

Economics of Financial Markets
MSc in Banking & Finance
Athens University of Economics & Business
Instructor: Associate Prof. George Economides

Aims and objectives:

The aim of this course is to introduce students to the economics of financial markets and especially to help them understand the role that financial markets play in the business environment. In addition, it focuses on many public issues and examine how the most important players in financial markets, central banks, operate and how monetary policy is conducted. It starts with an overview of the financial system with emphasis on the structure of financial markets and the role of financial intermediaries, and especially the role of the private banking sector. It covers topics on multiple deposit creation and the money supply process, determinants of the money supply, tools of monetary policy, monetary policy goals, strategy and tactics, the demand for money, aggregate demand and supply analysis, effects of monetary and fiscal policy, transmission mechanisms of monetary policy, the government's role, fiscal policy instruments, the foreign exchange market and the international financial system.

At the end of the course, the students will have a good understanding of the functioning of the financial institutions as well as of the roles of the central bank and the government. Also, they will have acquired knowledge about the tools of monetary policy, and the way that monetary policy is conducted. They will be able to understand the implications of a monetary, but also of a fiscal, policy announcement for the financial markets (domestic and foreign) and the real economy.

Course outline and reading list

1. **Introduction**
(markets, households, firms, industries, market forces of supply and demand, resource allocation, inflation, unemployment, output, economic policy, growth and development, national accounts, measuring national income and wealth)
2. **Why study money, banking and financial markets?**
(bond markets, interest rates, stock markets, financial and banking institutions, money and monetary policy, money and business cycles, money and inflation, money and interest rates, conduct of monetary policy)
3. **An overview of the financial system.**
(function of financial markets, direct and indirect finance, debt and equity markets, primary and secondary markets, money and capital markets, financial market instruments, capital market instruments, internationalization of financial markets, function of financial intermediaries, transaction costs, risk sharing, asymmetric information, regulation of the financial system, impact of economic factors in investment markets)
4. **What is money?**
(definition of money, functions of money, time value of money, evolution of the payments system, measurements of money, the monetary system)
5. **Multiple deposit creation and the money supply process**
(monetary base, multiple deposit creation)

6. **Determinants of the money supply**
(factors that affect the money supply, money multiplier)
7. **Tools of monetary policy. What should Central Banks Do? Monetary Policy Goals, Strategy and Tactics.**
(the market for reserves, open market operations, discount policy, reserve requirements, interbank rate, monetary policy tools of the European Central Bank, monetary targeting, inflation targeting, monetary policy with an implicit nominal anchor, the Taylor rule)
8. **The Demand for money. The IS-LM model. Aggregate supply - aggregate demand analysis. Monetary and fiscal policy.**
(quantity theory of money, Keynes's liquidity preference theory, further developments in the Keynesian theory, empirical evidence on the demand for money, determination of aggregate output, business cycles, government's role, analysis of taxes, analysis of debt, role of international trade, equilibrium in the goods market, equilibrium in the money market, IS-LM approach to aggregate output and interest rates, effectiveness of monetary versus fiscal policy, IS-LM in the long-run, aggregate demand, aggregate supply, equilibrium in aggregate supply and demand analysis, changes in equilibrium caused by shocks)
9. **Transmission Mechanisms of Monetary Policy: The Evidence. Inflation. Rational Expectations.**
(structural model evidence, reduced-form evidence, traditional interest rate channels, other asset price channels, credit view, lessons for monetary policy, money and inflation, views of inflation, cost-push inflation, demand-pull inflation, budget deficits and inflation, the Lucas' critique of policy evaluation, effects of anticipated or unanticipated monetary or fiscal policy)
10. **The foreign exchange market. The International Financial System.**
(currency exchange rates, exchange rates in the long-run, law of one price, theory of PPP, exchange rates in the short-run, intervention in the foreign exchange market, unsterilized and sterilized intervention, balance of payments, exchange rate regimes, capital controls, the role of the IMF, international considerations and monetary policy, exchange rate targeting as an alternative monetary policy strategy)

Text Books:

Bailey R. (2005): *The Economics of Financial Markets*. Cambridge University Press, Cambridge.

Ball L. (2012): *Money, Banking and Financial Markets* (2nd edition). Worth Publishers, New York.

Begg D., S. Fischer, and R. Dornbusch (2005): *Economics* (8th edition). McGraw-Hill, London.

Blanchard O. (2013): *Macroeconomics* (6th edition). Prentice Hall International, Inc., New Jersey.

Economides G., *Lecture Notes in Economics and Monetary Policy* (unpublished).

Mishkin F. S. (2010): *The Economics of Money, Banking and Financial Markets* (10th edition). Pearson Education, Inc., Boston.

Mishkin F. S. and S. Eakins (2014): *Financial Markets and Institutions* (8th edition). Prentice Hall International, Inc., New Jersey.