

Understanding South African Financial Markets

Chapter 1: Fundamentals of the financial system



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Study outcomes

When you have studied this chapter you should be able to

- define and describe the elements that make up the financial system
- elucidate the functions of the financial system
- discuss the significance of financial system stability in a domestic and international context
- outline the recent international financial crisis and its implications for the future.



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Introduction

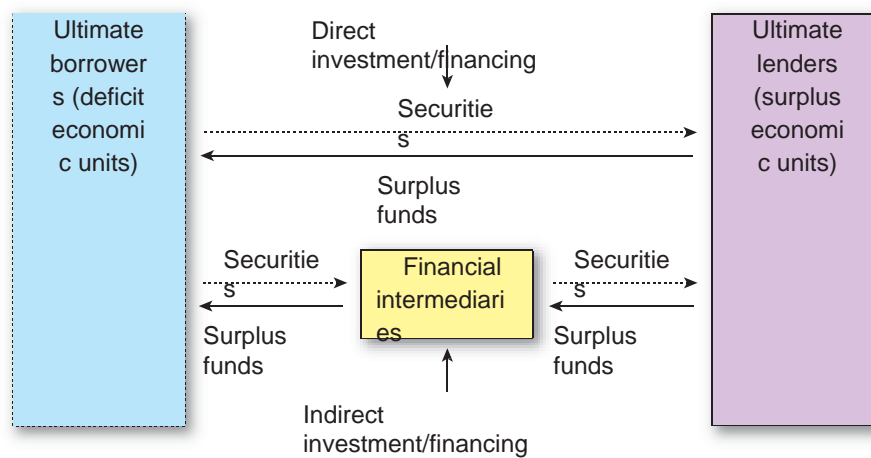
Overview

- Defining the financial system
- Six elements of the financial system
- Functions of the financial system
- Domestic and international financial system stability
- The international financial crisis and the future

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Defining the financial system

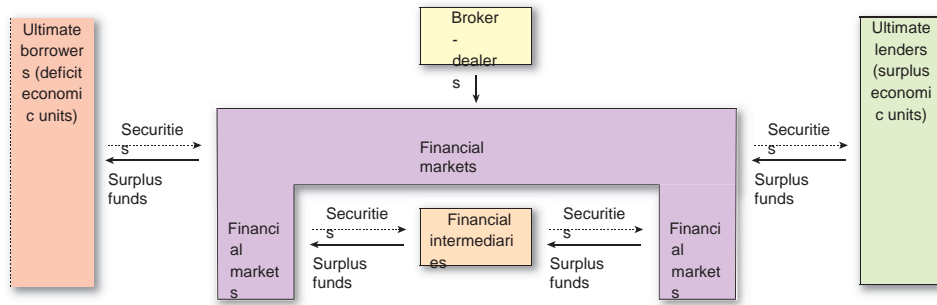
Figure 1.1 Financial system (simplified) (Textbook page 4)



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Defining the financial system

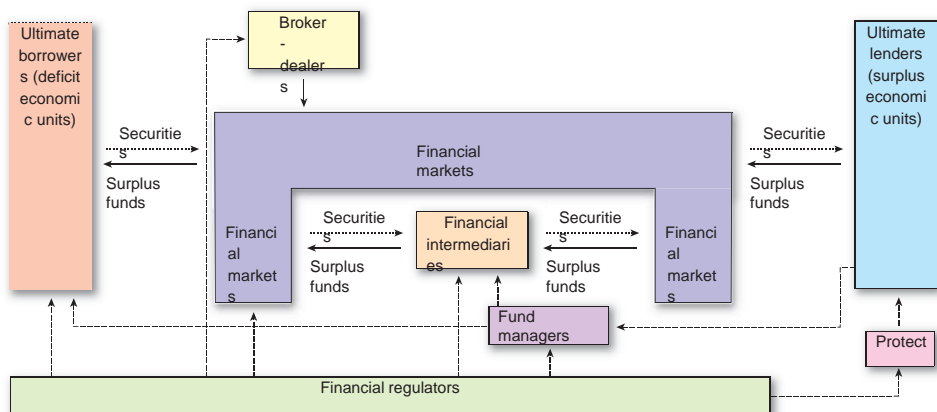
Figure 1.2 Financial markets and broker-dealers in financial system (Textbook page 5)



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Defining the financial system

Figure 1.3 (Most) elements of the financial system (Textbook page 7)



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Six elements of the financial system

1. *Lenders and borrowers*
2. *Financial intermediaries*
3. *Financial instruments*
4. *Creation of money*
5. *Financial markets*
6. *Price discovery*



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Six elements of the financial system

Element 1: lenders and borrowers

- *Household sector*
- *Corporate sector*
- *Government sector*
- *Foreign sector*

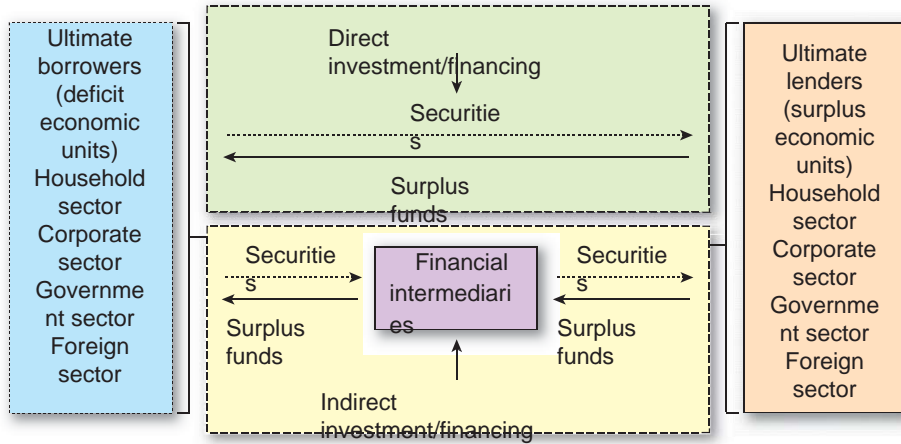


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Six elements of the financial system

Element 1: lenders and borrowers

Figure 1.4 Ultimate lenders and borrowers (Textbook page 8)



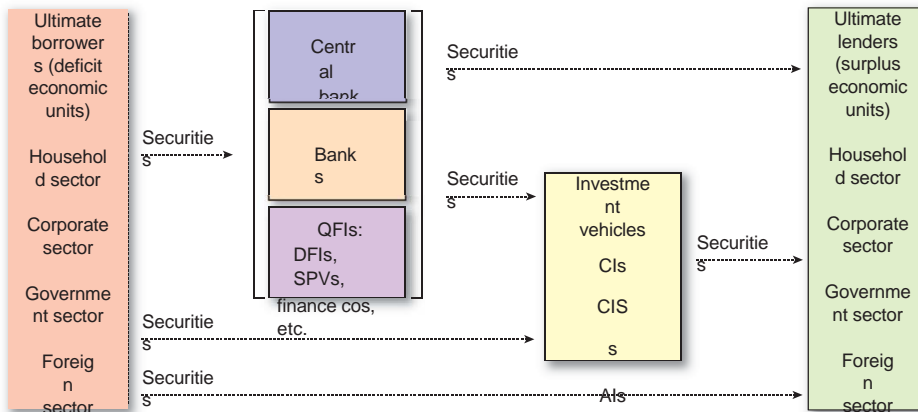
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Six elements of the financial system

Element 2: financial intermediaries

Table 1.1 Financial intermediaries (Textbook 8)

Figure 1.5 Financial intermediaries (Textbook page 9)



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Element 3: financial instruments

Figure 1.6 Financial intermediaries and instruments/securities (Textbook page 11)

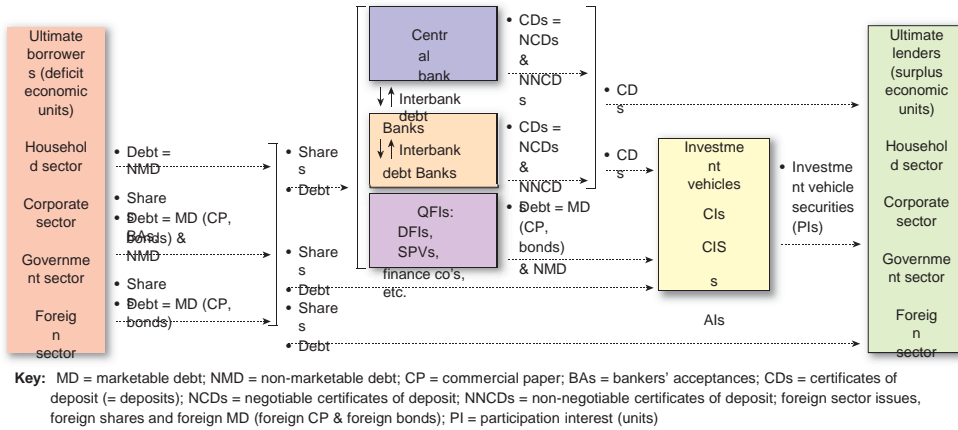
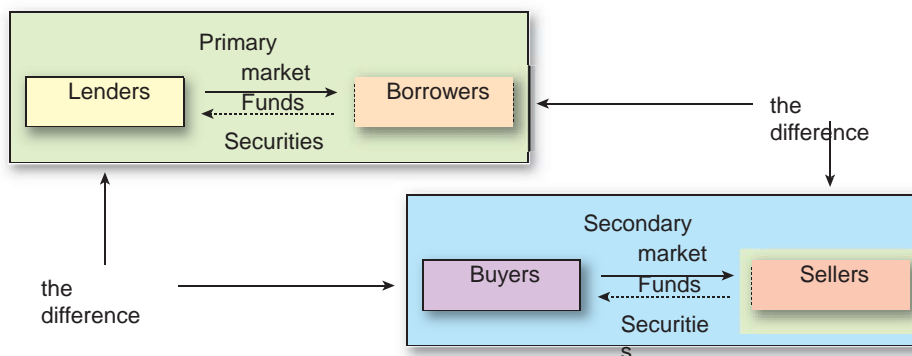


Table 1.2 Financial instruments/securities (Textbook page 13)

Element 4: financial markets

- Primary and secondary markets

Figure 1.7 Primary and secondary markets (Textbook page 14)

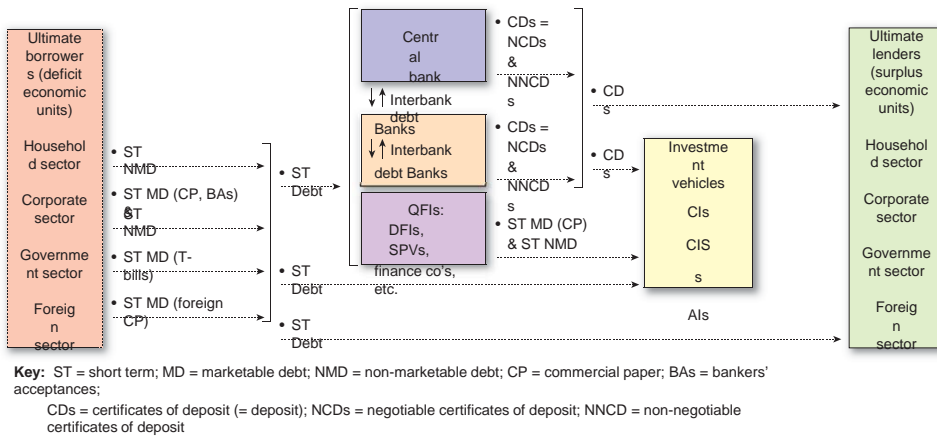


Six elements of the financial system

Element 4: financial markets

- Over-the-counter and exchange-driven markets
- Debt market

Figure 1.8 Money market (Textbook page 16)

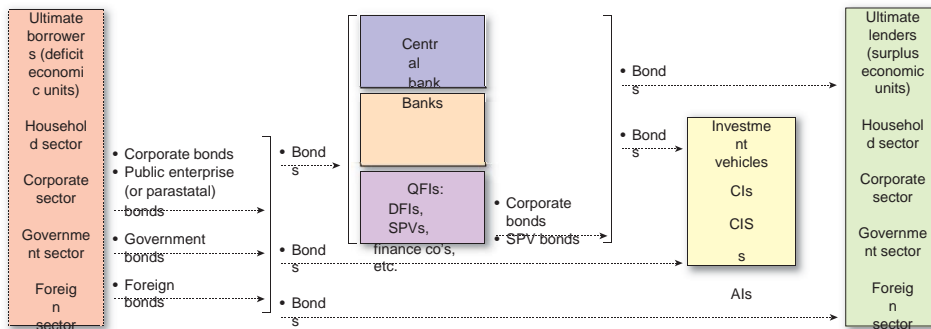


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Six elements of the financial system

Element 4: financial markets

Figure 1.9 Bond market (Textbook page 18)



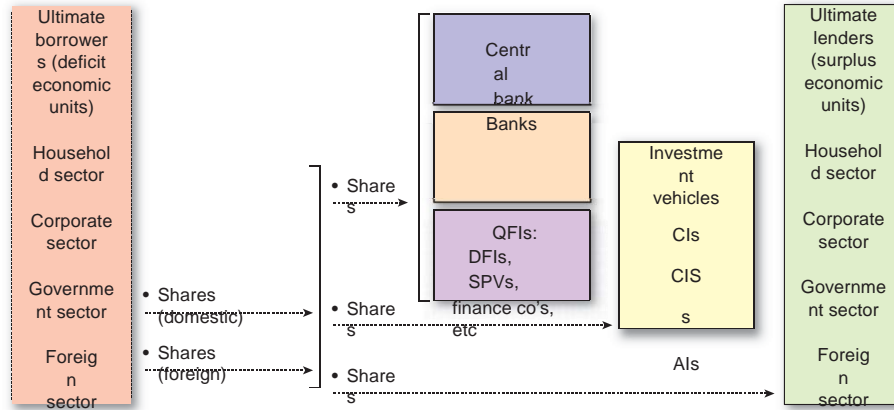
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Six elements of the financial system

Element 4: financial markets

• Share market

Figure 1.10 Share market (Textbook page 19)



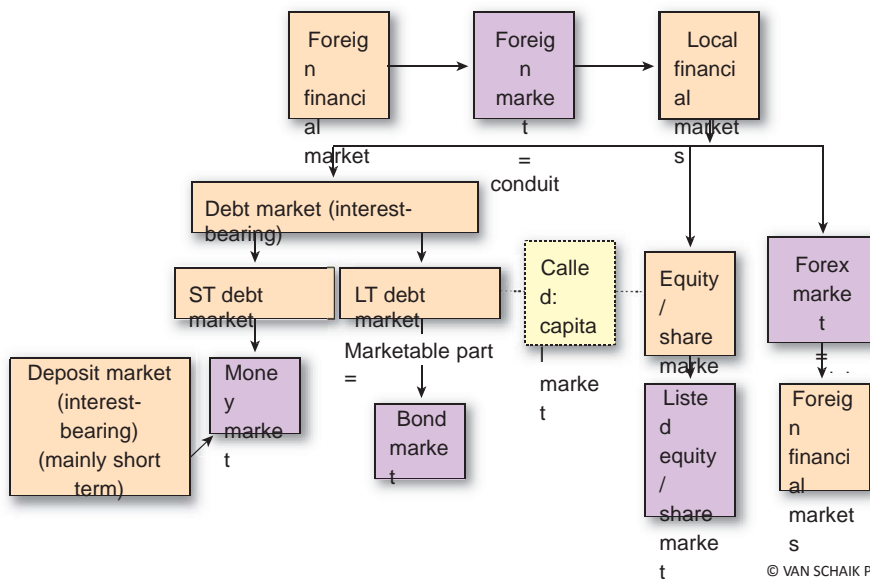
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Six elements of the financial system

Element 4: financial markets

• Foreign exchange market

Figure 1.11 Financial markets (Textbook page 20)



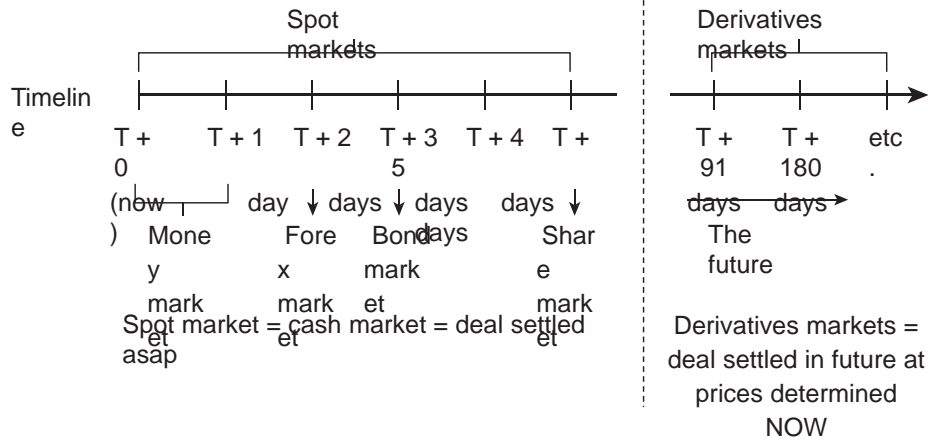
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Six elements of the financial system

Element 4: financial markets

• Spot and derivatives markets

Figure 1.12 Spot and forward settlement (derivatives markets) (Textbook page 21)

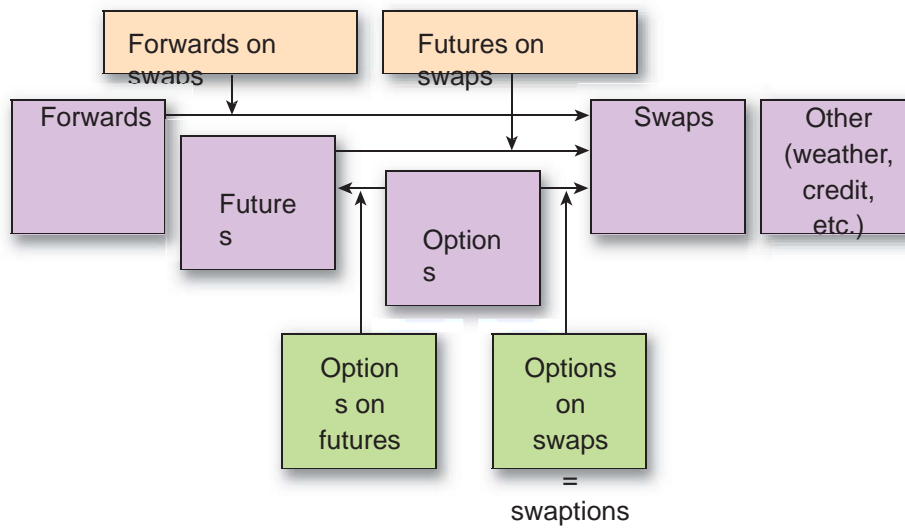


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Six elements of the financial system

Element 4: financial markets

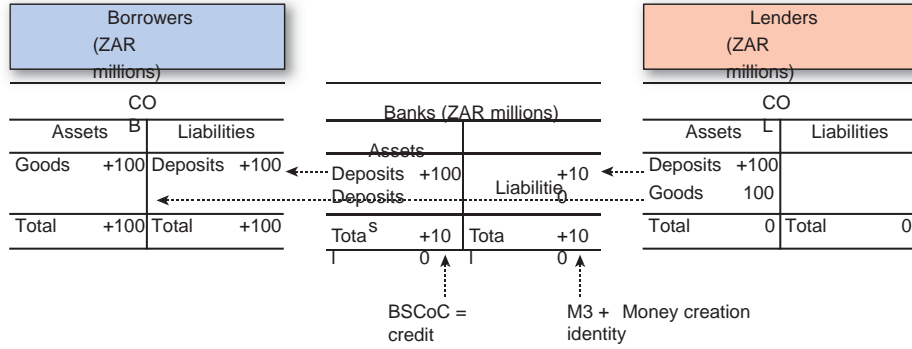
Figure 1.13 Derivatives instruments/markets (Textbook page 21)



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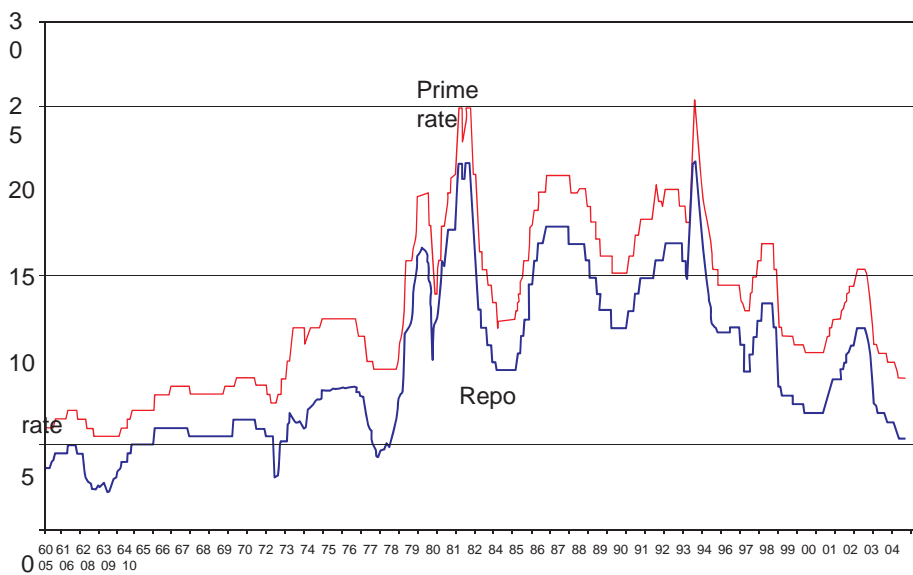
Element 5: money creation

Figure 1.14 Money creation (Textbook page 23)



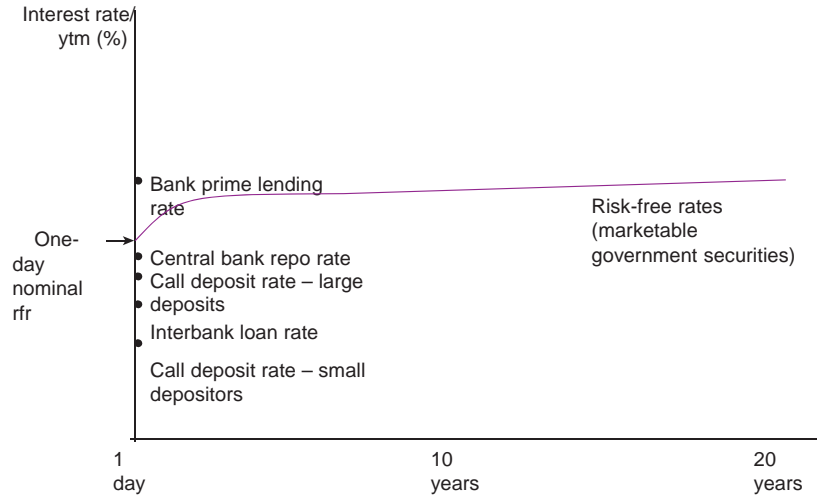
Element 5: money creation

Figure 1.15 Repo rate and prime rate (Textbook page 24)



Element 6: price discovery

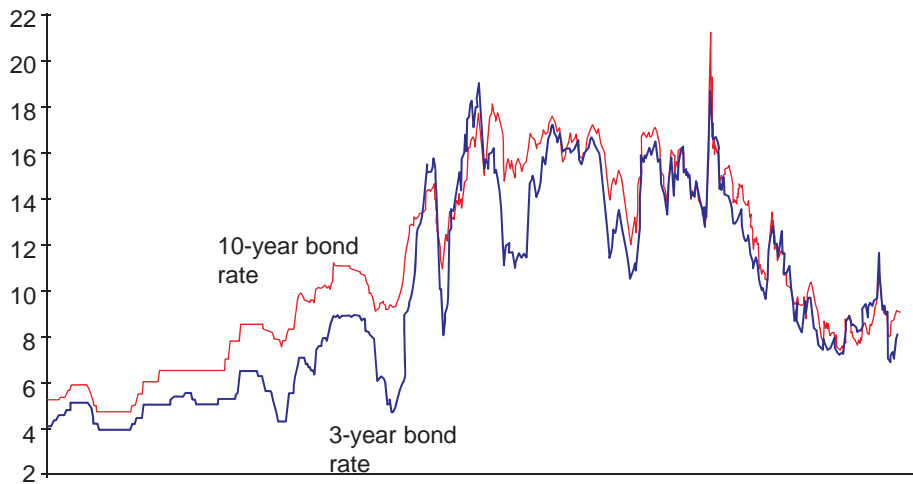
Figure 1.16 Short-term banking rates and yield curve for government securities (Textbook page 25)



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Element 6: price discovery

Figure 1.17 Three- and 10-year bond rates (Textbook page 26)




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Element 7: allied participants in the financial system

- *Principal participants*
- *Non-principal participants*



Functions of the financial system

Introduction

Channelling of savings into investments

Pooling of savings

Efficient allocation of funds

- Transferring of funds through time and across borders




Money creation

An efficient payment system

Enhanced liquidity and economies of scale

Reduction of risk

Price discovery/information



**Domestic and international
financial system stability**

The international financial crisis and the future



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