180.266 Financial Markets and Institutions
Final study guide
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The final will be a 2 hour exam.

Bring a calculator: there will be some calculations.

If you have an accommodation for extra time, your exam will be given in the disability center, be sure to contact me in advance so that I can make arrangements.

There is no re-take; excused absences will simply have other grades re-weighted.

The exam will have some questions involving definitions and some involving basic real-world quantities. These will be very much as on the quizzes and midterm . Terms and quantities are summarized in the next two sections of these notes. As on the midterm, there will be some conceptual questions. The study guide sketches the overall perspective and should provide a guide to reviewing the notes, text, and readings.

Our intention will be to provide an exam such that the reasonably well-prepared do not feel rushed. However, sometimes this is hard to predict.

Key terms (across entire term):

adverse selection
arbitrage
asset
asset-backed security
asymmetric information
balance sheet
bank
bank panic/bank run
bank reserves
basis point
Board of Governors of the Federal Reserve System
bond
- principal value
- par value
- rating
- coupon bond
- zero coupon bond
- callable
- covenenant
- convertible
- coupon, coupon payment, coupon rate,
- current yield
- municipal
- taxable vs. not taxable bond
- yield to maturity

capital or net worth as a balance sheet notion
capital gain
capital loss
capital market
central bank
central bank independence
central bank, single mandate
central bank, dual mandate
central bank, transparency
central bank, lender of last resort
central bank, nominal anchor
certificate of deposit
collateral
commercial bank
commercial paper

common stock
compound interest
consol or perpetuity
conventional monetary policy
conventional monetary policy, Taylor rule
conventional monetary policy, unemployment rate gap
conventional monetary policy, inflation gap
conventional monetary policy, wealth channel, interest sensitive spending channel, exchange rate channel
covariance, correlation
credit risk
credit default swap
currency
currency, appreciation
currency, depreciation
currency, exchange rate
dark pool
debt
default, default risk
defined-contribution pension plan
deflation
demand deposit
depository institution
derivative security
direct finance
diversification
ECB (European Central Bank)
equity
equity market
exchange rate
expectations theory of term
expected return
expected value
face value
face value of bond
fallen angel
Federal Open Market Committee (FOMC)
financial institution
financial instrument
financial market
forward contract

futures contract
hedge
idiosyncratic risk
illiquid asset
income statement
indirect finance
inflation
inflation rate
inflation risk
information costs
insurance
insurance, life insurance
insurable interest.
interest rate
interest-rate risk
interest-rate spread
interest rate swap
internal rate of return
interquartile range
inverted yield curve
inverted yield curve
investment bank (core activities)
    initial public offering, seasoned offering, private placement
    mergers, acquisitions, leveraged buyout
investment-grade bond
junk bond
law of one price
leverage, leverage ratio
liability
limited liability laws
liquidity
liquidity premium theory of the term structure
liquidity risk
liquidity crisis
market, primary and secondary
market maker
market capitalization (of company, or of a stock market)
mean, median, mode
moral hazard
mortgage, 30-year fixed rate
mortgage-backed security
mutual fund

National Best Bid and Offer (NBBO)
NASDAQ Composite Index
net interest margin
net worth
nominal interest rate
operational risk
options
  call option
  put option
  American vs. European
  out of the money
  in the money
  at the money
orders (for brokers)
  market order
  limit order (buy and sell)
  stop order (buy and sell)
organized exchange vs. over the counter market
perpetuity
portfolio
present discounted value, or simply, present value
prices:
  bid price
  ask price
  bid ask spread
principal
pure discount bond
quantity theory of money, quantity equation
rating agency
rating downgrade
rating upgrade
real exchange rate
real interest rate
repurchase agreement
required reserve ratio
reserves (bank)
  required and excess
reserve requirement
return on assets (ROA)
return on equitys (ROE)
risk
risk premium

risk sharing
risk-free asset
risk-free rate of return
savings deposits
seigniorage
shadow banking
solvency crisis
spot price
standard deviation
stock
stock valuation
    Gordon Growth model
    price-earnings ratio
stock market
stock, dividend
stock index
    Dow
    S&P 500
    NASDAQ
systemic risk
term structure of interest
theory of efficient markets
too-big-to-fail
trading or market risk
transactions costs
U.S. Treasury bill
U.S. Treasury bond
unconventional monetary policy tools
unconventional monetary policy tools, forward guidance (regarding policy interest rate)
unconventional monetary policy tools, large scale asset purchases
underlying instrument (related to derivative securities)
unsecured loan
variance
value at risk (VaR)
yield
yield curve
yield to maturity
zero-coupon bond
zero lower bound (in context of monetary policy)

Real-world data facts:

Time periods and basic meaning of major macroeconomic events:

- Great depression
- Great inflation
- Great moderation
- financial crisis and great recession

Total dollar value of some things:

- Debt of household, nonfinancial business, and government sectors
- total assets of banking sector
- total assets of pension funds
- total assets of insurance companies
- U.S. nominal GDP
- Stock market capitalization U.S. and world

For commercial banks in U.S.

- Share of assets and liabilities in major categories
    - Assets: reserves, securities, loans
    - Liabilities: Deposits, Borrowing
- ROA, ROE, NIM
- total asset of largest banks

Basic facts about:

- the pattern of interest rates (both risky and risk free) since the Great Depression.
- the term structure of interest rates
- stock returns
- exchange rates

Basics of the financial system:

Financial systems have been developing since the beginning of time.

They serve to make funds flow more efficiently from those with savings to those with productive uses for those funds. Where funds flow more freely, we see wealthier economies.

Funds flow through direct and indirect finance. Two main forms of financing are debt and equity. Direct debt tends to be in the form of bonds. Indirect often takes the form of bank loans.

Which channel (direct or indirect) and which form (debt-like or equity-like) tend to be more important. Asymmetric information problems such as moral hazard and adverse selection are important in explaining why flows take the form they do.

Key institutions/functions/practices:

Commercial banks are key providers of indirect finance. You should be familiar with bank balance sheets, income statements, key risks and how they are managed.

Investment banks provide a host of services to facilitate the function of direct finance. You should know the core activities and particularly the role of reputation in overcoming information problems.

Two providers of specialized financial products: Pension funds and insurance companies.

Central Banks. Federal Reserve, ECB, etc. You should know basics of objectives, governance, and how policy is conducted in normal times and at present.

Secondary markets. You should know the basics involved in one person selling shares to another on secondary markets.

Regulation. The regulatory environment is still changing in response to the crisis. You should know the broad lessons about regulation we emphasized.