Aims

EC2211, Financial markets and institutions, is a second year course. It is a core course for the BSc (Econ) Financial and Business Economics and BSc Finance and Mathematics. Second-year students on other Economics degrees, and on some Economics joint degrees, may take it as an option. EC2211 is a half unit offered in the Spring term.

The course will consider the economic principles underlying the working of national and international financial institutions. It aims to cover the basic theory and operation of financial systems from an economist’s viewpoint. The stress is on financial instruments, markets in which they are traded, and attendant structures.

Learning Outcomes

Upon completion of the course students should be able to:

- Understand what a financial system is and does, and the distinct functions of each component
- Understand some important financial instruments and the economic principles underlying their use
- Understand the relationship among assets, agents, and institutions
- Solve simple problems using quantitative or graphical tools
- Appreciate country differences in a world of interdependence and rapid change
- Critically evaluate the institutions and instruments of modern financial activity.

Course objectives

- To apply an economics perspective to the study of financial assets and institutions, and
- To help form a coherent view of the disparate variables in financial activity, markets, and their governance.

Assessment and coursework

- Unseen examination contributing 70% of the final mark, taken during the Summer term. The exam will test your knowledge and understanding of material covered in the course; your ability to present it diagrammatically and/or algebraically; your ability to use and illustrate concepts.
- EC2211 is a half-unit course, the final exam is two hours long.
- Summative assessment also comprises of a written piece of work (5% weight), two group exercises during the lecture slot (5% total) and three online tests (20% total).
Deadlines and dates for the tests and the written assignment can be found in the handbook and reminders will be provided on Moodle.

Please use your lecture notes, seminar exercises, and textbook for regular study and exam revision.

Course materials can be accessed via MOODLE, materials may be withdrawn if students are seen to be substituting classes for Moodle.

Course delivery

The course is delivered through a weekly two-hour lecture, and a weekly one-hour seminar. Specific learning outcomes and prescribed reading are provided for each week.

Seminars will be based upon the previous week’s lecture. Seminar groups will be formed once classes start. Please find your group and participate actively. Poor attendance could result in your being issued with a formal warning for your entire programme.

The lecturer is available for consultation (by you individually, or in small groups) during advertised office hours or by appointment.

Please note, the lecture, recommended reading, and seminar work are integrated. You must not consider you have progressed from one week to the next unless you have completed the three to your own satisfaction.

Reading

No textbook fully covers all of the materials in the course. Detailed reading will be provided in the lecture notes.

The following textbook covers over 80% of the material, but students have found it heavy going in the past; students only need to cover the materials relevant to the lectures and problem sets. EC2211, Financial Markets and Institutions, will use the following book.

- Howells, Peter and Keith Bain (2008, 4e), The economics of money, banking, and finance: a European text, Harlow, Financial Times and Prentice-Hall (H&B)

The library has numerous copies of this and earlier editions (332.494 HOW), but you are advised to buy your own copy if you can.

*Note, these authors have a book which sounds similar to our course title, and which has now gone into its fifth edition (Financial Markets and Institutions, 332.10942 HOW). That is useful supplementary reading, but not to be confused with our textbook!*

Hillier, Ross, Westerfield, Jaffe and Jordan (2012, 2nd European Edition or 2016, 3rd European Edition), Corporate Finance, contains some of the more advanced materials covered in the course, this is an MSc/MBA level textbook.

Keith Pilbeam (2010, 3e) Finance & Financial Markets, Palgrave Macmillian (332.PIL) is another UK focused book that I would recommend for this course, one chapter of this book will be available to download from Moodle.

Glen Arnold (2011) Modern Financial Markets, Financial Times and Prentice-Hall is a well written alternative, but does not fully cover the course.
Mishkin et al (The Economics of Money Banking and Financial Markets – various European Editions) is a textbook commonly used for a course of this level, however it covers less than H&B and is less UK focussed.

As undergraduates at Royal Holloway, you may have access to the general collections of other libraries in the University of London. This facility could help you supplement your reading over the vacations or if you have some free time in term.

In addition, there are useful web sources.

1) Your first port of call should be http://www.booksites.net, to follow textbooks by author. For example, if you end it with /howells, this site will give you chapterwise self-test questions and other interactive study materials.

2) Another useful address is economics.ltsn.ac.uk of the Economics LTSN, Learning and Teaching Support Network Centre for Economics. You will find it invaluable throughout your BSc. It gives you question papers and lecture notes from a variety of Economics courses at several universities.

3) At all events, use Economics subject resources on the web wisely. PENALTIES FOR MISUSE ARE HEAVY. By all means, use e-resources to study. Do not, however, attempt to pass downloaded material off as your own. Do not be tempted to cheat. It could cost you your course, year, degree, or place at College: read your handbook.

**EC 2211 Tentative Schedule Financial Markets and Institutions**

(Online tests could take place a week later than advertised, but will be based on the materials of the respective lecture)

**Lectures 1 & 2**

Introduction to the financial system, UK intermediaries and institutions.

- H & B Chapters 1, 2, 3 and 25
- Hillier 19.1-19.3

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand how the financial sector supports the real economy
2) Learn basic concepts and terminology of borrowing and lending
3) Understand the components and functions of a financial system
4) Understand the nature of financial markets and need for regulation.
5) Understand the concept of intermediation and its many forms
6) Understand the structure and functions of some intermediaries.

**ONLINE TEST 1 BASED ON LECTURE 1**

**Lecture 3**

Money and Money markets

- H & B Chapters 12 (12.1, 12.2) and 15

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand the role of banks and monetary authorities in the macroeconomy.
2) Understand the different money market instruments available.
3) Understand the importance and the functions of money.

**Lectures 3 + 4  Interest Rates and Bond Markets.**

H & B Chapters 9 and 16

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand factors in interest rate determination.
2) Understand the loanable funds framework.
3) Understand the liquidity preference theory of interest rate determination.
4) Understand the concepts of maturity and pricing.
5) Solve simple numerical problems on ‘yield’ and ‘interest’.
6) Distinguish between short- and long term in the assets market

**Lecture 5  Equity markets**

H & B Chapter 17
Hillier 18.2

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Distinguish between stocks and bonds
2) Understand the structure of equity markets, and the role of agents and instruments
3) Understand the basis of pricing.

**SHORT WRITTEN ASSIGNMENT WILL BE DUE BEFORE READING WEEK**

**READING WEEK**

**Lecture 6  Group Exercise 1 – details will be announced closer to the time.**

**Lecture 7  Portfolio theory**

H & B Chapter 8
Hillier 10 (optional)

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand the rationale for asset diversification.
2) Understand risk and return in a simple portfolio.
3) Understand types of risk and their ‘management’

**ONLINE TEST 2 BASED ON THIS TOPIC**

**Lecture 8  Foreign exchange markets + Derivatives**

H & B Chapter 18 + 19 & 20
In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand the foreign exchange market in a framework of international trade and international capital movements
2) Understand the importance of foreign exchange to the assets and goods markets
3) Understand exchange rate formation in the spot and forward markets.
4) Understand the basics of arbitrage in the foreign exchange market.
5) In addition to learning the material covered in the reading and lecture, by the end of this week you should:
6) Understand the reasons for the recent growth in derivatives
7) Appreciate the range of instruments available and their characteristics.

Lecture 9

Group Exercise 2.

Lecture 10

Financial Market Efficiency
H & B Chapter 26
Hillier 13

In addition to learning the material covered in the reading and lecture, by the end of this week you should:

1) Understand the concept of financial market efficiency
2) Know how to test for financial market efficiency
3) Be familiar with the empirical evidence regarding financial market efficiency.

Online test 3 will take place during the final week of term.

More detailed reading requirements will be given during the lectures/ seminars and on Moodle.