Notes on financial assets, banks, markets and investments

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Abstract: The essay aims to represent the relationship between financial assets, banks, markets and investment. In particular it highlights the public interest so that banks and markets are actually useful for the performance of production processes. Subsequently it consider the factors that alter the physiological functioning of the circuit, that are the growing public debt, the excessive proliferation of financial instruments, the high market volatility and the uncertainly of political activity. Finally, it identify the possible leeway helpful to the recovery and support investments.

Keywords: assets; banks; markets; investments.

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Biographical notes: Michele Patanè is an Associate Professor of Financial Markets Economics and Interest Rate Derivatives, Department of Business and Law – University of Siena. The most recent topics of his research are related to the analysis and empirical evidence of functioning of markets, intermediaries activities and on forecasting techniques to evaluate portfolios risk of financial instruments. Further researches deal with the study of links between macroeconomic news, monetary policy and the dynamics of volatility and prices of assets on financial markets.

Financial assets, banks and markets are the key elements for investment support and promotion and consequently for the development of productive activities. Anyone who wants to acquire a minimum of knowledge in the functioning of the economy cannot overlook the study of the relationships that exist among financial assets, banks and financial markets. The analysis of those relations is further justified by the observation that when people and communication media discuss about banks, markets, financial activities or about the economy, the main attention is reserved to considerations, data, percentages that highlight or focus on the details or on the malfunctions of the economic system.

Governments save banks. The stock market collapses. The spread skyrockets. The ECB intervenes with quantitative easing. The euro does not hold up against the dollar or

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the Swiss franc. GDP rises more or less than expected. The unemployment rate stands at certain levels instead of others. The stock index *x*, *y* or *z* rises or falls by specific percentages that do not help to understand the dynamics of stock prices. The European or American consumption data show that changes should be anyway integrated to be evaluated. Disasters appear on the horizon. The news provides excessive information but also a fragmented and a disorganised one. The spotlight is on everything that describes the economy (banks, markets, etc.), which becomes something to be wary, incomprehensible that we must look with suspicion and stay away from it. All the information, especially on more accessible media is often misleading. So, for example, weather forecasts instead of explaining the climatic phenomena they resemble real war bulletins. It is rarely that anyone tries to explain the physiology of something important without creating additional apprehensions on top of the daily fears of human existence. Information is often focused on contingencies. Nothing puts the common person in a position to understand and have a whole picture of things. This is the task that I am facing, albeit briefly, and therefore with the inevitable simplifications, regarding the topic assigned for this panel discussion.

Financial assets are the normal allocation of savings. Everyone keeps track of their savings kept in the pockets or in the most secret drawers. We are referring to cash, bank accounts, government bonds, stocks, mutual funds, insurance policies and many other things having weird names, sometimes incomprehensible. Well, without financial assets and therefore with no banks and other intermediaries, the economy could not survive. Financial assets are the instruments in which flow the surplus or savings of individuals who spend less than what they earn. Financial assets are also the instruments in which those who spend more than they earn, such as countries and businesses in deficit, draw resources.

Without banks, small amounts of savings and those geographically distant from the centres of expenditure would remain unused and the investment savings circuit could not be closed. Banks have the ability of offering products both acceptable to savers and investors. The savers want security, liquidity, a minimum return (now close to zero) while the investors want financial resources for longer times possibly at low cost. The banks allow all of this. Without them, and without the support of the markets, under which traders can liquidate, sell or invest in financial assets, the economic system could not function.

There is an interest that stock prices move gradually and without shocks. In fact, the regulations establish that the stock market prices are formed with strong mechanisms that leave very little room to speculation and that the securities involved in unclear activities are suspended and then reinstated and so on. The stock market price is defined in a transparent manner so that the purchase orders are matched to sale orders of equivalent price or better (lower) and those sale order to purchase orders of equivalent price or better (higher). In other words, in the stock market, buyers get the purchase price or a better price (lower) and sellers get the offering price or a higher one.

These remarks may help to understand that banks and markets are indispensable tools. Their correct functioning is somewhat of a public interest, which needs to be supported by policies to ensure their stability and efficiency. So, there is nothing outrageous in government's behaviour trying to protect the system and somehow save the banks, which, in turn, have financed the states fuelling a non-virtuous cycle. But it is here that some problems mainly related to Europe might arise.

Banks have gradually filled their balance sheet with government securities. This operation has reduced the margins of normal banking operations. In practice both at the European level but especially at the Italian level, the influence of each country in the economy is really getting too heavy. Each government takes care of health, education, transport, defence and many other things but usually does so with great use of resources. It was then established that the massive increase of government bonds has saturated the space (since there is no adequate amount of savings) for loans and therefore to finance productive activities. Existing receivables have become uncollectible for the main part. Banks, which are considered to be the mirror of the economy, are no longer under the operating conditions to provide further lending. This is due to both a lack of fresh resources (flows of new savings were in fact depleted) and because banks do not see, in the future, adequate economic advantages. The system goes into crisis.

The first type of crisis is the liquidity one. The deterioration of liquidity conditions has put a strain on the system of payments. To avoid consequences, undoubtedly dramatic, central banks had to intervene with massive purchases of government bonds putting a lot more cash in the system.

Meanwhile, in addition to traditional financial instruments new categories of financial assets of the derivatives type have been gradually introduced in the financial system. Derivatives are like knives, if handled with care, are very useful, but handled improperly, can cause serious damage. Derivatives are born with insurance purposes and their value depends on other underlying financial instruments. Meanwhile some categories of financial derivative instruments were developed and transformed and made them similar to betting. Within a very short time period these tools allow very high rewards or completely deplete their original value. There is nothing wrong if buyers are aware of what they are doing. Although it is a different story if buyers are not aware of the high risks they are exposed. I note that the majority of savers are not aware that in finance it is possible to achieve higher yields only exposing themselves to higher risks. Whoever claims otherwise, does not know enough or is not in good faith. The markets represent the benchmark (a kind of average limit) and if anyone can do better than average someone else will do worse.

Derivatives which are called futures, swaps, cap, floor, options, forward rate agreements, CDS, and so on and so forth, can certainly contribute to make the financial system even more unstable. There is no doubt that the increasingly circulation of derivatives has considerably intensified market volatility. It is hardly necessary to observe that this circumstance discourages the creation of savings, the demand for consumer goods and investment decisions, which are the main driver of economic development.

In the last few years resulted in a decisive dominance of finance on real economy. The amount of financial assets is no longer tied up, as it would be prudent, to the real economy (GDP, national income and so on) but it has increased regardless of economic growth.

In these conditions the instability of all types arises in our horizons. The prices go crazy (in the sense that fluctuate noticeably in both directions, see the oil and other commodities). The volatility rules, the markets are dominated by nervousness and consequently expand the margins for trading in derivatives and speculation in general. Volatility is the key for any bets so the economic outlook remains uncertain and promote further recession.

A context of political instability, especially in our country, is added to all of this. The markets have doubts about the quality of the government. In the market's eye, they appear shortsighted and too attracted by the political power. Markets are aware that politicians in office are particularly committed to leave a sign of their mandate endorsing or approving rough and sometimes very costly reforms for the financial public system. This means more income tax, more real estate taxes and more sales taxes. Rushed decisions and reforms that are born overnight, that last very little and whose effects are often devastating. Classic example of what is being said is the long series of reforms in the tax law recently occurred over time.

It is important to observe that the markets conditions are a direct result of political uncertainty that does not create a reassuring institutional environment to support investment and starting of businesses. In the current environment, the yields of the main categories of financial assets (bonds and shares) are determined by the expansive monetary policy and not by the growth of real economy. Following this, bond yields are shrinking and the liquidity injected into the system offers opportunity to the equity markets to rise.

The European context is, in any case, strongly influenced by an organisational structure that, as mentioned above, seeks to protect the right to public health, pensions, education, transport and in general to protect the weakest social class. Consequently, the stimulation of investment could be the indirect justification of a gradual withdrawal of the government presence in social protection. The lack of attention to the latter condition is in fact very common in countries with a high rate of development as China, Korea, India and so on, which are sometimes improperly considered as possible benchmarks. These countries are, however, notoriously and on average, less careful to the quality standards of the living conditions of their populations because they concentrate their efforts on specific production targets and growth.

It is inevitable, however, that in an environment of lacking resources, the recovery and support of investments, is more difficult to go along with the social protection of the weakest class. In these economic trends is more essential than ever to rethink economic arrangements in a strictly ethical sense by taking as reference the unique social and economic structure of the most advanced countries such as Scandinavia, Canada and Australia.

Using football terms, many of us feel coaches of the economy. Too often, however, the structures that you hope for the recovery crush with the rights of the weakest parts. The only room for manoeuvre available to us is therefore the rationalisation of public spending which means strict control of the excessive and unproductive one. Then it becomes very important the elimination of waste, the control of widespread unruliness and corruption and the continuation of the most basic forms of social protections. Every drop of public expenditure must still be used with extreme caution, with absolute sparingly, solely in the interest of the ones who deserve it. If there is a way to support forms of investment this will be necessary directed to areas that identify our excellence (tourism, culture, environment, fashion, special products and so on). We must stay away from choices that are not compatible with our traditions or to approach trends that inevitably will use inefficiently, resources and energy.

Only giving the economy ethical values you can make the most appropriate decisions to create a growth path that is clean, linear and powered by wise basic choices that have nothing to do with speculation, destruction of the territory or depletion of opportunities.

The basic problem is that, unfortunately, in this country it is hard to put in place a mechanism of selection of the public managers that puts, who is more capable, who can effectively evaluate close and far effect of decisions, who is more balanced, who has ethical and moral values and especially those who are more honest, able to assume managerial positions. Inevitably too many opportunities and different positions in public management remain available to those who does not find adequate paths to support forms of sustainable development.