

Third Lecture

Instruments: What Does Finance Look Like?

In what sense are bonds and stocks “income generating”? In what sense are currencies, commodities and derivatives “income distributing”?

Money

- Neutrality or power?
- Inflation – does the tide really lift all boats?
- Money: is ownership “unreal”?

Instruments

- Finance as capital
- Value = expected future income / (rate of interest * risk factor)
- Debt, equity, commodities, derivatives
- “income-generating” vs. “income redistributing”

Debt

- Promise vs. expectation
- Bond value = interest payment / (rate of interest * risk factor)
- How the rate of interest is determined?
- Government debt and taxation: commodifying state power
- Government debt and the birth of capitalism
- The bond market
- Liquidity and benchmarking
- Monetary policy: short term rates, long-term yields – what determines what?
- Fiscal policy: government deficit, government debt

Equity

- Equity vs. debt
- Balance sheet and income statement
- Interest → debt
- Profit → equity
- Equity value = expected profit / (rate of interest * risk factor)
- Bigger returns, bigger risk
- Stock prices and the economy: a very imperfect fit

Securitization and the commodification of power

- Equity and the corporation
- Capitalization: mother credit
- Structure of corporate finance
- Capitalism: debt-based versus equity-based

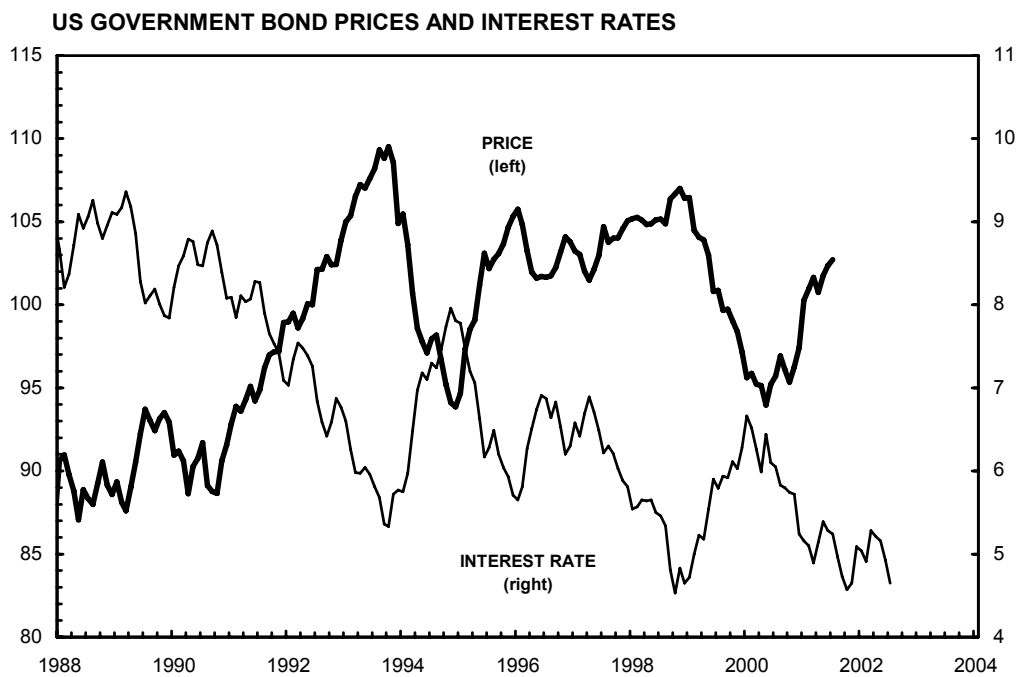
Redistributive investment

- Currencies, commodities and derivatives
- What makes the exchange rate move – relative prices, relative return, speculation
- Commodities: the roulette of finance
- Derivatives: the Russian roulette of finance
- Risk transfer and stabilization

Capitalization:

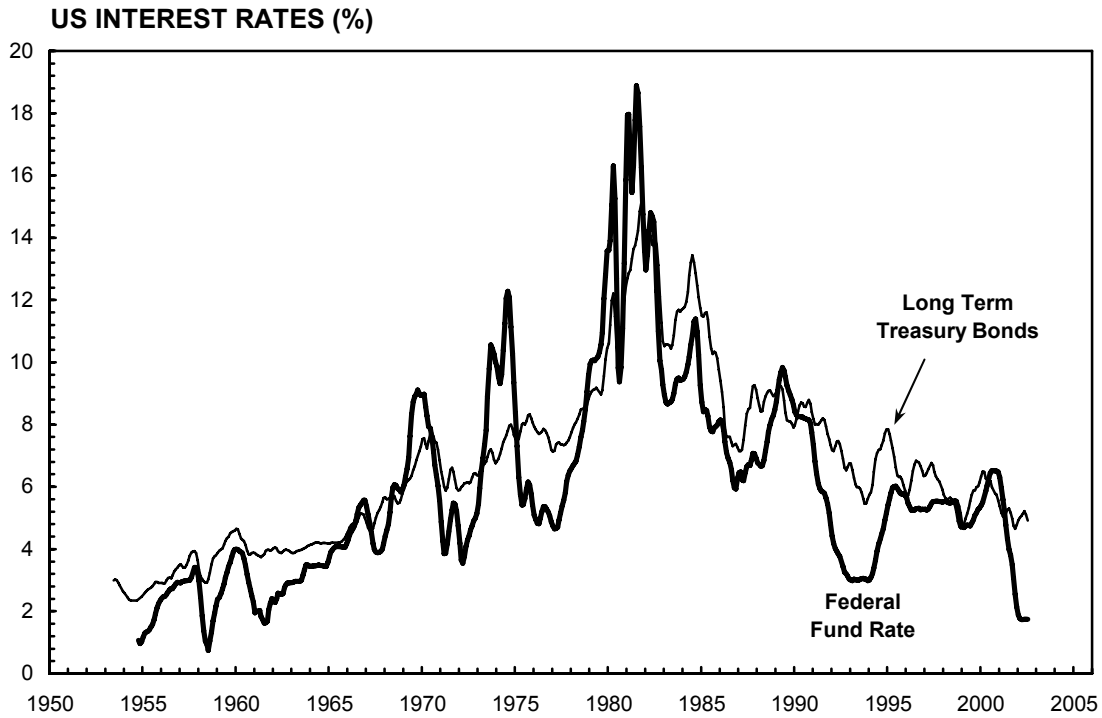
$$\text{capitalisation} \equiv \frac{\text{expected earnings}}{\text{risk} \times \text{normal rate of return}}$$

$$\$1bn \equiv \frac{\$60mn}{1.2 \times .05}$$

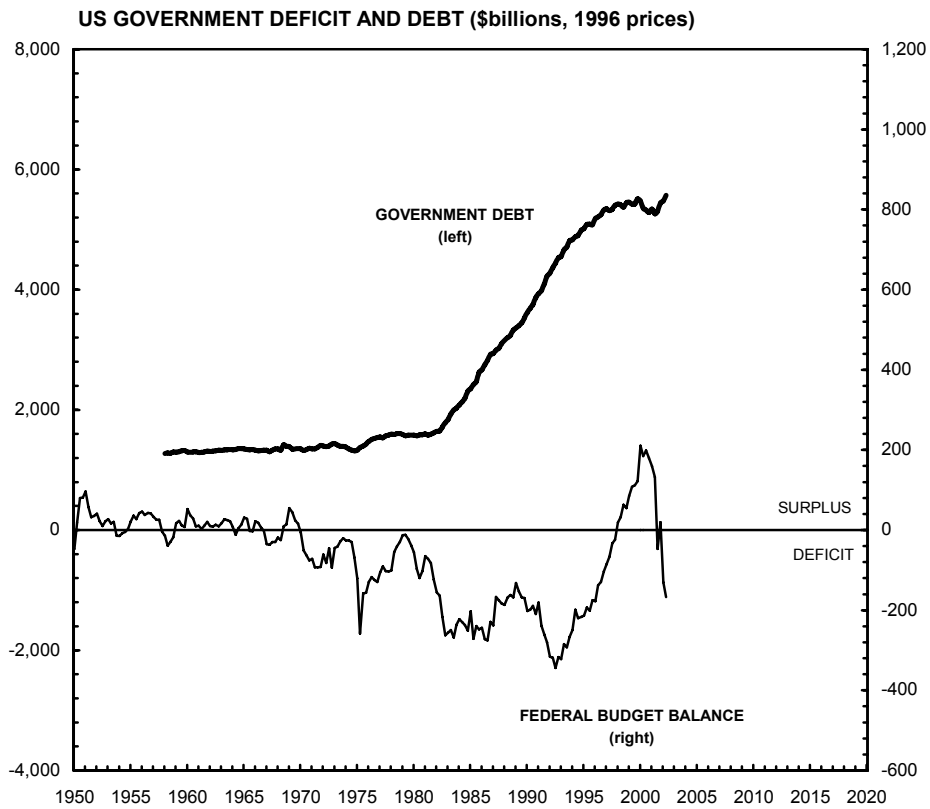


NOTE: Data based on long term government bonds.
SOURCE: DRI

USStkBon.xls

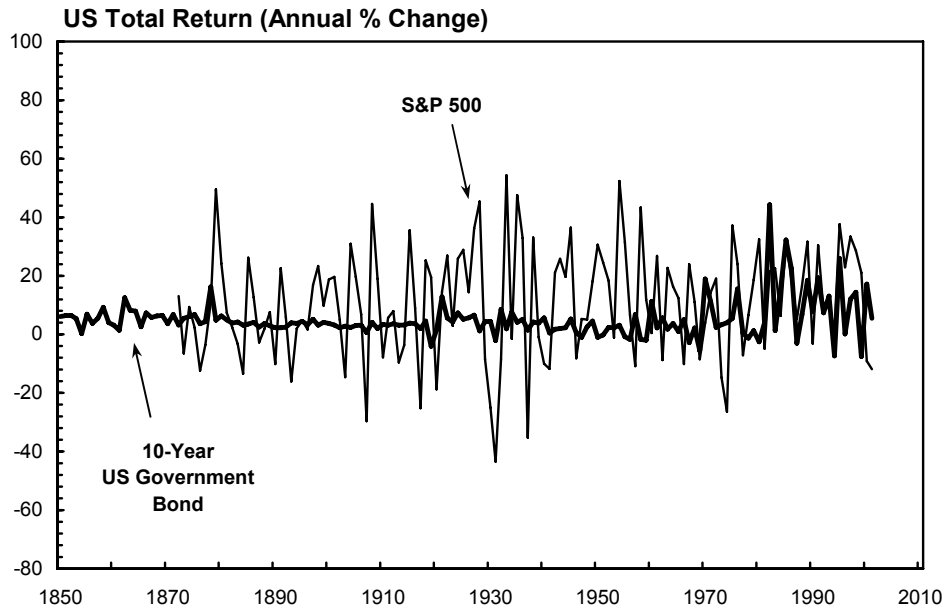


NOTE: Series are expressed as 3-month moving averages.
 SOURCE: US Federal Reserve Board; DRI

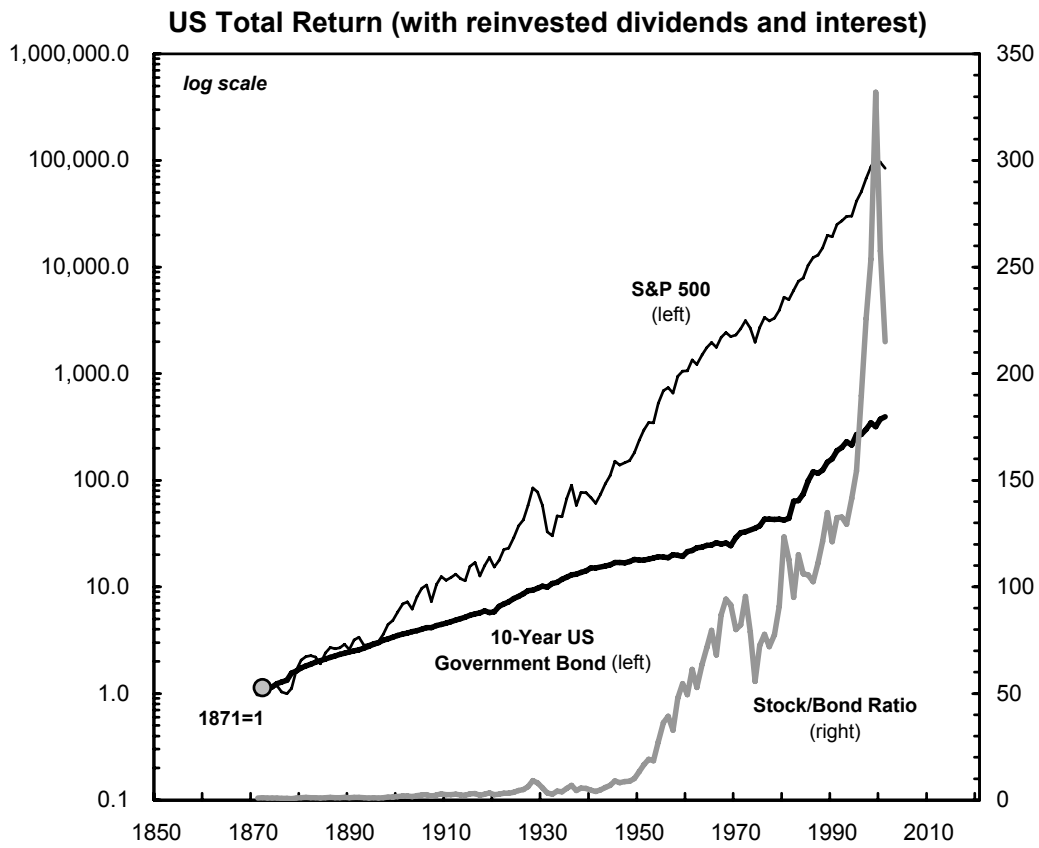


SOURCE: DRI.

US-R-M1.xls; US-FA1.xls

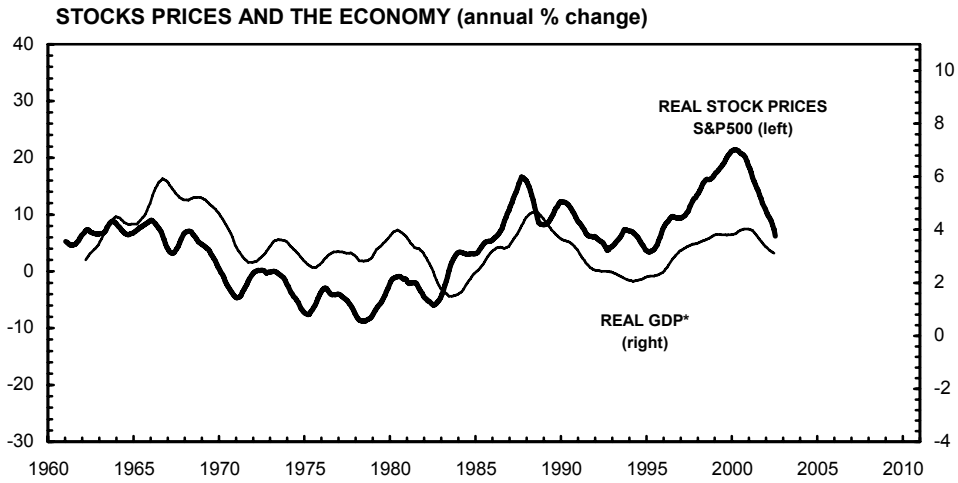


SOURCE: Global Financial Data

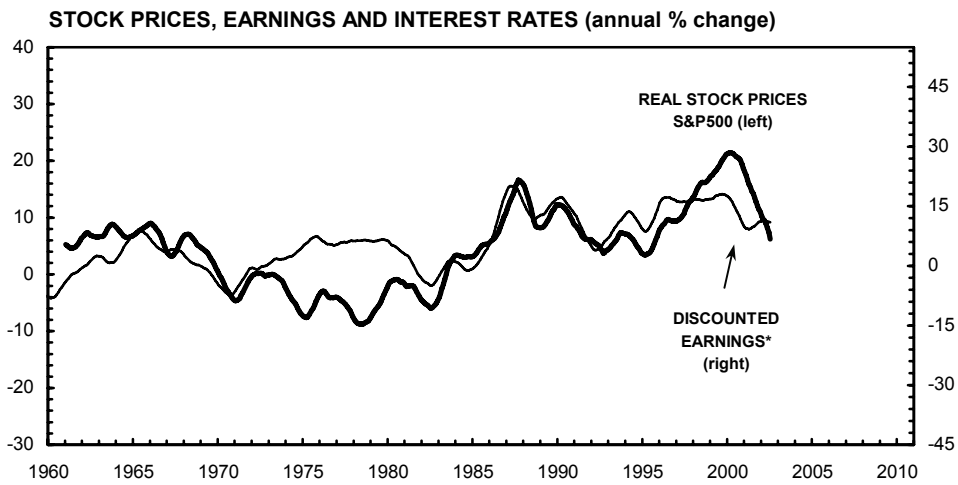


SOURCE: Global Financial Data

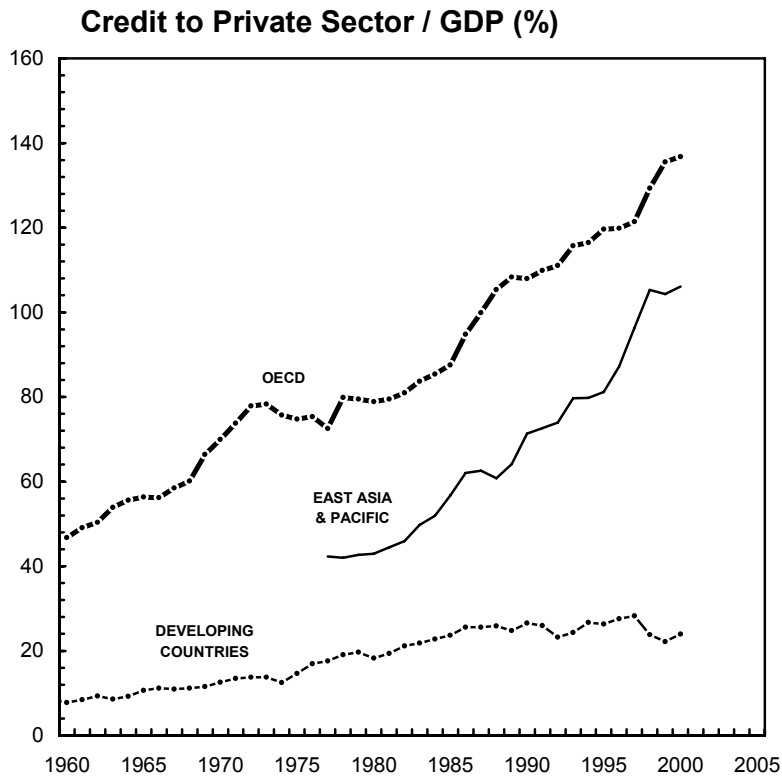
Total Return Indices.xls



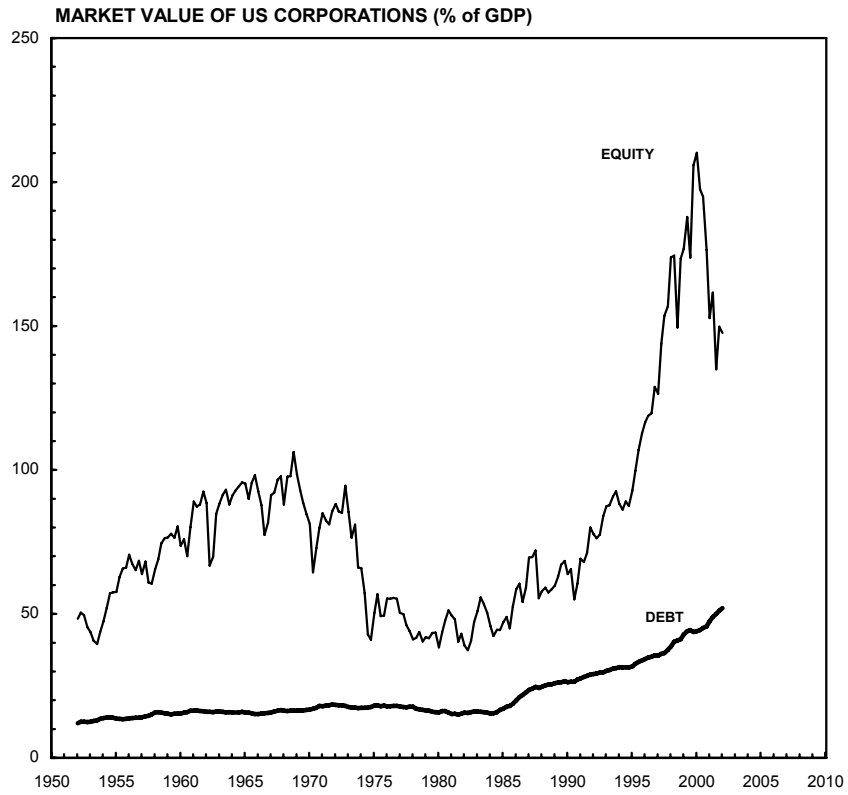
* Converted from quarterly figures.
NOTE: Series are expressed as 12 month moving averages
SOURCE: DRI



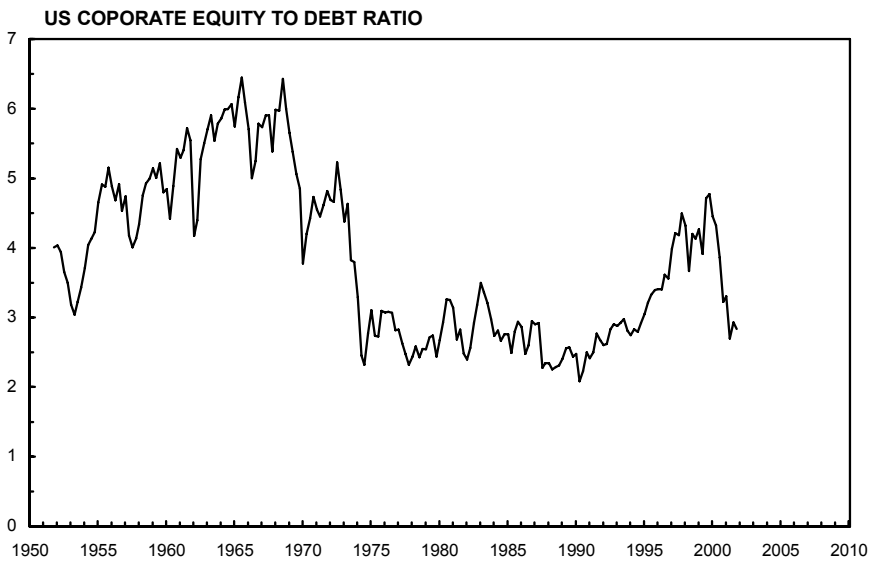
* Long term earnings divided by long term bond yields
NOTE: Series are expressed as 5-year moving averages
SOURCE: DRI



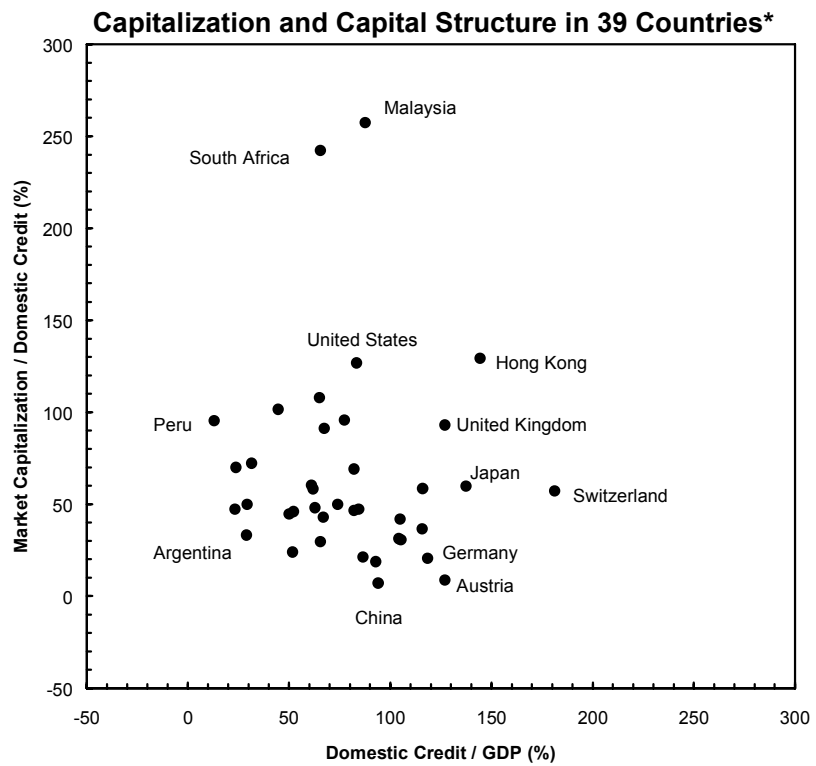
SOURCE: WORLD BANK



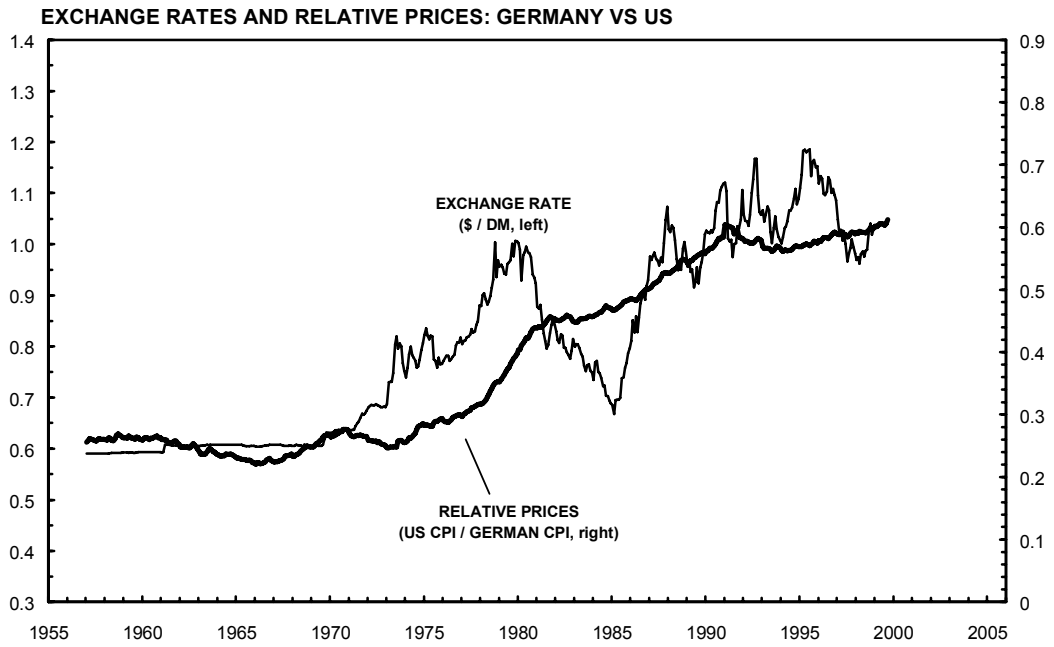
*Equity FFUNDS code: 893064105, Corporate debt FFUNDS code: 893163005, 263163003.
SOURCE: Federal Reserve Board; US Bureau of the Census; DRI.



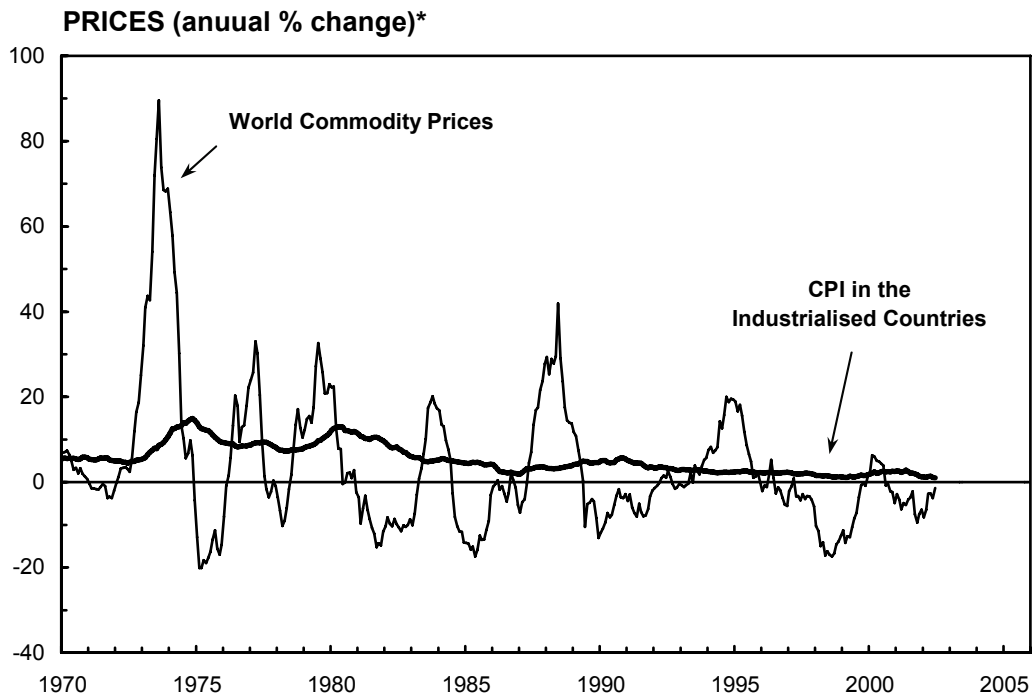
*Equity FFUNDS code: 893064105, Corporate debt FFUNDS code: 893163005, 263163003.
SOURCE: Federal Reserve Board; DRI.



* Data points are averages of 1990 and 1996
 SOURCE: WORLD BANK; IFC; US Department of Commerce



SOURCE: IMF; DRI



* In \$US.
SOURCE: IMF; DRI