

# MACQUARIE UNIVERSITY



Division of Economic and Financial Studies

## UNIT OUTLINE

2003

### **ECON350: MONEY AND FINANCE**

Unit homepage: [www.econ.mq.edu.au/courses/econ350](http://www.econ.mq.edu.au/courses/econ350)

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Dr Kim Hawtrey  
Lecturer-in-charge

ECON350 MONEY AND FINANCE  
2003

I. OVERVIEW

The financial sector links together the various component parts of the economy. Money also provides a vital link between Australia and world markets. This sector has become highly sophisticated and is enjoying rapid growth, with new innovations emerging all the time.

This course:

- studies the key features of modern financial **markets**
- analyses **interest rates** and the **pricing** of financial assets
- looks at issues of **risk** and **forecasting**
- examines the **strategies** and **players** in financial markets
- relates financial processes to relevant aspects of **monetary** analysis.

Both theoretical principles and applied techniques are studied. ECON350 concerns itself primarily with *domestic* (not international) financial *markets* (not institutions). The companion course ECON 360 provides the global perspective and another course ECON335 studies financial institutions.

II. ENQUIRIES

Staff for the course are:

Kim Hawtrey (Weeks 1-7)

Room: C5C 392 Telephone: 9850-8504 Email: khawtrey@efs.mq.edu.au

Sean Turnell (Weeks 8-13)

Room: C5C 380 Telephone: 9850-8493 Email: sturnell@efs.mq.edu.au

Students can receive help with study skills, lecture content, essay, resources, assessment, etc.

If you have general enquiries about the course, contact the Lecturer-in-charge (Dr Hawtrey) in person, or by email. For specific enquiries about course notes, lectures, etc., contact the relevant lecturer for each part of the course. It is helpful to include your contact telephone number in email messages.

III. UNIT PRIZE

The *Australian Finance Conference Prize for Money and Finance* is awarded each year to the student selected as the most outstanding performer in ECON350. The prize is open to all students proceeding to the degree of Bachelor and is valued at \$150.

#### IV. UNIT TIMETABLE

Students attend three classroom hours per week, comprising **lectures**. These are delivered in First Semester in the following sessions:

**Daytime:** Thursday 3-6pm (X5BT1) **OR**

**Evening:** Tuesday 6-9pm (W5AT2)

Lecture slides can be obtained prior to each lecture by downloading from the unit webpage ([www.econ.mq.edu.au/courses/econ350](http://www.econ.mq.edu.au/courses/econ350)) or in hard copy from ERIC.

#### V. ONLINE 'TUTORIALS'

There are no face-to-face tutorials. Instead, there are **weekly online tutorials** involving multiple choice, true/false, practice essay questions, case studies and web-based exercises. This **Testbank** material is linked to the Valentine textbook and written by Kim Hawtrey. It is designed to help students test their understanding of topics and practice for the examination. **Solutions** to Testbank Questions (excluding case studies) are provided as part of the online package. The Testbank is NOT to be formally submitted for marking. Students should complete one chapter per week.

**How to use the Testbank:** Log onto [www.prenhall.com/valentine\\_au](http://www.prenhall.com/valentine_au) and in the top left corner use the 'jump to' field to select the required chapter. This brings up a menu. Use it to work through the various exercises week-by-week. Upon completion of a Multiple Choice or True/False section, click 'Submit for Grading' to find your score and receive feedback on your answers. After completing the Essays, click on 'Hint' to check your answer. Solutions to Case studies and Internet Exercises are not included – these components are optional.

#### VI. ASSESSMENT

Essay (25%) All students are required to submit an essay (on the set topic - see p.12) by **8.00 pm Monday 28 April 2003**. The essay should be approximately 2500 words in length, neatly written or typed, using one side of the paper only, and properly annotated with supporting footnotes and bibliography. Standard academic presentation guidelines should be adhered to (if in doubt, consult a common essay-writing guide). Keep a dated, witnessed photocopy of your essay in case of misadventure. Late essays will be subject to penalty, and plagiarism will receive strict disciplinary measures. Essays submitted late may or may not be accepted, at the discretion of the lecturer-in-charge. The essay is compulsory.

**IMPORTANT:** The essay will be submitted at the Division Office (Room C5C 244) in the lodging box provided by 8.00 pm sharp on the due date, using the cover sheet at the end of this handout, with declaration signed.

Exam (75%) The final examination will consist of multiple choice and essay-type questions, testing the full range of conceptual and practical aspects of the course.

## VII. OUTLINE OF TOPICS

### 1. DEBT SECURITIES AND MARKETS

Provides an overview of interest-bearing securities and the money market. How to use various financial instruments (such as bills, notes and bonds) and why markets are divided into separate operating categories such as discount versus coupon, original versus derivative, primary versus secondary, spot versus forward.

### 2. ISSUING AND TRADING FINANCIAL SECURITIES

How to arrive at the optimal strategy when buying and selling tendered public sector financial instruments under uncertainty: bond/note tenders, auction theory. Looks at the role of dealers including bid-offer spreads and explains how underwriters set establishment fees.

### 3. THEORIES OF THE INTEREST RATE

What economic forces determine the rate of interest? Discussion, from first principles and with rigorous intertemporal foundations, of competing theories of the 'real' interest rate in a closed economy. Looks at the 'nominal' interest rate via the aggregate relationship between inflation and interest rates, known as the Fisher identity.

### 4. STRUCTURE OF INTEREST RATES

Shows how the 'yield curve' can be used to advantage and discusses the term-structure of interest rates. Lists influences on the spread between short and long-term rates. Compares expectations theory, liquidity preference theory and segmentation theory. Unpacks the risk-structure of interest rates and outlines how a borrower or investor can lock in a future rate.

### 5. FINANCIAL CALCULATIONS

How to calculate prices and holding-period yields on standard financial securities. How calculations are affected by early repayment, term to maturity and duration. Examples.

### 6. DERIVATIVES: FIXED RATE

Illustrates how fixed-rate derivatives such as forwards, futures, swaps and FRAs work. How to use these tools to hedge risk. The relationship between a derivative and the physical instrument that underlies it.

### 7. DERIVATIVES: OPTIONS

Describes how options work and how they allow users to hedge downside risk while still retaining access to upside potential. Discusses various option strategies for the domestic financial markets.

8. **EQUITY SECURITIES AND MARKETS**  
Provides an overview of dividend-bearing securities and the sharemarket. Outlines the various equity instruments (such as shares, warrants, EFTs) and how shares are traded. Looks at risk and return in the sharemarket and key concepts such as beta and CAPM.
9. **CHARTING AND TECHNICAL ANALYSIS**  
Introduces the methods of technical analysis and looks at how chartists track market movements in practice. Defines various terms such as head and shoulders, momentum models and support level. Discusses the fundamentals versus technical analysis debate.
10. **EFFICIENCY OF FINANCIAL MARKETS**  
Financial economics often assumes that economic agents form their expectations rationally ('information efficiency'). Evaluation of this view. Discussion of 'dynamic efficiency', 'operational efficiency (liquidity, orderliness) and 'competitive efficiency'.
11. **e-MONEY**  
Electronic commerce and financial markets and the issues raised. The growth of internet banking and the impact of electronic delivery channels.
12. **MONETARY ANALYSIS**  
How central banks measure the money supply and the sources of change in monetary aggregates. How RBA transactions affect money formation. Derivation of money multiplier relationships and their use.
13. **TRANSMISSION MECHANISM**  
How the RBA carries out daily liquidity management and implements changes to monetary policy settings. Contrasting monetary aggregates and interest rates as channels for policy. How a change in interest rates feeds through to the rest of the economy.

## VIII. TEXTBOOK AND READING GUIDE

(a) Course Textbook:

Valentine, T., G. Ford & R. Copp, *Financial Markets and Institutions in Australia*, Prentice Hall, 2003

Available from the Co-Op bookshop.

(b) Other relevant books:

Juttner, J. & K. Hawtrey, *Financial Markets, Money and Risk*, 4<sup>th</sup> edition, Addison Wesley Longman, Melbourne 1997

McGrath, M. and C. Viney, *Financial Institutions, Instruments and Markets in Australia*, 3<sup>rd</sup> edition, McGraw-Hill: Sydney, 2000.

Eichberger, J. & I. Harper, *Financial Economics*, Oxford University Press, UK 1997.

Houthakker, H and P. Williamson, *The Economics of Financial Markets*, New York: OUP, 1996.

Kolb, R. and R. Rodriguez, *Principles of Finance*, 3rd edition, Allen and Unwin, 1995.

(c) Financial reference:

Phillips, D., M. Bignaud and F. Thompson, *Elsevier's Dictionary of Financial Terms*, Amsterdam, 1997 (Second Edition).

Newman, P., M. Milgate & J. Eatwell, *The New Palgrave Dictionary of Money and Finance*, Volumes 1-3, Macmillan, 1994.

Paxson, D. & D. Wood, *The Blackwell Encyclopedic Dictionary of Finance*, Blackwell Publishers: UK, 1997.

McKinnon, C., *Reuters Financial Glossary*, Prentice Hall: London, 2000.

(d) Useful websites

Reserve Bank of Australia:

[www.rba.gov.au](http://www.rba.gov.au)

Bank for International Settlements:

[www.bis.org](http://www.bis.org)

Australian Bureau of Statistics:

[www.abs.gov.au](http://www.abs.gov.au)

Australian Stock Exchange:

[www.asx.com.au](http://www.asx.com.au)

New York Stock Exchange:

[www.nyse.com](http://www.nyse.com)

Australian Financial Review:

[www.afr.com](http://www.afr.com)

Australian Financial Markets Association:

[www.afma.com.au](http://www.afma.com.au)

Sydney Futures Exchange:

[www.sfe.com.au](http://www.sfe.com.au)

Australian Prudential Regulation Authority:

[www.apra.gov.au](http://www.apra.gov.au)

Australian Securities and Investments Commission:

[www.asic.gov.au](http://www.asic.gov.au)

(e) Additional reading

Extra references may be recommended in class by the lecturers for selected topics.

(f) Glossary of terms

A list of terms used in the course can be found in the textbook (Valentine).

## IX. 2003 COURSE CALENDAR - ECON350

Week	Date	Topic	Textbook	Online	Lecturer
	commencing		chapter set reading	testbank available? #	
1	3 March	Debt securities and markets	3	yes	Kim
2	10 March	Trading and issuing securities	..	no	Kim
3	17 March	Theories of interest rates	..	no	Kim
4	24 March	Structure of interest rates	8	yes	Kim
5	31 March	Financial calculations	7	yes	Kim
6	7 April	Derivatives: fixed rate	14	yes	Kim
BREAK					
7*	28 April	Derivatives: options	15	yes	Kim
8	5 May	Equity securities and markets	10	yes	Sean
9	12 May	Charting and technical analysis	13	yes	Sean
10	19 May	Efficiency of financial markets	..	no	Sean

11 Sean	26 May	e-money	11	yes
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- 12 Sean	2 June	Monetary analysis	2	yes
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- 13 Sean	9 June	Transmission mechanism	9	yes
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# Testbank exercises: these are available at [www.prenhall.com/valentine\\_au](http://www.prenhall.com/valentine_au)  
 (Note that there is no online tutorial for weeks 2, 3 and 10)  
 It is expected that students work steadily through a portion  
 each week, aiming to complete the exercises by week 13.

\* Essay: due by Monday 28 April (8.00 pm sharp)



X. ESSAY TOPIC:

Question: Discuss the speed of the transmission mechanism from cash rates to money market rates to retail rates and the wider economy. What can we learn from the empirical evidence in Australia and other countries? How is financial innovation affecting the transmission mechanism? What issues are raised for the implementation of monetary policy?

Starting references:

Allen, D. & N. Morkel-Kingsbury (2000), Australian Retail Interest rate Adjustment: A time-series approach, *Paper presented at 12<sup>th</sup> PACAP/FMA Finance Conference*, Melbourne, mimeo.

Gruen, D., J. Romalis & N. Chandra (1999), The Lags of monetary policy, *Economic Record*, 75(230), September, pp 280-294

Bredin, D., T. Fitzpatrick & G. O'Reilly (2001), Retail interest rate pass through: the Irish experience, *Technical paper 06/RT/01*, Central Bank of Ireland, November

Mozzami, B. (1999), Lending rate stickiness and monetary policy transmission: the case of Canada and the US, *Applied Financial Economics*, 9, pp 533-538

Proceedings of a conference Financial Innovation and Monetary Transmission (2002), *Federal Reserve Bank of New York Economic Policy Review*, 8(1), May. (Three papers by McDonough, Volcker and Kuttner/Mosser).

Battelino, R., J. Broadbent & P. Lowe (1997), The Implementation of monetary policy in Australia, *Research Discussion Paper 9703*, Reserve Bank of Australia, Sydney, July.

SURNAME: .....

ESSAY COVER SHEET: to be stapled to the front

DUE DATE: Monday 28 April 2003 (8.00 pm)  
(To be deposited in ECON 350 Box in ERIC, C5C 244).

CHECKLIST:

1. Have you made a photocopy of your essay?
2. Have you included a synopsis and used section headings?
3. Have you stapled all pages together? Do not submit essay in a manilla or plastic folder.
4. Have you read, signed and attached the University statement against plagiarism (overleaf)? Plagiarism will be penalised.

Name: \_\_\_\_\_ Student No. \_\_\_\_\_  
(Surname) (Initials)

Short  
Title: \_\_\_\_\_

ASSESSMENT	Good	Fair	Poor
Presentation			
Synopsis			
Acknowledgements			
References			
Length			

MARKS DEDUCTED

(Lateness; No Synopsis; No Bibliography/Acknowledgments;  
Illegibility; Too short or too long; Poor grammar) \_\_\_\_\_

FINAL MARK (out of 25) \_\_\_\_\_

MARKER'S COMMENTS:

ECON 350

## PLAGIARISM DECLARATION

Plagiarism involves using the work of another person and presenting it as one's own. Any of the following acts constitutes plagiarism **unless the source of each quotation or piece of borrowed material is clearly acknowledged:**

- (a) copying out part(s) of any document of audio-visual material (including computer-based material);
- (b) using or extracting another person's concepts, experimental results, or conclusions;
- (c) summarising another person's work;
- (d) in an assignment where there was collaborative preparatory work, submitting substantially the same final version of any material as another student.

Encouraging or assisting another person to commit plagiarism is a form of improper collusion and may attract the same penalties.

### STATEMENT TO BE SIGNED BY STUDENT:

- 1. I have read the definition of plagiarism that appears above.
- 2. In my essay I have carefully acknowledged the source of any material which is not my own work.
- 3. I am aware that the penalties for plagiarism can be very severe.

.....  
(signature)

.....  
(name)

.....  
(student number)

**THIS PAGE MUST BE COMPLETED AND ATTACHED TO THE ESSAY**