EC132.02
Principles of Macroeconomics

Boston College

Thursday, February 28

Announcements and Reminders

Aplia homework on Production and Growth due this Friday, March 1, at 9am.

Aplia homework on Saving, Investment and the Financial System due Friday, March 22, at 9am.

Today and the week after break: Ch 26 Saving, Investment and the Financial System

Next: Ch 28 Unemployment

Ch 26 Saving Investment and the Financial System

1. Financial Institutions in the US Economy
   A. Financial Markets
   B. Financial Intermediaries
2. Saving and Investment in the National Income Accounts
3. The Market for Loanable Funds
   A. Supply and Demand for Loanable Funds
   B. Public Policies and the Market for Loanable Funds

Today

After Break

The Bond Market

Some recent US government, corporate, and municipal bond rates:

Borrower	Maturity Date	Interest Rate
US Government	March 2014	0.19%
US Government	February 2043	3.15%
General Electric	January 2023	3.19%
Chesapeake Energy	March 2019	6.47%
MBTA	July 2037	3.40%

The Stock Market

A stock is a certificate that represents a claim to partial ownership in a firm and hence a share of the profits that the firm makes.

A firm will usually pay out some of its profits as dividends to its shareholders.

The Stock Market

Example: Intel Corporation has about 5 billion shares of stock outstanding.

Each share represents 1/5 billion ownership.

Each share sells for about $20, so the business is worth about $20 x 5 billion = $100 billion.

Each share paid $0.86 in dividends during 2012, so the business returned $0.86 x 5 billion = $4.3 billion to its owners last year.

Debt Versus Equity

From the borrower's point of view, the sale of stock to raise funds is called equity finance, while the sale of bonds is called debt finance.

From the saver's point of view:

	Good Economic Times	Bad Economic Times
Bonds (Debt)	Pays interest and principal.	Still pays interest and principal (except in the rare case of bankruptcy).
Stocks (Equity)	Dividends and hence the share price will increase as the firm earns higher profits.	Dividends and hence the share price may decrease as the firm earns lower profits.

In the US, the bond market is actually larger than the stock market.

Debt Versus Equity, US, 2012 Q3

Note: All Figures are in Billions of Dollars	
Commercial Paper	$957.2
US Treasury Bonds	$11,255.5
US Government Agency Bonds	$7,543.9
Municipal Bonds	$2,969.7
Corporate Bonds	$12,041.0
TOTAL DEBT	$34,767.3
TOTAL EQUITY	$25,826.4

Banks

Banks:

1. Accept deposits from savers.
2. Make loans to borrowers.

Banks cover their costs and make profits by charging a higher interest rate on their loans than they pay on their deposits.

Banks

Banks are also special in that they allow savers to write checks on some types of deposits.

That is, bank deposits serve as a medium of exchange as well as a store of value.

Mutual Funds

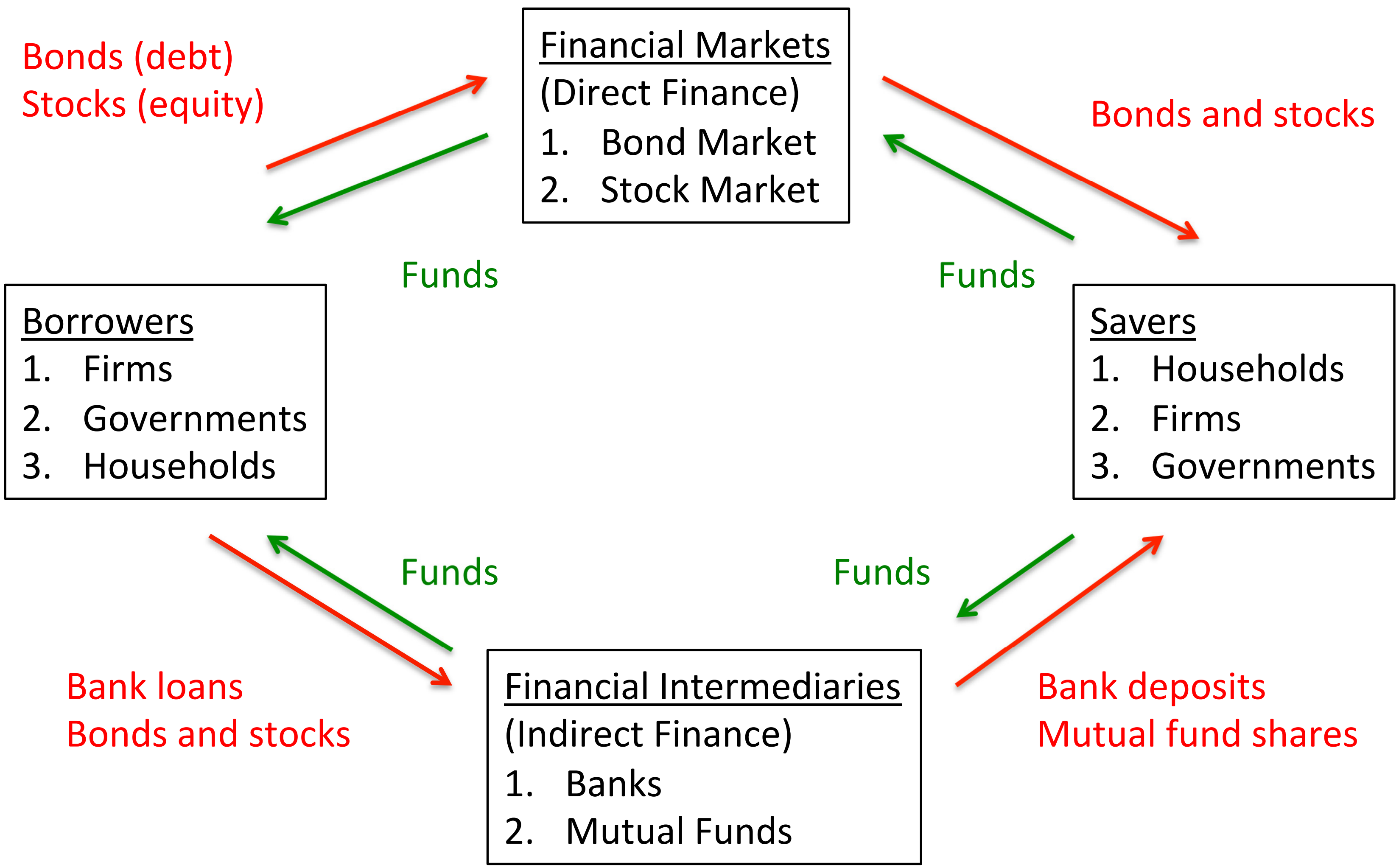
Mutual Funds

1. Sell shares to savers.
2. Use the proceeds to buy a collection or portfolio of stocks and/or bonds.

Mutual funds help with diversification by holding many stocks and bonds.

They also allow savers to delegate stock and bond selection to a professional money manager.

Financial Institutions in the US



Financial Institutions in the US