (pp. 204 – 237) • Mishkin and Eakins ch. 9 (pp. 211 – 233) • Valdez & Molyneux ch. 6 (pp. 140 – 149)
<p>Week 5</p>	<p>Monetary Policy in the Eurozone (contrast with USA)</p> <ol style="list-style-type: none"> 1. The market for bank reserves 	<ul style="list-style-type: none"> • Mishkin chs. 16+17 (pp. 374 – 385; 393 – 403) • ECB ch. 4 (pp. 93 – 116)

	<ol style="list-style-type: none"> 2. High-powered money and the multiplier 3. Instruments of monetary policy 4. Eurozone – reserve auctions, reverse transactions 5. USA – federal funds market 6. Federal funds rate v. EONIA 	<p>Supplementary:</p> <ul style="list-style-type: none"> • Mishkin & Eakins ch. 9 (pp. Appendix ch. 8, ref. week 2)
<p>Week 6</p> <p>Midterm Week</p>	<p>The International Financial System</p> <ol style="list-style-type: none"> 1. Exchange rates and exchange-rate regimes 2. The foreign exchange market 3. Problems (balance of payments – stability – persistent imbalances and crisis) <p>MIDTERM</p>	<ul style="list-style-type: none"> • Howells & Bain chs. 8+9 (pp. 243 – 258; 261 – 285) • Mishkin chs. 20+21 (pp. 462 – 483; 487 – 510) <p>Supplementary:</p> <ul style="list-style-type: none"> • Mishkin & Eakins chs. 13+14 (pp. 305 – 319; 337-355) • Krugman, Obstfeld, Melitz ch. 20 (pp. 587 – 610)
<p>Week 7</p>	<p>The Stock Market and Financing of Corporations</p> <ol style="list-style-type: none"> 1. Corporate investment decision criteria 2. The stock market and corporate finance (investment banks and IPOs) 3. Organization of stock exchanges 4. Stock pricing 5. Rational expectations 6. Efficient-markets hypothesis 	<ul style="list-style-type: none"> • Howells & Bain ch. 6 (pp. 149 – 199) • Mishkin ch. 7 (pp. 141 – 163) <p>Supplementary:</p> <ul style="list-style-type: none"> • Arnold chs. 12+13 (pp. 300 – 361) • Mishkin & Eakins ch. 11 (pp. 259 – 275)
<p>Week 8</p>	<p>Bond Markets and Financing Economic Activity</p> <ol style="list-style-type: none"> 1. Bond pricing/yields; market participants (corporations, governments, foreign sector) 2. Principal features of treasuries and corporate bonds 3. Innovations in the bond market (junk bonds, mortgage bonds, ABS, securitization) 	<ul style="list-style-type: none"> • Arnold chs. 10+11 (pp. 242 – 290) • Mishkin & Eakins ch. 10 (pp. 237 – 256) <p>Supplementary:</p> <ul style="list-style-type: none"> • Valdez & Molyneux ch. 6 (pp. 149 – 165)
<p>Week 9</p>	<p>The Clients of the Financial System and the Need for Regulations in the European Union</p> <ol style="list-style-type: none"> 1. Government 2. Corporate sector 3. Household sector 4. Foreign sector 5. Can the financial sector lay golden eggs? 6. Need for regulation (asymmetric information, moral hazard) 7. Regulatory measures (Basel, banking union) 	<ul style="list-style-type: none"> • Howells & Bain chs. 11+12+13 (pp. 308 – 398) <p>Supplementary:</p> <ul style="list-style-type: none"> • Mishkin & Eakins ch. 24 (pp. 617 – 634) • Arnold ch. 18 (pp. 477 – 490)

Week 10	Case Study: Anatomy of Banking Crises in Iceland, Ireland and Australia Class presentations based on internet research and recommended articles.	
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COURSE-RELATED TRIPS:

- Excursion to the Dorotheum, Vienna on November, 21st 2018

REQUIRED READINGS:

- Arnold, Glen. Financial Markets. Pearson: Financial Times Guides (2012)
- Blanchard, O. Macroeconomics (4. Ed), Pearson/Prentice Hall (2006)
- Choudhry, M. An Introduction to Banking: liquidity risk and asset-liability management, Wiley (2011) European Central Bank (ECB). The Monetary Policy of the ECB, ECB/Eurosystem (2011).
- Howells, P. and K. Bain. Financial Markets and Institutions (5. Ed.), FT/Prentice Hall (2007)
- Hull, J.C. Risk Management and Financial Institutions (3. Ed.), Wiley Finance (2012)
- Krugman P., M. Obstfeld and P. Melitz. International Economics: theory and policy (9. Intl. Ed.), Pearson International Edition (2010).
- Melvin, M. & S. Norrbin. International Money and Finance. Elsevier Inc (2013).
- Mishkin, Frederic S. The Economics of Money, Banking, and Financial Markets (10. Edition). Pearson 2013.
- Mishkin, F. and S. Eakins. Financial Markets and Institutions (6. Ed.), Pearson International Edition (2009)
- Steiner, Bob. Foreign Exchange and Money Markets. Butterworth-Heinemann Finance (2002)
- Valdez, S. & P. Molyneux. An Introduction to Global Financial Markets (6. Ed.). Palgrave Macmillan (2010).

ADDITIONAL READINGS:

- Admati, Anat, Hellwig, Martin: The Bankers' New Clothes: What's Wrong with Banking and What to Do about it. Princeton 2014
- Desai, Mehir: The Wisdom of Finance. London 2017.
- Eichengreen, Barry: Hall of Mirrors: The Great Depression, The Great Recession, and the Uses-and Misuses-of History. Oxford University Press 2015.
- Kay, John: Other People's Money: Masters of the Universe of Servants of the People. London 2015.
- King, Mervin: End of Alchemy. Money, Banking and the Future of the Global Economy. Norton & Norton, New York et al. 2016.
- Stocker, Ferry: Zahltag: Finanz-, Schulden- und Wirtschaftskrise und ökonomische Prinzipien. 3rd ed. Vienna 2015.