

**Solution Manual for Financial Markets and Institutions 8th  
Edition by Mishkin and Eakins ISBN 013342362X  
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# **Chapter 1**

## **Why Study Financial Markets and Institutions?**

### **Why Study Financial Markets?**

Debt Markets and Interest Rates

The Stock Market

The Foreign Exchange Market

### **Why Study Financial Institutions?**

Structure of the Financial System

Financial Crises

Central Banks and the Conduct of Monetary Policy

The International Financial System

Banks and Other Financial Institutions

Financial Innovation

Managing Risk in Financial Institutions

### **Applied Managerial Perspective**

### **How We Will Study Financial Markets and Institutions**

Exploring the Web

Collecting and Graphing Data

### **Web Exercise**

### **Concluding Remarks**

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## ■ Overview and Teaching Tips

Before embarking on a study of financial markets and institutions, the student must be convinced that this subject is worth studying. Chapter 1 pursues this goal by showing the student that financial markets and institutions is an exciting field because it focuses on phenomena that affect everyday life. An additional purpose of Chapter 1 is to provide an overview for the entire book, previewing the topics that will be covered in later chapters. The chapter also provides the students with a guide as to how they will be studying financial markets and institutions with a unifying, analytic framework and an applied managerial perspective.

In teaching this chapter, the most important goal should be to get the student excited about the material. I have found that talking about the data presented in the figures helps achieve this goal by showing the students that

the subject matter of financial markets and institutions has real-world implications that they should care about. In addition, it is important to emphasize to the students that the course will have an applied managerial perspective, which they will find useful later in their careers. Going through the web exercise is also a way of encouraging the students to use the web to further their understanding of financial markets and institutions.

## ■ Answers to End-of-Chapter Questions

1. Because they channel funds from those who do not have a productive use for them to those who do, thereby resulting in higher economic efficiency.
2. Businesses would cut investment spending because the cost of financing this spending is now higher, and consumers would be less likely to purchase a house or a car because the cost of financing their purchase is higher.
3. A change in interest rates affects the cost of acquiring funds for financial institution as well as changes the income on assets such as loans, both of which affect profits. In addition, changes in interest rates affect the price of assets such as stock and bonds that the financial institution owns which can lead to profits or losses.
4. No. People who borrow to purchase a house or a car are worse off because it costs them more to finance their purchase; however, savers benefit because they can earn higher interest rates on their savings.
5. The lower price for a firm's shares means that it can raise a smaller amount of funds, and so investment in plant and equipment will fall.
6. Higher stock prices mean that consumers' wealth is higher and so they will be more likely to increase their spending.
7. It makes foreign goods more expensive and so British consumers will buy less foreign goods and more domestic goods.
8. It makes British goods more expensive relative to American goods. American businesses will find it easier to sell their goods in the United States and abroad, and the demand for their products will rise.
9. Changes in foreign exchange rates change the value of assets held by financial institutions and thus lead to gains and losses on these assets. Also changes in foreign exchange rates affect the profits made by traders in foreign exchange who work for financial institutions.
10. In the mid to late 1970s and the late 1980s and early 1990s, the value of the dollar was low, making travel abroad relatively more expensive; that would have been a good time to vacation in the United States and see the Grand Canyon. As the dollar's value rose in the early 1980s, travel abroad became relatively cheaper, making it a good time to visit the Tower of London.
11. Banks accept deposits and then use the resulting funds to make loans.
12. Savings and loan associations, mutual savings banks, credit unions, insurance companies, mutual funds, pension funds, and finance companies.
13. Answers will vary.

14. The profitability of financial institutions is affected by changes in interest rates, stock prices, and foreign exchange rates; fluctuations in these variables expose these institutions to risk.
15. Because the Federal Reserve affects interest rates, inflation, and business cycles, all of which have an important impact on the profitability of financial institutions.

## ■ Quantitative Problems

1. The following table lists foreign exchange rates between U.S. dollars and British pounds during April:

Date	U.S. Dollars per GBP	Date	U.S. Dollars per GBP
4/1	1.9564	4/18	1.7504
4/4	1.9293	4/19	1.7255
4/5	1.914	4/20	1.6914
4/6	1.9374	4/21	1.672
4/7	1.961	4/22	1.6684
4/8	1.8925	4/25	1.6674
4/11	1.8822	4/26	1.6857
4/12	1.8558	4/27	1.6925
4/13	1.796	4/28	1.7201
4/14	1.7902	4/29	1.7512
4/15	1.7785		

Which day would have been the best day to convert \$200 into British pounds?

Which day would have been the worst day? What would be the difference in pounds?

**Solution:** The best day is 4/25. At a rate of \$1.6674/pound, you would have £119.95. The worst day is 4/7. At \$1.961/pound, you would have £101.99, or a difference of £17.96.