Appendix 01: Financial assets

- An ***asset*** is anything of value owned by a person or a firm.
- A ***financial asset*** is a financial claim, which means that if you own a financial asset, you have a claim on someone else to pay you money. For instance, a bank checking account is a financial asset because it represents a claim you have against a bank to pay you an amount of money equal to the dollar value of your account. Economists divide financial assets into those that are *securities* and those that aren't.
- A ***security*** is a claim on some future flow of income. A security is *tradable*, which means that it can be bought and sold in a *financial market*.

→ ***There are five key categories of financial assets:***

1. ***Money*** is anything that people are willing to accept in payment for goods and services or to pay off debts. The **money supply** is the total quantity of money in the economy. Money plays an important role in the economy, and there is some debate concerning the best way to measure it.
2. ***Stocks,*** also called ***equities***, are financial securities that represent partial ownership of a corporation. When you buy a share of Microsoft stock, you become a Microsoft *shareholder*, and you own part of Microsoft, although only a tiny part because Microsoft has issued millions of shares of stock. As an owner of a share of stock in a corporation, you have a legal claim to a share of the corporation's assets and to a share of its profits, if there are any. Firms keep some of their profits as retained earnings and pay the remainder to shareholders in the form of **dividends**, which are payments corporations typically make every quarter.
3. ***Bonds.*** When you buy a **bond** issued by a corporation or a government, you are lending the corporation or the government a fixed amount of money. The **interest rate** is the cost of borrowing funds (or the payment for lending funds), usually expressed as a percentage of the amount borrowed. A bond that matures in one year or less is a *short-term bond*. A bond that matures in more than one year is a *long-term bond*. Bonds can be bought and sold in financial markets, so, like stocks, bonds are securities.
4. ***Foreign exchange***. Many goods and services purchased in a country are produced outside that country. Similarly, many investors buy financial assets issued by foreign governments and firms. To buy foreign goods and services or foreign assets, a domestic business or a domestic investor must first exchange domestic currency for foreign currency. **Foreign exchange** refers to units of foreign currency. The most important buyers and sellers of foreign exchange are large banks. Banks engage in foreign currency transactions on behalf of investors who want to buy foreign financial assets. Banks also engage in foreign currency transactions on behalf of firms that want to import or export goods and services or to invest in physical assets, such as factories, in foreign countries.
5. ***Securitized loans***. If you lack the money to pay the full price of a car or house in cash, you can apply for a loan at a bank. Banks made loans with the intention of making profits by collecting interest payments on a loan until the loan was paid off. It wasn't possible to sell most loans in financial markets, so loans were financial assets but not securities. Loans that banks could sell on financial markets became securities, so the process of converting loans and other financial assets that are not tradable into securities is known as **securitization.**

→ ***Financial markets*** are places or channels for buying and selling stocks, bonds, and other securities, such as the New York Stock Exchange. If you own a share of stock in Apple or Google, you own a security because you can sell that share in the stock market. If you have a checking account at Citibank or Wells Fargo, you can't sell it. So, your checking account is an asset but not a security.

References: Hubbard Glenn and O'Brien Tony (2012). ***Money, Banking, and the Financial System***. Pearson Education, Inc. Boston. USA. P2-3.