



# AFCP8088

## Economics of Financial Markets

AFC term 2, Weekday attendance, Melbourne 2020

*Department of Applied Finance*

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## General Information

Unit convenor and teaching staff Jeff Oughton <a href="mailto:jeff.oughton@mq.edu.au">jeff.oughton@mq.edu.au</a> Contact via Email
Credit points 5
Prerequisites AFCP801 or AFCP8001 or ECFS865
Corequisites
Co-badged status
Unit description The aim of this unit is to provide a greater understanding of the role and interaction of economic factors with the financial sector. We utilise topical developments and issues as subject matter. This unit explores the structure and growth of the economy, the determination of interest rates, exchange rates and equity prices, the role of finance, the changing importance of banks, institutional investors and security markets, and the economics of regulation with focus on the Global Financial Crisis and to a lesser extent the Asian Crisis. We also look at topical issues in economics and financial markets, for example the implications of the surge in Government debt, the implications for markets of an ageing population.

## Important Academic Dates

Information about important academic dates including deadlines for withdrawing from units are available at <https://www.mq.edu.au/study/calendar-of-dates>

## Learning Outcomes

On successful completion of this unit, you will be able to:

**ULO1:** Analyse and explain economic and financial concepts and theories.

**ULO2:** Analyse current and potential economic and financial market developments, with reference to economic and financial concepts, theories, evidence, and practice.

**ULO3:** Explain the structure of an economy and its financial system, why this structure has economic and financial impacts and how this structure can be used to achieve desired outcomes/goals.

**ULO4:** Analyse and explain the role and interaction of economic factors (including instruments of economic policy and financial regulation) with the financial sector.

**ULO5:** Critically evaluate major economic and financial challenges and their implications for financial markets and institutions.

## Assessment Tasks

### Coronavirus (COVID-19) Update

Assessment details are no longer provided here as a result of changes due to the Coronavirus (COVID-19) pandemic.

Students should consult [iLearn](#) for revised unit information.

[Find out more about the Coronavirus \(COVID-19\) and potential impacts on staff and students](#)

## General Assessment Information

### Information - Extension Requests / Penalties

#### Pre-course Assignment (10%)

No extensions will be granted.

There will be a deduction of 10% of the total available marks for each 24 hour period or part thereof. This penalty does not apply for cases in which an application for Special Consideration has been made and approved.

No submission will be accepted after solutions have been discussed or posted by the lecturer. As this normally occurs on day 2 of classes, students need to be aware that submissions are rarely accepted beyond the first 24 hour late period.

Note: Applications for Special Consideration must be made within 5 (five) business days of the due date and time.

Refer to MAFC Program Rules at <https://mafcstudents.mq.edu.au/> for information on the University's [Special Consideration Policy](#).

#### Post-course Assignment (30%)

No extensions will be granted. There will be a deduction of 10% of the total available marks made from the total awarded mark for each 24 hour period or part thereof that the submission is late (for example, 25 hours late in submission incurs a 20% penalty). This penalty does not apply for cases in which an application for Special Consideration is made and approved.

Late submissions will be accepted up to 96 hours after the due date and time.

Note: Applications for Special Consideration must be made within 5 (five) business days of the due date and time.

Refer to MAFC Program Rules at <https://mafcstudents.mq.edu.au/> for information on the University's [Special Consideration Policy](#).

### **Final Exam (60%)**

You are expected to present yourself for examination at the time and place designated in the relevant MAFC Timetable at <https://www.mq.edu.au/about/about-the-university/faculties-and-departments/business/study-with-us/macquarie-applied-finance-centre/timetables>.

Deferral of an examination is not permitted unless an application for Special Consideration is made and approved.

Students who do not attend receive a mark of zero. This penalty does not apply in cases where an application for Special Consideration has been made and approved.

Note: Applications for Special Consideration must be made within 5 (five) business days of the due date and time.

Refer to MAFC Program Rules at <https://mafcstudents.mq.edu.au/> for information on the University's [Special Consideration Policy](#).

## **Delivery and Resources**

### **Coronavirus (COVID-19) Update**

Any references to on-campus delivery below may no longer be relevant due to COVID-19.

Please check here for updated delivery information: [https://ask.mq.edu.au/account/pub/display/unit\\_status](https://ask.mq.edu.au/account/pub/display/unit_status)

### **CLASSES**

**Face-to-Face Teaching:** Generally 20 hours over 4 days.

**Timetable:** Detailed timetable for classes are available at <https://www.mq.edu.au/about/about-the-university/faculties-and-departments/business/study-with-us/macquarie-applied-finance-centre/timetables>

### **Consultation Times:**

Students who wish to contact any of the teaching staff may do so through:

- The unit's iLearn site, in relation to general queries (so that all students may benefit); or
- Individual consultation with the lecturer by email in the first instance, if necessary.

### **REQUIRED AND RECOMMENDED TEXTS AND/OR MATERIALS**

**Text:** Nil.

**Additional Readings:**

- Additional readings, handouts and lecture slides are available via iLearn.
- Students should assume these readings are examinable unless otherwise advised.

**Lecture Notes:** Available via iLearn.

**Pre-unit Materials:** Information papers on statistics, regression, accounting and other material may be found at <http://mafstudents.mq.edu.au/new-to-mafc/pre-course-materials/>. All students should work through this material prior to commencing the degree. The material will remain a useful reference as students progress through the program.

**Calculators:**

- A calculator is not required for this unit.
- Numerical calculations are basic in nature and approximations will suffice.
- No calculators, mobile phones or computers are permitted in examinations.

**Assumed Knowledge:**

- No previous formal study of economics is required.
- It is highly recommended that students read the unit notes before the first class to familiarise themselves with the material. Reading the notes *before* classes begin *does* improve outcomes.

**Assumed Access:**

- Access to a computer with internet access, word processing and spreadsheet capability may assist students with the unit to a limited degree.

## **TECHNOLOGY USED AND REQUIRED**

**Unit iLearn Site:**

- Found by logging on to iLearn [ilearn.mq.edu.au](http://ilearn.mq.edu.au), then clicking on **AFCP8088 Economics of Financial Markets**.
- This is where you will find a link to forums, downloadable resources and other important pages.
- iLearn allows you to communicate with other students and lecturer(s) and may provide supplementary material.
- You are requested to post your questions to iLearn forums at least 24 hours prior to the assignment submission date or the examination date. Questions posted after that time may not be answered. **Please try to not leave your questions to the last few days, before the final assessment.**

**Important:**

- It is important that you familiarise yourself with the unit's iLearn site.

- All students should check the unit's iLearn site regularly (minimum twice a week and prior to all lectures) and look for updates and distribution of materials (including case studies) related to the unit or assessments and participate in the unit's forum discussions.

## Unit Schedule

### Coronavirus (COVID-19) Update

The unit schedule/topics and any references to on-campus delivery below may no longer be relevant due to COVID-19. Please consult [iLearn](#) for latest details, and check here for updated delivery information: [https://ask.mq.edu.au/account/pub/display/unit\\_status](https://ask.mq.edu.au/account/pub/display/unit_status)

### TOPIC 1: INTRODUCTION AND OVERVIEW OF THE ECONOMY

The objective of this lecture is to introduce economic concepts important to the understanding of developments in financial markets and more broadly the financial system. The focus is on current relevance and the ability to analyse current economic and financial market issues.

#### Outline:

- Introduction and overview of the course
- Why does economics and finance matter?
- Measuring economic activity and financial systems
- Potential and actual growth of the economy
- Consumer and asset inflation/deflation
- Balance of payments and the international economy
- Business cycles – ups and downs in economic activity
- Gauging and forecasting the economy
- Risk and uncertainty Application of Concepts:
- Objectives for managing the economy and the financial system
- Assessment of aggregate output, incomes, assets and liabilities, and sustainability and stability
- Wealth, debt and income effects
- Promotion of inflation targeting, external and internal balance and financial stability
- Understanding key drivers of economic activity and its financial linkages Readings:
- RBA Governor, Dr Philip Lowe, Trust & Prosperity, Speech to CEDA, November 2018 - <https://www.rba.gov.au/speeches/2018/sp-gov-2018-11-20.html>
- Ostry, J.D. "Growth or Inclusion?" Finance & Development, June 2018 - <https://www.imf.org/external/pubs/ft/fandd/2018/06/economics-of-promoting-inclusive-growth/ostry.htm>

- Borio, Claudio, On Money Debt, Trust & Central Banking, BIS WP No. 763 - <https://www.bis.org/publ/work763.pdf>
- Deputy Governor, Dr Guy Debelle, Risks to the Outlook, 14th Annual Risk Conference, Sydney, August 2019 - <https://www.rba.gov.au/speeches/2019/sp-dg-2019-08-15.html>

## **TOPIC 2: MACROECONOMIC AND FINANCIAL POLICIES**

The objective of this lecture is to examine the use of some of the instruments of economic policy and how they affect closely related financial market prices and more generally, the stability of the financial system.

### **Outline:**

- The goals of economic policy
- Interest rates
- Exchange rates
- Fiscal policy
- Monetary policy
- Macro prudential policy
- Structural policy and reform
- International economic policy and the global monetary system Application of Concepts:
- The role of policy makers in macroeconomic and financial stabilisation
- Fiscal policy – effectiveness and sustainability?
- Monetary policy decisions: what next?
- What are the impacts of QE on financial assets?
- Inflation targeting: goods and services prices only or asset prices too?
- How does macroprudential policy help to safeguard the whole financial system?
- Currency unions and exchange rate regimes - fixed, floating or common?
- China's exchange rate: appreciation or stability?
- The Reserve currency debate and rebalancing global growth
- Bitcoin and e-currencies Readings:
- RBA Governor, "The Labour Market & Spare Capacity", CEDA June 2019 - <https://www.rba.gov.au/speeches/2019/sp-gov-2019-06-20.html>
- RBA, "The Transmission of Monetary Policy" - <https://www.rba.gov.au/education/resources/explainers/pdf/the-transmission-of-monetary-policy.pdf>
- Claudio Borio, Head of the Monetary and Economic Department of the BIS, Sep 2017 - Through the Looking Glass. - <https://www.bis.org/speeches/sp170922.pdf>

- John C. Williams, “Monetary Policy in a Low R-star World”, Aug 2016 - <https://www.frbsf.org/economic-research/publications/economic-letter/2016/august/monetary-policy-and-low-r-star-natural-rate-of-interest/> - a short summary
- Summers, L.H, et al “On Falling Neutral Real Rates, Fiscal Policies and the Risk of Secular Stagnation, Brookings Papers, March 2019 - <https://www.brookings.edu/wp-content/uploads/2019/03/On-Falling-Neutral-Real-Rates-Fiscal-Policy-and-the-Risk-of-Secular-Stagnation.pdf> - skim and focus on key drivers
- Stijn Claessens, An Overview of Macroprudential Policy Tools, IMF WP – 14/214, December 2014 - <http://www.imf.org/external/pubs/ft/wp/2014/wp14214.pdf>

For in class monetary policy discussion - see latest RBA announcements - <https://www.rba.gov.au/monetary-policy/int-rate-decisions/2019/>

#### **Readings for pre-course assignment:**

- Dr Donald T. Brash, then Governor, Reserve Bank of New Zealand, “The Pros and Cons of Currency Union: A Reserve Bank Perspective”, 22 May 2000 - <https://www.rbnz.govt.nz/research-and-publications/speeches/2000/speech2000-05-22>
- Mojmir Hampi: To be or not to be in the Eurozone? An answer from Prague, May 2018 - <https://www.bis.org/review/r180531a.pdf>
- Governor of the Bank of Greece, Yannis Stournaras, “A Retrospective on Euro Area Monetary Policy etc,” Rethymno, May 2019 - <https://www.bis.org/review/r190612i.pdf>

### **TOPIC 3: FINANCE IN THE ECONOMY**

The objective of this lecture is to examine the role of finance in the economy, why countries differ in the financial structure that has developed and why this structure has economic impacts.

Copies of the PowerPoint slides used in the lecture will be available in iLearn. Outline:

- Role of finance in the economy: asymmetric information and the costs of information and transactions as drivers of financial development
- Savings and investment – further insights in economic and financial activity
- Intermediation and disintermediation
- Financial Accounts – an accounting framework for the financial system
- Financial sector structure and economic development
- Indicators/drivers of viable capital markets Application of Concepts:
- Are financial intermediaries and capital markets alternatives or complementary? Good or bad?
- What companies are likely to use intermediated bank finance rather than



disintermediated financial instruments in capital markets? And why?

- What are the major influences on financial structure?
- What causes procyclicality and instability in the banking and financial system?
- How to develop robust and viable capital markets?
- How to avoid and manage financial crises?

### **Readings:**

- Christopher Kent, Assistant Governor RBA, “The Availability of Business Finance - <http://www.rba.gov.au/speeches/2017/sp-ag-2017-12-13.html>
- H2 Ventures KPMG, et al Fintech 100 – Presenting the world’s leading fintech innovators for 2018 - [https://h2.vc/wp-content/uploads/2018/11/Fintech100-2018-Report\\_Final\\_22-11-18sm.pdf](https://h2.vc/wp-content/uploads/2018/11/Fintech100-2018-Report_Final_22-11-18sm.pdf) - skim for examples of emerging innovative financial product and services providers
- Jean-Claude Trichet, President of the European Central Bank, “What role for finance?” at the Universidade Nova de Lisboa, Lisbon, 6 May 2010 - <http://www.bis.org/review/r100510a.pdf>
- Mark Carney, Governor of the Bank of England, A Transition in Thinking and Action, April 2018 - <https://www.bankofengland.co.uk/-/media/boe/files/speech/2018/a-transition-in-thinking-and-action-speech-by-mark-carney.pdf> - climate finance and risk management is moving into the mainstream – greening finance

### **In Class Discussion:**

- Bank of Japan, Research and Statistics Department “Flow of Funds – Japan, US and Euro area Overview” Bank of Japan - <http://www.boj.or.jp/en/statistics/sj/sjhiq.pdf>

## **TOPIC 4: ECONOMICS OF SECURITIES MARKETS**

The objective of this lecture is to build some of the drivers of primary and secondary markets for securities and their derivatives, including exploring some valuation issues from an economics perspective.

Copies of the PowerPoint slides used in the lecture will be available on iLearn. Outline:

- Effective demand and supply
- Supply-side and demand-side factors for securities
- Judging effectiveness – efficiency and inefficiency in the foreign exchange, bond and equity markets
- Alternative valuation approaches and their uses

### **Application of Concepts:**

- What are the key drivers of long-term government bond yields?
- What are the signs investors to judge the limit of excessive Government borrowing?
- The calculation and relevance of Tobin's q and Shiller's p/e ratios
- Short term vs. long-term volatility and returns?
- Are bubbles inevitable and impossible to deflate without a crisis?

### **Readings:**

- Cash & Government Bonds - Read generally around the topic of fiscal deficit and debt sustainability. There is lots of good material on the IMF website – especially the bi-annual IMF reports – especially the latest “Fiscal Monitor” - <http://www.imf.org/en/publications/fm>
- Stijn Claessens and M. Ayhan Kose, “Asset prices and macroeconomic outcomes: a survey” BIS Working Paper No. 676, November 2017 - <https://www.bis.org/publ/work676.pdf>
- Advisor Perspectives –Market commentary as well as maintains the Q ratio as well as other top down equity market valuations - <http://www.advisorperspectives.com/dshort/updates/Q-Ratio-and-Market-Valuation.php>

## **TOPIC 5. ECONOMICS OF FINANCIAL REGULATION**

The objective of this lecture is to explore the rationale for regulation and supervision of the financial sector – notably both markets and banking and financial services providers - and how regulatory power can be best used to achieve desired outcomes.

Apart from the lecture notes, in class discussion will focus on the causes of the US subprime crisis, European sovereign crisis and subsequent Global Financial Crisis and the lessons learned for financial regulators, supervisors, bankers, portfolio managers and other stakeholders.

Copies of the PowerPoint slides used in the lecture will be available on iLearn. Outline:

- Economic rationale for regulation and supervision
- Costs of regulation
- Regulation and financial innovation
- Lessons from the US sub-prime mortgage market
- Lessons from the Asian crisis
- Lessons from the European Sovereign crisis Application of Concepts:
- What regulatory factors helped or fuelled the Global Financial Crisis?
- What regulatory factors helped or fuelled the Asian Crisis?
- What are recent examples of conflicts of interest and moral hazard?
- What should regulators do about Systemically Important Financial Institutions &

Infrastructure?

- How do you protect consumers of financial products and services?
- What financial reforms will deliver the better economic results?

### Readings:

- Financial Stability Board, Chairman's (Latest) Letter, March 2018 - <http://www.fsb.org/2018/03/fsb-chairs-letter-to-g20-finance-ministers-and-central-bank-governors/>
- CGFS, Establishing Viable Capital Markets, Press Release, January 2019 - <https://www.bis.org/press/p190123.htm>
- IMF Global Financial Stability Reports – Executive Summary – a couple of pages
  - "A Decade after the GFC: Are We Safer?", October 2018 - <https://www.imf.org/en/Publications/GFSR/Issues/2018/09/25/Global-Financial-Stability-Report-October-2018>
  - "Vulnerabilities in a Maturing Credit Cycle", April 2019 - <https://www.imf.org/en/Publications/GFSR/Issues/2019/03/27/Global-Financial-Stability-Report-April-2019>

### Post course readings:

- IMF, Global Financial Stability Report – released bi-annually – April & October – <http://www.rba.gov.au/fin-stability/resources/publications.html> Executive Summary - <http://www.imf.org/external/pubs/ft/gfsr/index.htm>
- RBA's – Financial Stability Reviews – April & October - <https://www.rba.gov.au/fin-stability/resources/publications.html>

## Policies and Procedures

Macquarie University policies and procedures are accessible from [Policy Central](https://staff.mq.edu.au/work/strategy-planning-and-governance/university-policies-and-procedures/policy-central) (<https://staff.mq.edu.au/work/strategy-planning-and-governance/university-policies-and-procedures/policy-central>). Students should be aware of the following policies in particular with regard to Learning and Teaching:

- [Academic Appeals Policy](#)
- [Academic Integrity Policy](#)
- [Academic Progression Policy](#)
- [Assessment Policy](#)
- [Fitness to Practice Procedure](#)
- [Grade Appeal Policy](#)
- [Complaint Management Procedure for Students and Members of the Public](#)
- [Special Consideration Policy](#) (**Note:** *The Special Consideration Policy is effective from 4*

*December 2017 and replaces the Disruption to Studies Policy.)*

Students seeking more policy resources can visit the [Student Policy Gateway](https://students.mq.edu.au/support/study/student-policy-gateway) (<https://students.mq.edu.au/support/study/student-policy-gateway>). It is your one-stop-shop for the key policies you need to know about throughout your undergraduate student journey.

If you would like to see all the policies relevant to Learning and Teaching visit [Policy Central](https://staff.mq.edu.au/work/strategy-planning-and-governance/university-policies-and-procedures/policy-central) (<https://staff.mq.edu.au/work/strategy-planning-and-governance/university-policies-and-procedures/policy-central>).

## Student Code of Conduct

Macquarie University students have a responsibility to be familiar with the Student Code of Conduct: <https://students.mq.edu.au/study/getting-started/student-conduct>

## Results

Results published on platform other than [eStudent](#), (eg. iLearn, Coursera etc.) or released directly by your Unit Convenor, are not confirmed as they are subject to final approval by the University. Once approved, final results will be sent to your student email address and will be made available in [eStudent](#). For more information visit [ask.mq.edu.au](http://ask.mq.edu.au) or if you are a Global MBA student contact [globalmba.support@mq.edu.au](mailto:globalmba.support@mq.edu.au)

## Student Support

Macquarie University provides a range of support services for students. For details, visit <http://students.mq.edu.au/support/>

## Learning Skills

Learning Skills ([mq.edu.au/learningskills](http://mq.edu.au/learningskills)) provides academic writing resources and study strategies to help you improve your marks and take control of your study.

- [Getting help with your assignment](#)
- [Workshops](#)
- [StudyWise](#)
- [Academic Integrity Module](#)

The Library provides online and face to face support to help you find and use relevant information resources.

- [Subject and Research Guides](#)
- [Ask a Librarian](#)

## Student Services and Support

Students with a disability are encouraged to contact the [Disability Service](#) who can provide appropriate help with any issues that arise during their studies.

## Student Enquiries

For all student enquiries, visit Student Connect at [ask.mq.edu.au](https://ask.mq.edu.au)

If you are a Global MBA student contact [globalmba.support@mq.edu.au](mailto:globalmba.support@mq.edu.au)

## IT Help

For help with University computer systems and technology, visit [http://www.mq.edu.au/about\\_us/offices\\_and\\_units/information\\_technology/help/](http://www.mq.edu.au/about_us/offices_and_units/information_technology/help/).

When using the University's IT, you must adhere to the [Acceptable Use of IT Resources Policy](#). The policy applies to all who connect to the MQ network including students.