

SIXTH EDITION

Lawrence S. Ritter & William L. Silber

PRINCIPLES OF

MONEY, BANKING, AND FINANCIAL MARKETS

SIXTH EDITION

Lawrence S. Ritter William L. Silber

BASIC BOOKS, INC., PUBLISHERS NEW YORK ". . . be careful in teaching, for error in teaching amounts to deliberate sin."

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Dwight M. Blood, Brigham Young University

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Thomas C. Chiang, *Drexel University*Dale Cloninger, *University of Houston at*Clear Lake

Bob Curl, Northwest Nazarene College J. Kenneth Davies, Brigham Young University

Robert M. Domine, University of Michigan

James S. Earley, *University of California*, *Riverside*

William P. Field, Jr., Nicholls State University

Stanley Fischer, Massachusetts Institute of Technology

Ian Giddy, *Columbia University* John B. Guerard, Jr., *University of Texas*

Satya P. Gupta, Augsburg College Jerry W. Gustafson, Beloit College

Philip J. Hahn, Youngstown State University
Gabriel Hawawini, INSEAD (The European
Institute of Business), Fontainebleau,
France

Naphtali Hoffman, Elmira College
Robert S. Holbrook, University of Michigan
Mary Jaffier, New York University
Edward J. Kane, Ohio State University
Peter M. Kerr, Southeast State College
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Richard W. Kjetsaa, Fairleigh Dickinson
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Gregor Lazarcik, State University of New York at Geneseo

Marie Lobue, University of New Orleans
Darryl W. Lowry, Roanoke College
Morgan J. Lynge, University of Illinois at
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John McArthur, Claremont Graduate School John J. Merrick, New York University H. Brian Moehring, *University of the Redlands*

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Alan Norton, St. John Fisher College John A. Orr, California State University at Chico

Peter Parker, Randolph-Macon College Braxton I. Patterson, University of Wisconsin at Oshkosh

Thomas J. Pierce, California State University at San Bernardino

Dean Popp, San Diego State University Thomas P. Potiowsky, Portland State University

Alan Rabin, University of Tennessee at Chattanooga

Henry Rennie, University of Toledo
Deborah E. Robbins, Wellesley College
M. Richard Roseman, California State
University at Los Angeles
David Sandberg, Brigham Young University

David Sandberg, *Brigham Young University* John M. Sapinsley, *Rhode Island College* Donald J. Schilling, *University of Missouri* Carole Scott, *West Georgia College*

Larry J. Sechrest, University of Texas at Arlington

Edward Shapiro, *University of Toledo*Milton M. Shapiro, *California Polytechnic State University*

Thomas J. Shea, Springfield College Cathy Sherman, University of Texas William O. Shropshire, Oglethorpe University

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Notes to the Instructor

In preparing this sixth edition we were influenced primarily by the sweeping changes that have occurred in our monetary and financial system during the fifteen years since *Principles of Money, Banking, and Financial Markets* was first published. Although each of our previous five editions has kept pace with current developments, this sixth edition represents by far the most substantial overhaul of all. Improvements have been made in institutional and theoretical coverage as well as in pedagogical techniques, however, we still maintain the casual conversational style that has highlighted earlier editions.

The expanded theoretical coverage appears in Parts 1 and 4. In Part 1, which covers the basics, we have introduced two new chapters titled "Calculating Interest Rates" and "The Level of Interest Rates." The first of these chapters provides a systematic introduction to interest rate computations, while the second presents a concise supply-demand model explaining how the level of rates is determined. These chapters permit courses that focus on financial institutions and markets to sidestep entirely the extensive material on monetary theory. To accomodate those wishing to concentrate on theoretical issues, however, we have reorganized Part 4 to highlight the separate chapters dealing with *ISLM* analysis and aggregate supply-demand analysis. An entirely new chapter titled "Rational Expectations: Theory and Policy Implications" has been added for more advanced theoretical discussion.

Improved coverage of financial institutions and markets also comes in two forms. In Part 1 we present introductory material systematically in two chapters titled "Financial Instruments and Markets" and "Financial Institutions: Purposes and Profile." In Part 5 we have expanded coverage of financial markets with two entirely new chapters titled "Other Fixed Income Markets" and "Financial Futures and Options," and with an appendix on duration. In addition, existing material on the government securities market and on the stock market has been expanded into chapters that more fully reflect the structure and organization of those markets.

A number of pedagogical improvements also appear in this edition.

In addition to news clippings that have always been interspersed throughout the text, we have introduced discussion boxes dealing with "Reading the Financial News" and special topics of popular interest. A completely new chapter on "Careers in Banking and Financial Markets" has been added to provide perspective to students on how they might eventually apply some of the material covered during the semester. Finally, the book now ends with a Glossary, which we hope your students find useful.

These improvements in the coverage of the book have been mirrored in both the Study Guide by Gabriel Hawawini and the separate Instructor's Manual with Test Bank by Paul Warner and Gabriel Hawawini. For instructors, the test bank is available on Harper Test, a microcomputer test-generation system for Apple II and IBM PC computers. We think this entire package will permit you to tailor the course to meet the needs of your students.

The specific organization of the book reflects the way we would teach a course in Money and Banking or Financial Institutions and Markets. However, we realize that there are alternative ways to organize such a course, ways that would involve a different ordering of chapters. We have therefore written the book with the ideal of flexibility in mind. Although every instructor can best structure his or her own course, here are some illustrative examples of the ways this book can be adapted to different approaches.

Part 1 ("The Basics") forms the foundation for all future topics. Thus the chapters in Part 1 might all be assigned in the beginning of the course. Alternatively, each of the chapters in Part 1 can be used to initiate subsequent parts of the book. For example, Chapter 2 ("Money, the Economy, and Inflation") belongs with Part 3 ("The Art of Central Banking") or even with Part 4 ("Monetary Theory"); Chapter 3 ("Financial Instruments and Markets") goes with Part 5 ("Financial Markets and Interest Rates"); Chapter 4 ("Financial Institutions: Purposes and Profile") introduces Part 2 ("Intermediaries and Banks"); finally, Chapter 5 ("Calculating Interest Rates") and Chapter 6 ("The Level of Interest Rates") can be used to launch Part 4 ("Monetary Theory") or any other section, for that matter.

The two major types of course organization are (1) a financial institutions and markets and central banking emphasis, and (2) a monetary theory and policy emphasis. The ordering of the chapters as they appear in the table of contents reflects the first type of approach: financial institutions and markets and central banking. Even within each of these categories, it is possible to emphasize different subjects. Here are some suggestions:

1. Financial institutions and markets and central banking: After the basics in Part 1, Parts 2 and 3 present a comprehensive analysis of the business of financial intermediaries and the art of central banking. A limited amount of theory on the role of money in the economy is given in Chapters 1 and 2, and interest rates are introduced in Chapters 5 and 6, to provide the proper framework for the discussion of central banking.

When the formal presentation of monetary theory begins in Part 4, it is possible to reduce the emphasis on theory by eliminating Chapters 21 and 22; these chapters construct and then apply ISLM analysis, but the rest of the book is written so that the omission of this material will not interrupt its continuity or intelligibility.

In a course devoted exclusively to financial institutions and markets. it is possible to avoid formal monetary theory entirely by going directly to Part 5 ("Financial Markets and Interest Rates") after Part 1. For such courses, the overview of money in Chapters 1 and 2 and the framework for interest rate determination in Chapter 6 provide a more than adequate discussion of theoretical material.

Many professors seem to prefer teaching Parts 1, 2, and 3 in sequence, then moving to Part 5 and possibly even 6 before backtracking to Part 4 ("Monetary Theory").

- 2. Monetary theory and policy: After Part 1 is completed, monetary theory can be introduced immediately by going directly to Part 4. One can then backtrack to Parts 2 and 3, which discuss financial institutions and central banking, and then continue with Part 5 ("Financial Markets and Interest Rates"). In fact, Chapters 28 and 33 ("The Structure of Interest Rates" and "Financial Futures and Options") could be brought into a theory-oriented course much earlier, right after Part 4.
- 3. International aspects: It is possible to put all of Part 6 ("International Finance") virtually anywhere one wishes, provided the basics in Part 1 have been covered. The international chapters, for example, could easily follow Part 3 ("The Art of Central Banking") or Part 4 ("Monetary Theory").

We hope that you find both the new and continuing features of the book useful teaching devices. If you have any comments or suggestions for the next edition, we would appreciate hearing from you.

About the Authors

LAWRENCE S. RITTER is John M. Schiff Professor of Finance and Economics at the undergraduate and graduate Schools of Business of New York University. A former Chief of the Domestic Research Division of the Federal Reserve Bank of New York, he has served as a consultant to the U.S. Treasury, the Federal Deposit Insurance Corporation, the Board of Governors of the Federal Reserve System, the American Bankers Association, the Association of Reserve City Bankers, and the Garvin Guy-Butler Corporation. He has been the Editor of the *Journal of Finance* and is a past President of the American Finance Association. Professor Ritter is also the author of numerous articles in professional journals and of *The Glory of Their Times*, a best-selling book about the early days of baseball.

WILLIAM L. SILBER is Professor of Finance and Economics and Director, L. Glucksman Institute for Research in Securities Markets at the Graduate School of Business Administration at New York University. A former Senior Staff Economist with the President's Council of Economic Advisers and a former Senior Vice President at Lehman Brothers Kuhn Loeb, he has served as a consultant to the Board of Governors of the Federal Reserve System, the President's Commission on Financial Structure and Regulation, the U.S. Senate Committee on the Budget, the House Committee on Banking, Currency and Housing, the Justice Department, the Federal Reserve Bank of New York, the Federal Home Loan Bank Board, the National Commission on Electronic Funds Transfers, and the Department of Housing and Urban Development. He is an Associate Editor of the *Review of Economics and Statistics* and is the author of five books and numerous articles in professional journals.

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