I. **Catalog Description**

EC 656, 657  Money and Capital Markets (4) (4)

Topics in monetary and capital theory. Liquidity creation, financial intermediation and capital formation. Development of capital policy. 4 lecture/discussions. Prerequisites: EC 408, EC 401, and EC 403. Unconditional standing required.

II. **Required Background or Experience**

EC 408, EC 401, and EC 403. Unconditional standing required.

III. **Expected Outcomes**

Students in EC 656 and EC 657 will:

a) examine the structure and working of financial institutions and markets,

b) identify and summarize financial and capital market innovations,

c) critically evaluate the contributions and limitations of the financial sector to monetary policy and economic goals,

d) analyze the theory and techniques of asset pricing, and

e) summarize the linkages of capital theory to the development of new financial innovations and the contributions, consequences and implications for global markets.

IV. **Text and Readings**

Texts:


Readings:


Monthly Federal Reserve Bulletins from the Federal Reserve Banks of San Francisco and St. Louis.

Investors Business Daily


The Wall Street Journal

V. Minimum Student Materials

Textbooks, notebooks and access to library references.

VI. Minimum College Facilities

Classroom suitable for lecture/discussions and equipped with audio-visual and computer access, ie. "smart" classroom.

VII. Course Outline

For Economics 656:

A. Introduction

1. Review of Concepts
   a) Expected Value
   b) Variance and Risk
   c) Utility and Risk
   d) Rational Expectations

2. Financial Instruments
   a) Debts vs Equity Claims
b) Relationship Between the Supply and Demand of Financial Instruments and the Supply and Demand of Funds

c) The Price and Risk of A Financial Asset

B. Financial Intermediaries

1. Role and Advantages of Financial Institutions

2. Classification of Financial Institutions (Depositary vs Non-Depositary Institutions)

3. Types of Risk and Their Solutions

4. The Role of Government Supervision

5. A View of International Government Supervision

C. Financial Markets

1. National and International Trends (Globalization, Off-Balance Sheet Activities)

2. Financial Innovations (Asset Securitization, Derivatives)

3. Organization and Structure of Markets
   a) Primary and Secondary Markets
   b) Wholesale and Retail Markets
   c) Auction and Over-the-Counter Markets

4. Role of Financial and Future Markets

5. Financial Market Theories

6. Types of Market Efficiency (Weak, Semi-Strong, and Strong)

7. Financial Markets and Economic Growth

D. Types of Financial Institutions

1. Banks and International Banking
2. National and International Trends in the Banking Industry
3. Savings and Loans
4. Credit Unions and Mutual Savings and Loans
5. Insurance Companies
6. Investment Banks
7. Pension Funds
8. Finance Companies

E. Organization and Structure of Markets

1. Money Market
2. Market for Government Debt
   a) Treasury and Agency Securities Markets
   b) Municipal Securities Markets
3. Market for Corporate Securities
   a) Common Stock Markets
   b) Stock Market Integration
   c) A View of Stock Markets Around the World
   d) Corporate Bonds
   e) Banks Obligations (Negotiable CD's, Federal Funds, Repo, Banker's Acceptances)
   f) Eurobond Market
4. Securitized Asset Market
   a) The Mortgage Market
   b) Asset-Backed Securities Market

D. Special Topics

1. Contributing Factors to Financial Crisis
2. Interest Rate Parity

3. Non-commercial Banks
   a) Bank for International Settlements
   b) International Monetary Funds
   c) The World Bank
   d) International Bank for Reconstruction and Development

4. Bank Profitability, Capital and Asset-Liability Management

5. Banks Around the World

For Economics 657:

A. Introduction

1. Review of Concepts
   a) Utility Theory and Risk
   b) Optimization and The Lagrange Multiplier
   c) Derived Demand

2. The Variance-Covariance Matrix

B. Interest Rate Theory

1. Theory of Interest Rate Determination
   a) Fisher Law
   b) Market Equilibrium Theories
   c) Efficiency Properties of Market

2. The Yield Curve

3. Determinants of the Shape of the Term Structure

4. Interest Rate and Present Value

5. Price and Yield Relationship
C. Portfolio Theory

1. Asset-Liability Management
2. A View of Financial Optimization Models
3. Linear Programming and Portfolio Management
4. Risk and Return
   a) The Optimum Solution (Markowitz-Tobin Theories)
   b) Asset Valuation and Investment Risk
   c) Portfolio Risk
   d) Diversification
   e) Systematic and Unsystematic Risk

D. Asset Pricing Models

1. Properties of Financial Assets
3. Price Efficiencies and their Implications for Portfolio Strategies
4. Pricing of Individual Assets
5. The Beta Coefficient: Meaning, Estimation, Use and Limitations
6. Capital Asset Pricing Model
7. Multifactor CAPM
8. Arbitrage Pricing Theory Model

E. The Market for Derivatives Securities

1. Future Markets
   a) The Role of Future Markets
b) Future Contracts
c) Forward Contracts
d) Risk and Return Characteristics
e) Pricing of Future and Forward Contracts
f) Uses of Future Contracts
g) International Future Markets

2. Option Markets

a) Option Contracts
b) Economic Role of the Option Market
c) Risk and Return Characteristics
d) Pricing of Options
e) Uses of Options

3. Stock Index Options and Future Markets

a) Stock Index Options
b) Stock Index Future Markets
c) Stock Index Contracts

4. Interest Rate Future and Options

a) Interest Rate Future Contracts
b) Forward Rate Agreement
c) Interest Rate Options
d) Interest Rate Swaps
e) Interest Rate Agreements

F. The Exchange Rate Market

1. The Operations of the Foreign Exchange Market
2. Spot, Forward and Swaps Transactions
3. Exchange Rate Risk
4. Instruments for Hedging Foreign Exchange Risk (Forward, Swaps, Future and Option Contracts)
5. International Comparison of Exchange Rate Markets
G. Special Topics

1. Merger and Acquisitions
2. The Stock Market Crash (1930, 1987)
3. Contributing Factors to the Globalization of Financial Markets

VIII. Instructional Methods

Lecture/discussions with student participation. Assigned readings and term papers on a money and capital markets topic. Presentation of the results of the term papers to the class. Written summaries of journal article capital markets.

IX. Evaluation of Outcomes

Students will be evaluated based on required homework assignments, quizzes, midterm and final examinations, a term paper and presentation of the paper to the class.