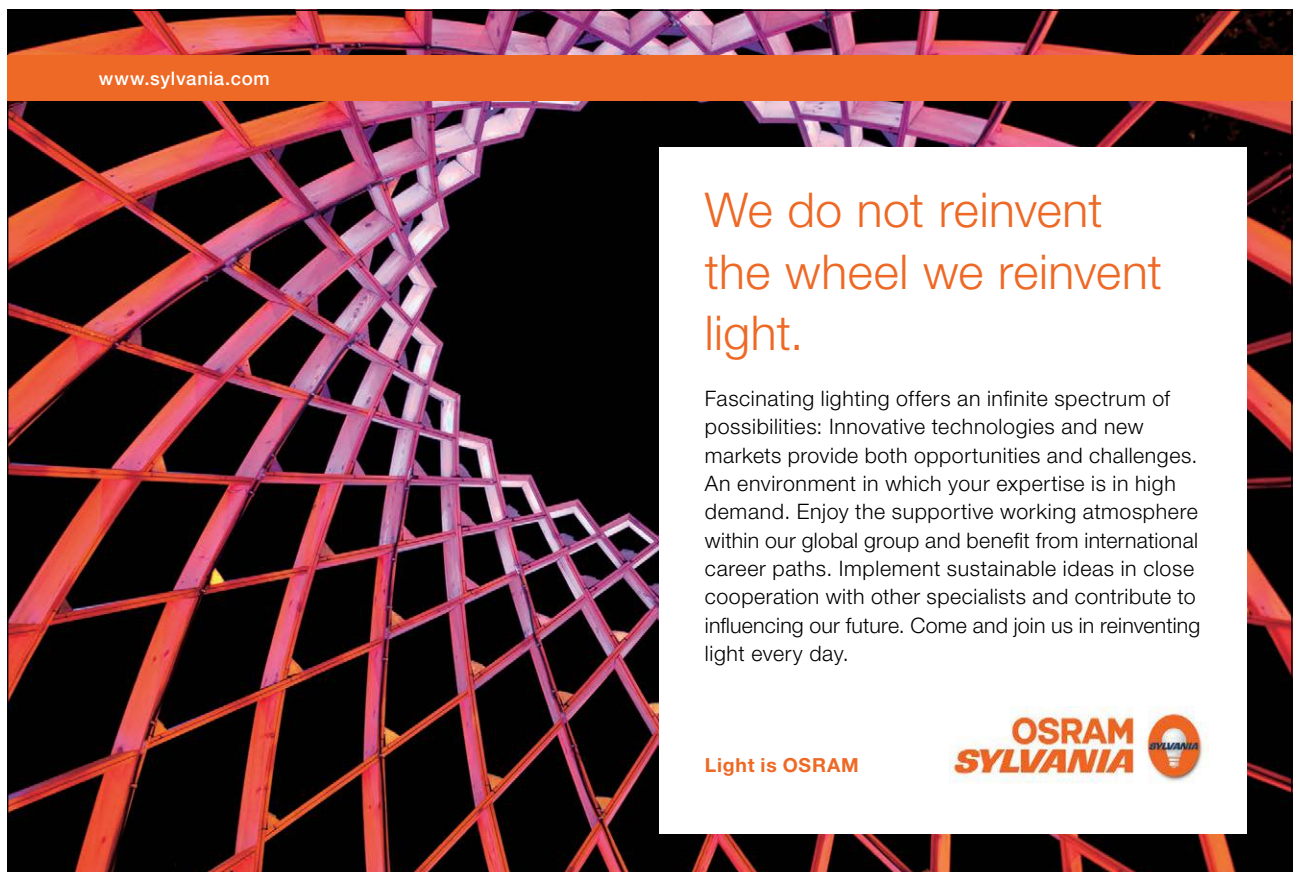


# Contents

<b>1</b>	<b>What are interest rates?</b>	<b>9</b>
1.1	Learning outcomes	9
1.2	Introduction	9
1.3	Financial system: a synopsis	11
1.4	Debt and deposits	13
1.5	The bank margin	16
1.6	Rate of interest	17
1.7	Time value of money	19
1.8	TMV and compound interest	20
1.9	Effective rate	24
1.10	Coupon rate	25
1.11	Price of a security: the principle	26
1.12	Price of a security: multiple future cash flows and yield to maturity	28
1.13	Other issues and terminology related to interest rates	31
1.14	References	37




www.sylvania.com

**We do not reinvent  
the wheel we reinvent  
light.**

Fascinating lighting offers an infinite spectrum of possibilities: Innovative technologies and new markets provide both opportunities and challenges. An environment in which your expertise is in high demand. Enjoy the supportive working atmosphere within our global group and benefit from international career paths. Implement sustainable ideas in close cooperation with other specialists and contribute to influencing our future. Come and join us in reinventing light every day.

Light is OSRAM

**OSRAM  
SYLVANIA** 



<b>2</b>	<b>Relationship of interest rates</b>	<b>38</b>
2.1	Learning outcomes	38
2.2	Introduction	39
2.3	Relationship between the policy interest rate and the banks' prime lending rate	39
2.4	The many, but related, interest rates on debt and deposits	40
2.5	Interbank market interest rates	51
2.6	Relationship of money market interest rates	64
2.7	References	65
<b>3</b>	<b>Composition of interest rates</b>	<b>66</b>
3.1	Learning outcomes	66
3.2	Introduction	67
3.3	The yield curve	67
3.4	Literature on the composition of interest rates	73
3.5	Composition of interest rates: an alternative analysis	75
3.6	Literature on the risk-free rate	77
3.7	The risk-free rate: an alternative view	79
3.8	Relationship of interest rates revisited	79
3.9	References	83



360°  
thinking.

**Deloitte.**

Discover the truth at [www.deloitte.ca/careers](http://www.deloitte.ca/careers)

© Deloitte & Touche LLP and affiliated entities.



<b>4</b>	<b>Interest rate discovery</b>	<b>85</b>
4.1	Learning outcomes	85
4.2	Introduction	85
4.3	Interest rate discovery and security valuation	85
4.4	Organisational structure of financial markets	86
4.5	Role of secondary markets	97
4.6	Interest rate discovery in the debt and deposit markets	99
4.7	Factors which impact on price discovery	113
4.8	References	114
<b>5</b>	<b>Bank liquidity &amp; interest rate discovery</b>	<b>115</b>
5.1	Learning outcomes	115
5.2	Introduction	115
5.3	Monetary policy models	115
5.4	A bank liquidity analysis	121
5.5	Quantitative easing	124
5.6	Quantitative easing and interest rates	131
5.7	Appendix 1: quantitative easing literature review	133
5.8	References	135

SIMPLY CLEVER

ŠKODA



We will turn your CV into  
an opportunity of a lifetime



Do you like cars? Would you like to be a part of a successful brand?  
We will appreciate and reward both your enthusiasm and talent.  
Send us your CV. You will be surprised where it can take you.

Send us your CV on  
[www.employerforlife.com](http://www.employerforlife.com)



Download free eBooks at [bookboon.com](http://bookboon.com)



Click on the ad to read more

<b>6</b>	<b>Role of interest rates</b>	<b>137</b>
6.1	Learning outcomes	137
6.2	Introduction	138
6.3	Primary tool of monetary policy	138
6.4	Part of bridge between present and future consumption	141
6.5	Advancing consumption / investment with debt	144
6.6	Inverse relationship with asset prices and the wealth effect	153
6.7	Interest rates and derivative instrument pricing	163
6.8	Interest rates and the foreign sector	166
6.9	References	166

I joined MITAS because  
I wanted **real responsibility**

The Graduate Programme  
for Engineers and Geoscientists  
[www.discovermitas.com](http://www.discovermitas.com)



**Month 16**

I was a construction  
supervisor in  
the North Sea  
advising and  
helping foremen  
solve problems

Real work  
International opportunities  
Three work placements



 **MAERSK**



7	<b>An optimal rate of interest: the natural rate</b>	<b>167</b>
7.1	Learning outcomes	167
7.2	Introduction	167
7.3	The Wicksell hypothesis	169
7.4	Literature review	170
7.5	An alternative interpretation	172
7.6	Reconciliation of PR and PIR / IBMR	174
7.7	Taylor rule	176
7.8	A proposed Taylor-type rule	179
7.9	References	182
	<b>Endnotes</b>	<b>184</b>

**ie** business school

#1 EUROPEAN BUSINESS SCHOOL  
FINANCIAL TIMES 2013

#gobeyond

**MASTER IN MANAGEMENT**

**Because achieving your dreams is your greatest challenge.** IE Business School's Master in Management taught in English, Spanish or bilingually, trains young high performance professionals at the beginning of their career through an innovative and stimulating program that will help them reach their full potential.

- Choose your area of specialization.
- Customize your master through the different options offered.
- Global Immersion Weeks in locations such as London, Silicon Valley or Shanghai.

*Because you change, we change with you.*

www.ie.edu/master-management | mim.admissions@ie.edu |

Download free eBooks at [bookboon.com](http://bookboon.com)



Click on the ad to read more