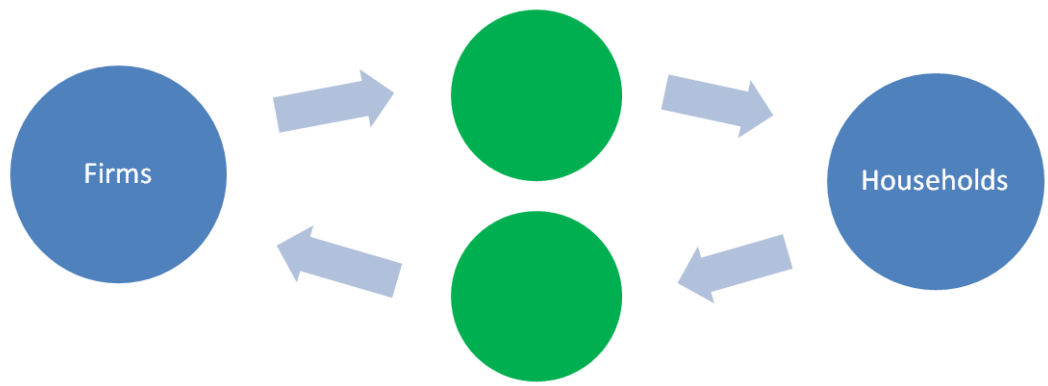
CONCEPT: FINANCIAL SYSTEM DEFINITIONS

● Households ____________ some of their money, while firms need money to ____________ in long-term assets.

  □ ***Financial System*** – the group of financial markets where firms acquire funds from savers

  □ ***Financial Markets*** – Markets for the purchase and sale of financial securities, such as ____________________



  □ ***Investment*** – current resources are devoted to _____________ future output

    > The term ***investment*** is different in economics from the definition you are used to:

Financial Investments are made by ___________________	Economic Investments are made by __________________

  □ ***Financial Intermediaries*** – Firms that act as a middleman between savers and borrowers

    > Example: Banks, mutual funds, pension funds, and insurance companies

● The financial system accomplishes three main goals:

  □ *Reducing Transaction Costs*

    > ***Transaction Costs*** – the ________________ of negotiating and executing a deal

    > Example: Business wants to raise $1B, but no individual investor would be willing to give $1B

  □ *Reducing Financial Risk*

    > ***Financial Risk*** – ________________ involving future gains or losses

    > Example: Diversifying investments or buying insurance

  □ *Providing Liquidity*

    > ***Liquidity*** – how easy it is to ______________ a financial asset to cash

    > Example: You own 10 shares of Apple stock, but need cash; you can sell it to another investor easily!