

Fiscal & Financial System in Japan A

2010 Spring

Session 2 Money (Mishkin Ch.2-3)

April 19, 2010

Hideyuki Iwamura

Senior Lecturer

Faculty of International Studies

Meiji Gakuin University

1 WHAT DO FINANCIAL MARKETS DO?

Financial Markets and Production

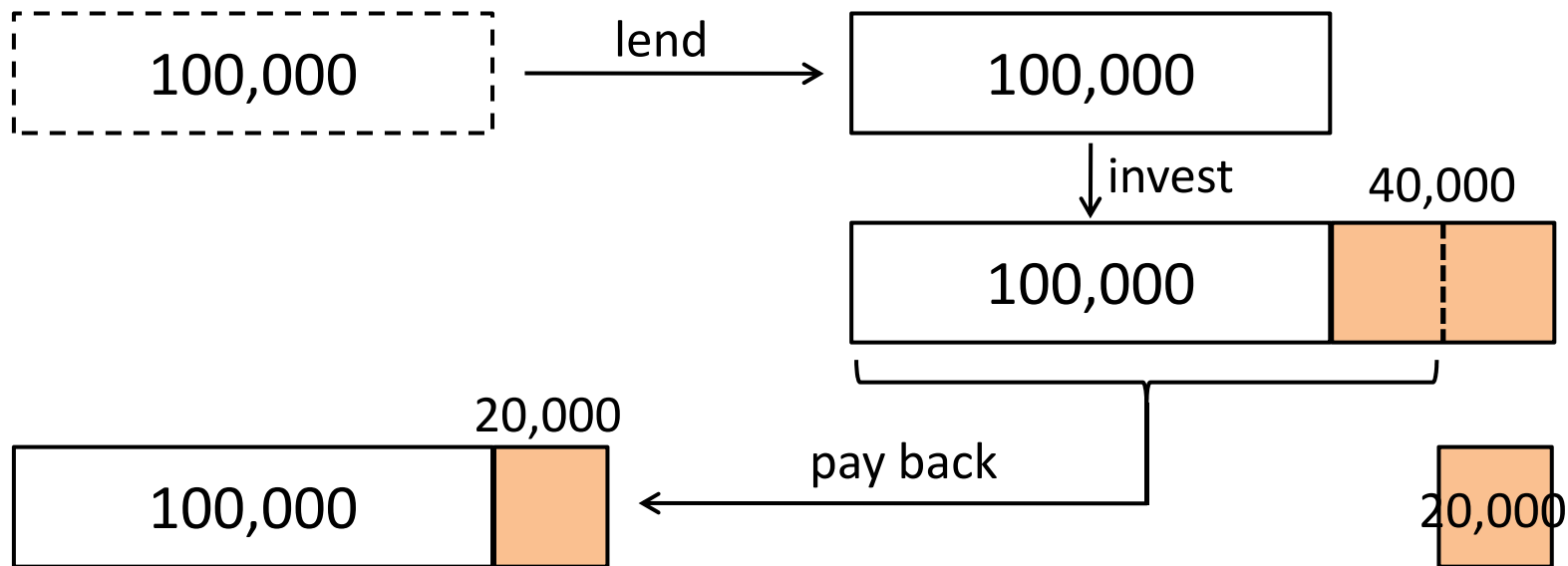
Bill

- 100,000 yen cash
- No plan to spend the money on



Alex

- No cash
- 100,000 yen investment plan to yield 140,000 yen after 1 year



Both would be better off.

Financial Markets and Production

What if Bill also has his own investment plan?

Bill

- 100,000 yen in cash
- 100,000 yen investment plan to yield 110,000 yen after 1 year

Alex

- No cash
- 100,000 yen investment plan to yield 140,000 yen after 1 year

Bill should give up his own plan and invest his money on Alex because ...

	Bill	Alex
Bill on his plan	110,000	0
Bill on Alex's plan	120,000	20,000

Financial Markets and Production

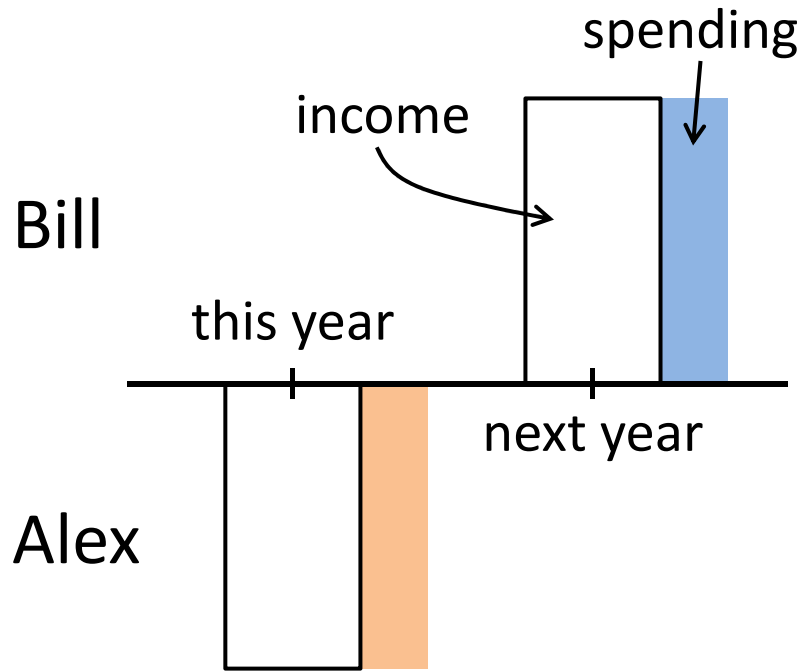
The people who have the most productive investment opportunities are not always the people who have enough money.

Financial markets channel funds from less productive investment opportunities to more productive ones, thus expanding the total production in our economy.

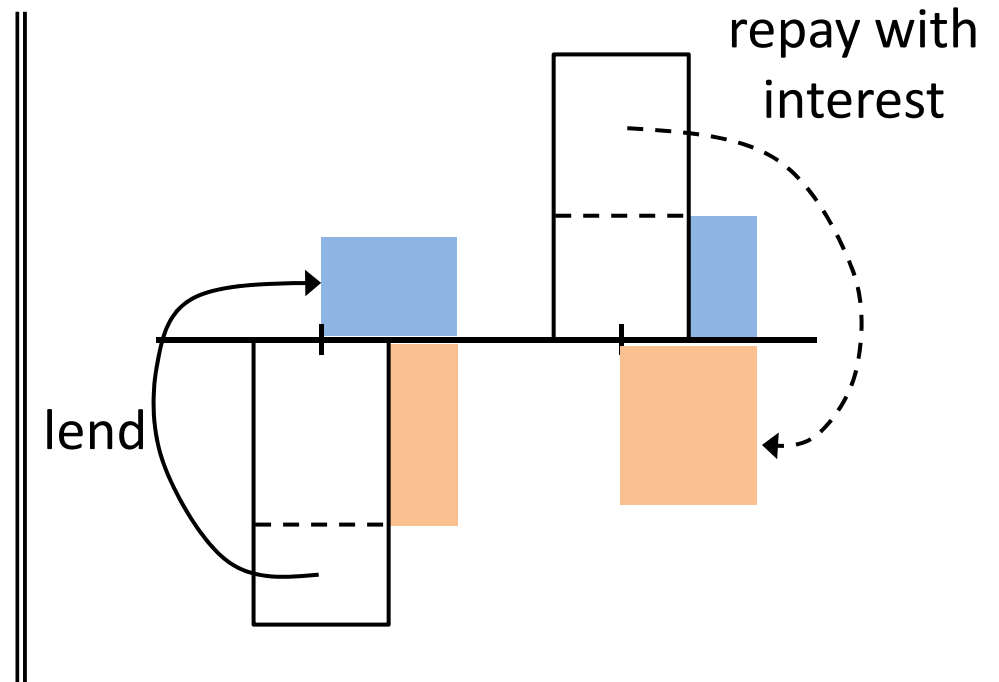
If the total production expands, everyone in the economy could be better off without worsening anyone.

If one use of the same funds produces more than another use, we say “the funds are used more efficiently.”

Financial Markets and Consumption



Without financial markets:
spending = income



With financial markets:
spending \neq income

Financial Markets and Consumption

Financial markets channel funds
from those who earn more than they need today (Alex)
to those who will earn more than they need in the future (Bill).

- People can smooth out their spending overtime.
- People are better off making small spending for a long time than making large spending for a short time.

→ Financial markets could help *everyone* (B & A) to be better off.

What Do Financial Markets Do?

Production

Financial markets channel funds from less productive use to more productive use, thus increasing the amount of goods or services produced in the overall economy.

Consumption

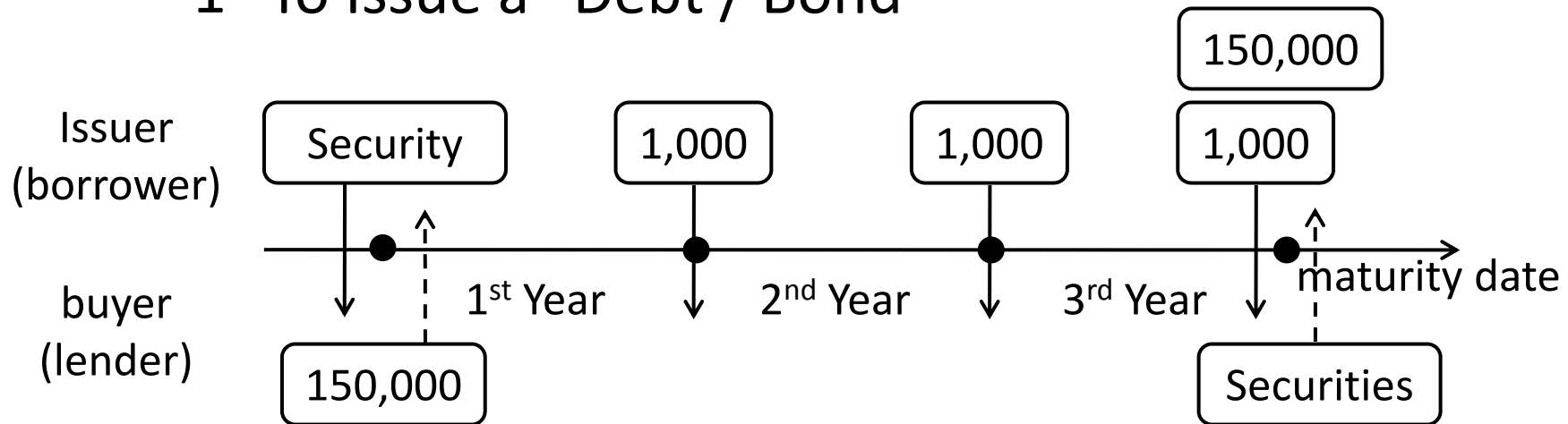
Financial markets could expand our choices for spending pattern, thus making us better-off.

How to Raise Funds: Debt/Bond

A borrower raises funds by issuing(selling) securities that specify a claim on the issuer's future income.

“Financial Instruments”

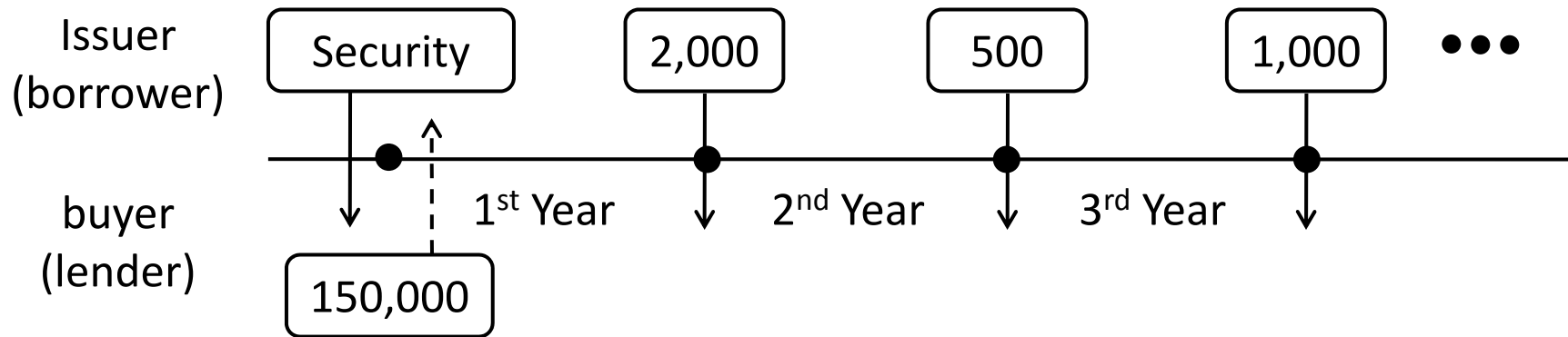
1 To Issue a “Debt / Bond”



Fixed amount of money (principal and interests) which are initially specified are paid at regular intervals until the maturity date

How to Raise Funds: Equity

2 To Issue an “equity”



- “Dividends” are paid at regular intervals, which are not specified and depend on the issuing company’s performance.
- No maturity. Dividends are *permanently* paid.

Financial Instruments

- Debt
 - Bank Deposits(銀行預金)
 - Bank Loans(銀行貸出)
- Bond
 - Corporate Bonds(社債)
 - State and Local Government Bonds(国債・地方債)
 - Commercial Papers(コマーシャルペーパー)
- Equity
 - Common Stocks(株式)

Some of the financial instruments also function as a means of settlement, circulate as “money.”