

THE STRUCTURE OF FINANCIAL MARKETS



Multiple choice

1. B
2. D
3. D
4. A
5. B

Matching terms

Changes in technology, such as an increase in the number of Automatic Teller Machines and increased use of credit cards, that has changed demand patterns for money.	Financial innovation
Markets in which the issuing company directly sells new securities to investors.	Primary financial markets
Markets in which investors trade second hand (previously issued) securities with each other.	Secondary financial markets
Responsible for the overall stability of the financial system.	Reserve Bank of Australia
Responsible for providing prudential supervision and regulation of all deposit taking institutions, life and general insurance, and superannuation funds.	Australian Prudential Regulation Authority
Responsible for corporate regulation, consumer protection and oversight of financial services.	Australian Securities and Investment Commission
Market for trading in foreign and domestic currencies.	Foreign Exchange market
The amount of ready cash in the economy.	Liquidity

True or false

Select the alternative true or false that best answers the question. Place a tick in the space provided.

	True ✓	False ✓
1 Shares are the most liquid form of asset.		✓
2 If the government budgets for a deficit, it is acting as a saver.		✓
3 The issue of a prospectus by Qantas is associated with a primary market activity.	✓	
4 The deregulation of the financial sector has led to an increase in the distinction between banks and non-bank financial intermediaries.		✓
5 Banks are the only institutions from which consumer home loans can be obtained.		✓
6 In general, the greater the risk associated with an investment, the greater the interest rate.	✓	
7 If the nominal interest rate is 9% and the inflation rate is 3%, the real rate of interest is 6%.	✓	
8 The financial deregulation that has occurred in Australia since the 1980s has led to a greater emphasis on self-regulation, rather than regulation by a central bank.	✓	
9 The Commonwealth Bank is the central bank for Australia's Commonwealth Government.		✓
10 Following financial deregulation, exchange settlement accounts have been abolished.		✓

Short answers

Question 1

- (i) An increase in interest rates, encouraging people to put more money into financial institutions.
- (ii) A lack of confidence in the future can cause people to save due to job insecurity and worries over future income levels.
- (iii) The introduction of a GST or an increase in its rate will cause people to reduce their spending to reduce their tax burden.

Question 2

A primary financial market is the sale of shares, bonds or securities by their issuer. The sale of Telstra shares by the government is an example.

A secondary market is the sale of shares, bonds or securities by their current owner. The sale of shares in Telstra by a person who had bought them 1 year ago is an example.

Question 3

There is a trade-off between risk and return because in order for entrepreneurs to attract funds for risky or uncertain enterprises, they must offer investors a high interest rate. Similarly, those financial institutions that want investors to deposit their funds for long, fixed periods (lowering liquidity) must offer high interest rates to induce them to give up access to their money for a long time.

Question 4

The financial system has been progressively deregulated since 1983. As a result, there has been an increase in the importance of the non-bank sector. Now building societies, credit unions and finance companies have a greater share of the consumer market. Additionally there has been a reduction in the role of the RBA in the market. It has passed its regulatory and supervisory functions to APRA. The RBA no longer directly determines lending and deposit rates, it can now only determine general directions of them.

Question 5

The major roles of the RBA are:

- To ensure stability of Australia's financial system
- Control the issue of notes and coins in the economy
- To regulate the system of payments in the economy with respect to cheques, credit and more recently electronic transactions
- To act as the banker to the banks
- To conduct monetary policy through the use of market operations