Week 1: Capital Markets:

Summary:

Conceptual Model for Consumption, Interest Rates and Property Markets:

- Consumption affects interest rate
- High Interest v Low Interest effect on Property Prices (& deposits)
  - Low Interest Rate -> High deposits -> High property prices
  - High interest rate -> Low deposits -> Low property prices
- Dispensable Income:
  - different from disposable income
  - income after mortgage and deposits
  - affected by rent, mortgage, etc.

Key concept:

Consumption -> Determines interest Rate -> Affects Property Price (through borrowing or purchasing power) -> leads to affordability -> Determines Household's dispensable income -> Overtime influence temporal consumption -> Then repeats (cyclical)

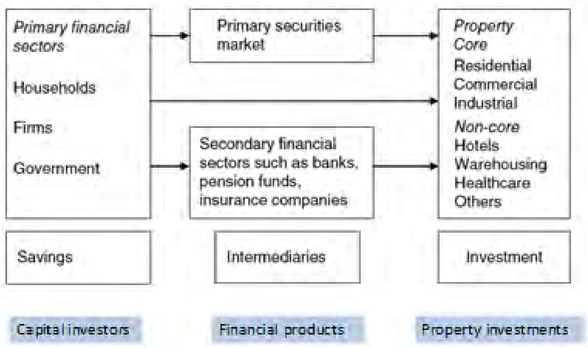
An example of outline of stakeholders of relevance

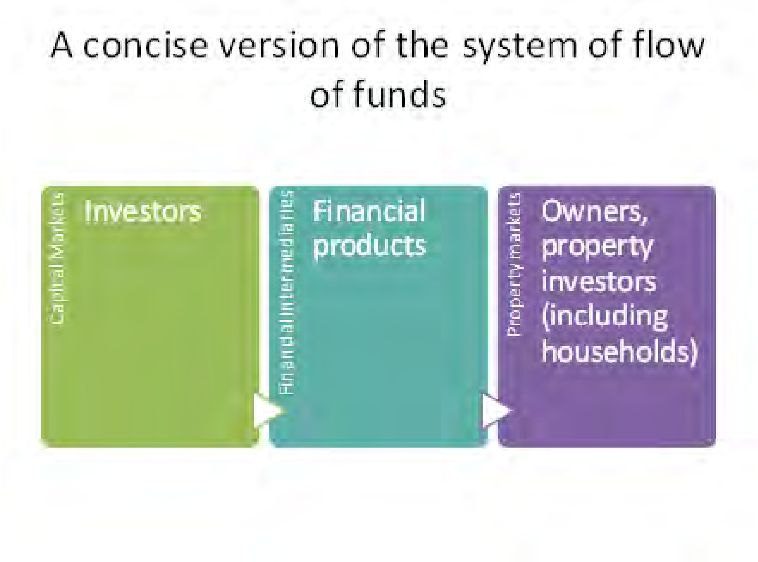
Concepts	Dispensable Income	Housing affordability	Property markets	Interest rate	Consumption
Households, owners & investors	XXX	XXX	XX	XXX	XXX
Government	XXX	XXX	XX	XX	XXX
Developers & professionals	X	XX	XXX	XXX	

"XXX" indicates potential a high level of connection.
"XX" indicates potential a middle level of connection.
"X" indicates potential a low level of connection.

Note that the above shows only one example of the level of connection/relevance. Bear in mind that this course encourages an "open mind-set learning environment" (refer to the slide in 'introduction to course' for "open mind-set learning").

System of flow of funds
(Figure 3.1 of Tiwari & White (2014))





Review Questions:

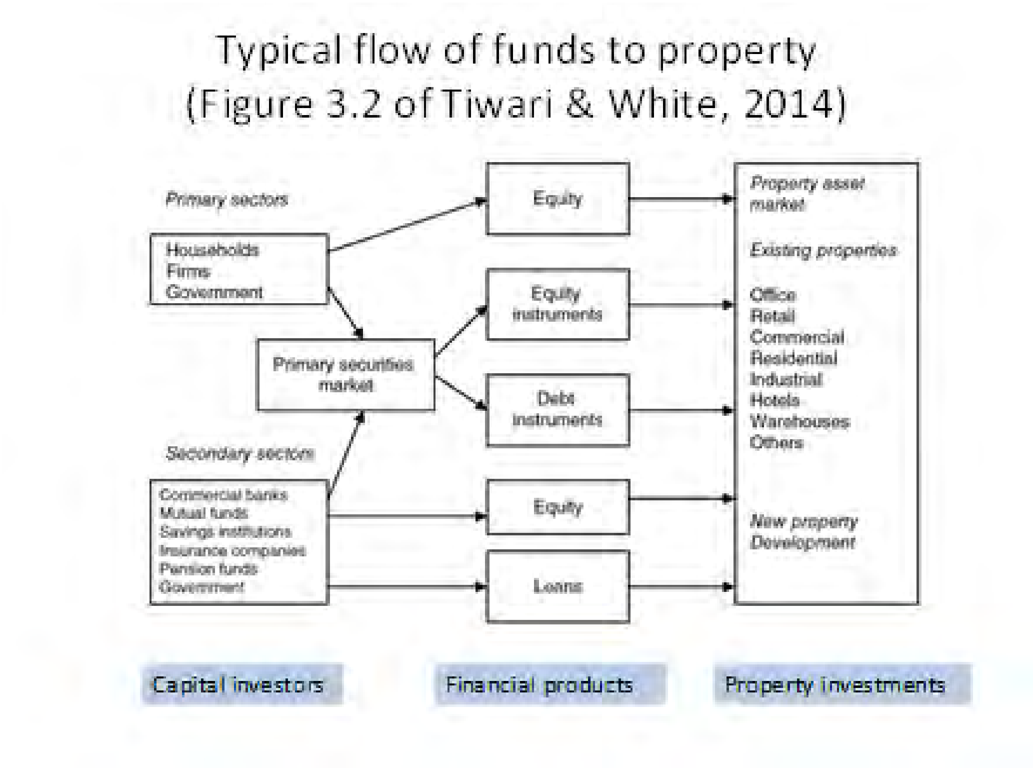
1. How do capital markets function and who are the stakeholders in these markets?
  -> Retail and Institutional Investors are Suppliers of Capital
  -> Users of the capital are businesses, individuals and governments
 -> Done by securities (stocks) or bonds (government)

2. What is the different between primary capital markets and the secondary capital markets?
 -> Primary Market:
   - Direct purchase of new stock or bond issues
 -> Secondary Market
   - Existing securities traded in the market (e.g. NASDAQ, NYSE)
   - Financial sectors such as HK, NY, Shanghai, Singapore

Reading: (Tiwari and White 2014)

Capital Market Summary:
- Capital markets are where people, company, and governments with more funds than they need (because they saved some income) transfer to those short of funds (because they spend more than their income).
- Two Main Capital Markets
  - Stocks and Bonds
- Role of capital markets is to promote economic efficiency by channeling money from those who do not have an immediate use for it to those who do.
- Wide trading of financial assets
  - Stocks, Bonds, Commodities (petrol, gold), Different currencies, derivatives (forward contracts, option contracts, future contracts), real estate/land, derivatives back by real estate.
- Stock exchanges play an important role in capital markets as it regulations of company listings, price-forming mechanism, supervision of trading, etc.
- Assets trade on International capital markets:
  -ADR (American depository receipts), Eurobonds, etc.

Typical Flow of Funds to Property



Debt Instruments:
 - Such as Bonds

Equity Instruments:
- Real estate funds

Secondary:
Loans – commercial debt

Reading: (Tiwari and White, 2014)

Simplified Scenario:
- Domestic/Foreign economic agents such as households, firms, and governments with surplus financial resources in present time (savings) can invest in those domestic/foreign opportunities (including property) that require these resources.
  - In return, earn risk adjusted return on their investments in the future.
- Two types of financial systems:
  1. Market based
  2. bank based
- Difference between the two systems is how savings are mobilised, investments are identified and risks are managed.
- Other difference is from legal perspective.
  - In a bank-based economy (Germany and japan) laws governing financial systems are enacted and implemented by the government (common in civil law countries)
  - Market based financial systems are found most often found in countries that have a common law

system (US and UK)

Four Types of Property Investors:
- Institutional Investors, Unregulated investors, households and proprietors and corporations.

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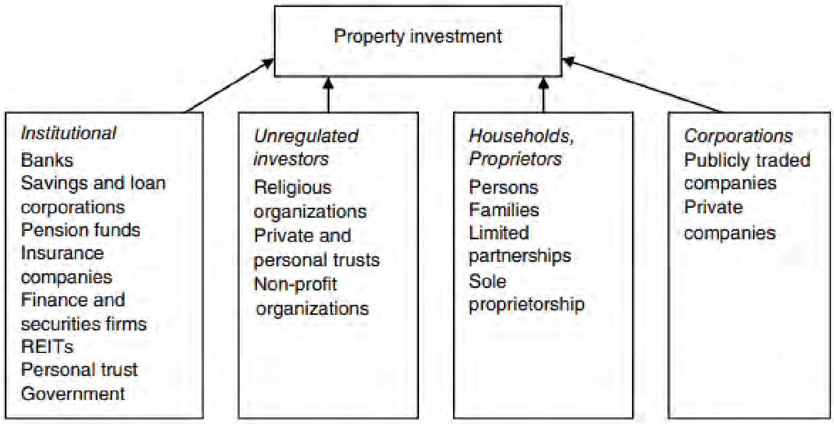
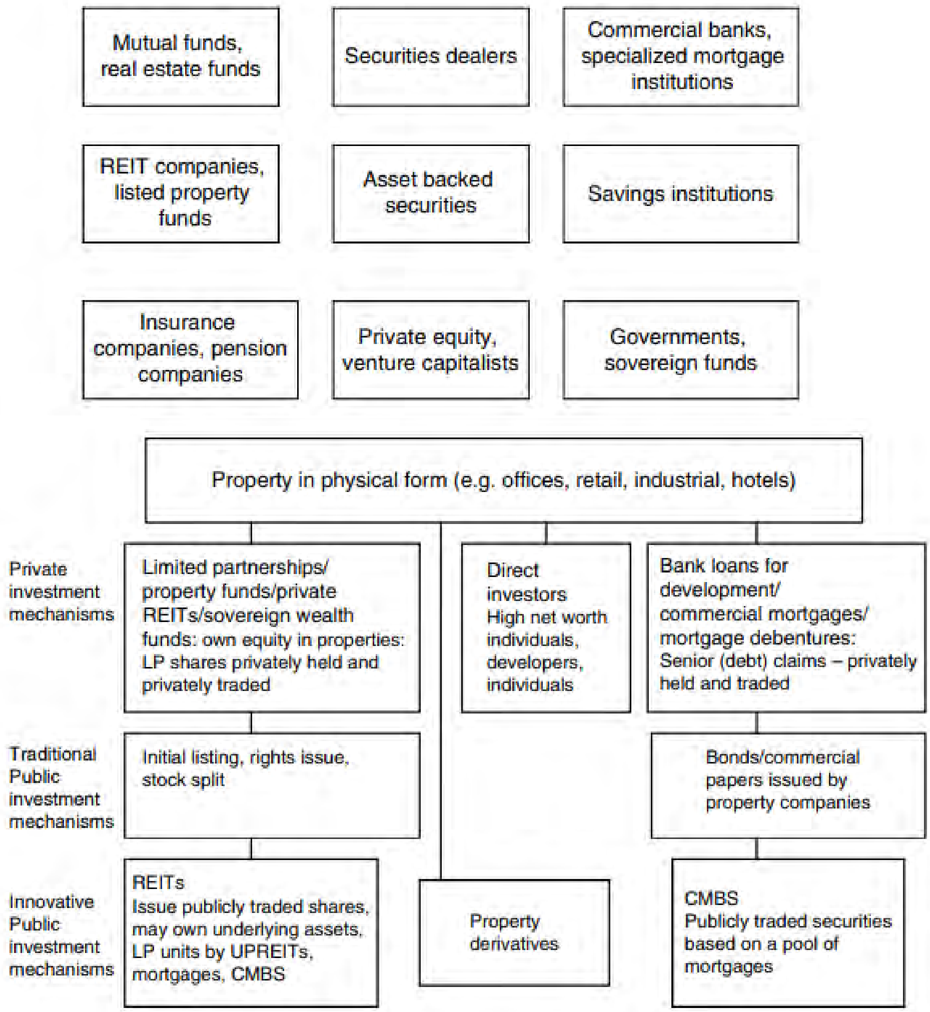
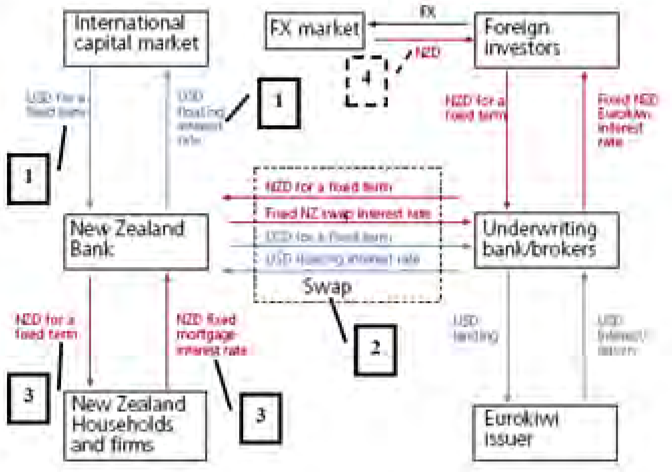


Investment Mechanisms:



New Zealand overseas funding system (Figure I of Dong (2011))



A brief illustration of New Zealand overseas funding system

(Steps match with number in boxes in Figure I of Dong (2011))

Step 1	New Zealand bank raises US dollars in the international capital market,
	paying floating interest rate.
Step 2	New Zealand bank swap raised US dollars in exchange for New Zealand dollars,
	through interest rate SWAPs and currency SWAPs (SWAP is one type of financial product).
Step 3	Then banks are able to provide local borrowers with cheap New Zealand dollars,
	gaining profit from the profit margin of interest rates.

A concise New Zealand overseas funding system

New Zealand bank borrows USD at a low interest rate

Use SWAP (a financial product) in exchange for NZD (at a cheap cost due to the above low interest rate and SWAP)

Banks in New Zealand are able to lend money at low rate to local borrowers.