

CHAPTER 1

Why Study Money, Banking, and Financial Markets?

Why Study Financial Markets?

1. Channel funds from savers to investors, thereby promoting economic efficiency
2. Affect personal wealth and behavior of business firms

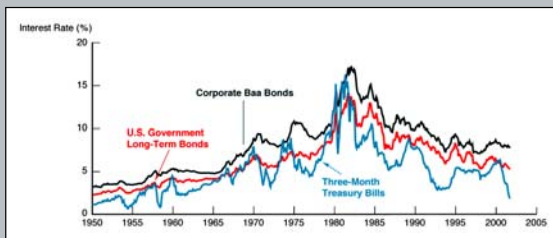
Why Study Banking and Financial Institutions?

1. Financial Intermediation
Helps get funds from savers to investors
2. Banks and Money Supply
Crucial role in creation of money
3. Financial Innovation

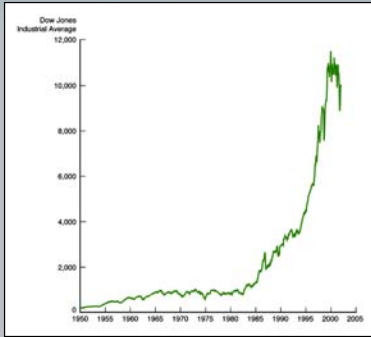
Why Study Money and Monetary Policy?

1. Influence on business cycles, inflation, and interest rates

Bond Market



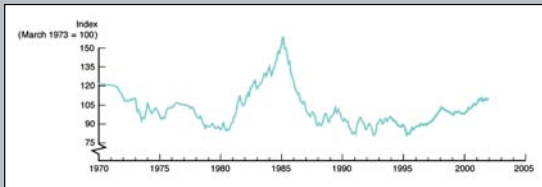
Stock Market



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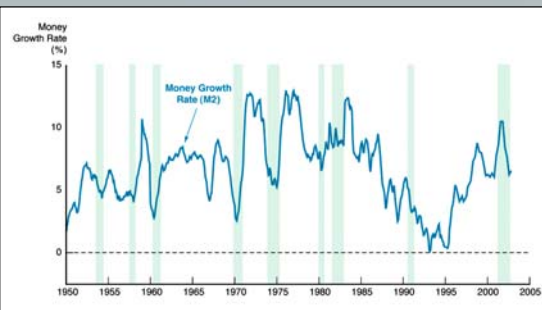
Foreign Exchange Market



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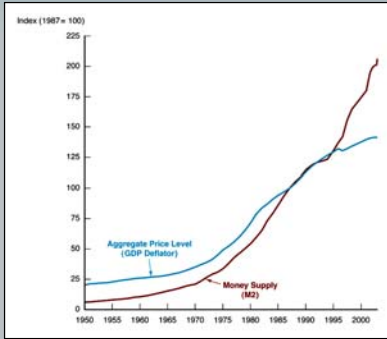
Money and Business Cycles



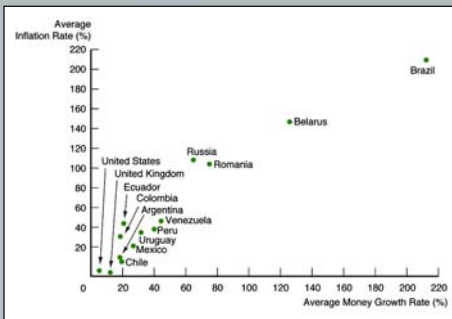
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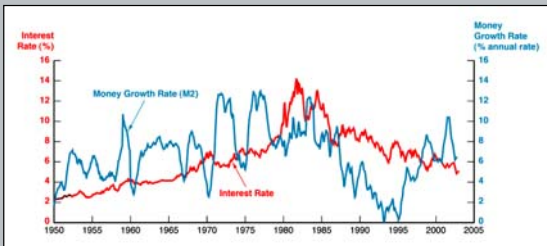
Money and the Price Level



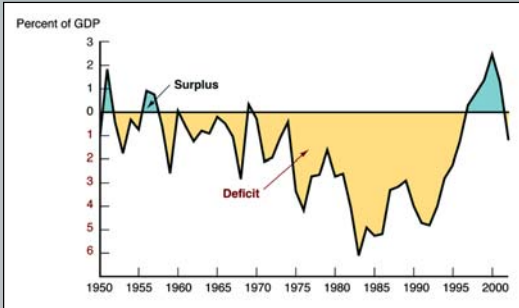
Money Growth and Inflation



Money Growth and Interest Rates



Fiscal Policy and Monetary Policy



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How We Study Money and Banking

Basic Analytic Framework

1. Simplified approach to the demand for assets
2. Concept of equilibrium
3. Basic supply and demand approach to understand behavior in financial markets
4. Search for profits
5. Transactions cost and asymmetric information approach to financial structure
6. Aggregate supply and demand analysis

Features

1. Case studies
2. Applications
3. Special-interest boxes
4. Following the Financial News boxes
5. Reading the Wall Street Journal
6. Web Exercises and URLs

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Appendix: Definitions

Aggregate Output

Gross Domestic Product (GDP) = Value of all final goods and services produced in domestic economy during year

Aggregate Income

Total income of factors of production (land, capital, labor) during year

Distinction Between Nominal and Real

Nominal = values measured using current prices

Real = quantities, measured with constant prices

Aggregate Price Level

$$\text{GDP Deflator} = \frac{\text{nominal GDP}}{\text{real GDP}}$$

$$\text{GDP Deflator} = \frac{\$10 \text{ trillion}}{\$9 \text{ trillion}} = 1.11$$

Consumer Price Index (CPI) price of "basket" of goods and services

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Appendix: Definitions

Growth Rates and the Inflation Rate

$$\text{Growth Rate} = \frac{x_t - x_{t-1}}{x_{t-1}} \times 100$$

$$\text{GDP Growth Rate} = \frac{\$9.5 \text{ trillion} - \$9 \text{ trillion}}{\$9 \text{ trillion}} \times 100 = 5.6\%$$

$$\text{Inflation Rate} = \frac{113 - 111}{111} \times 100 = 1.8\%$$
