Economic Horizons, May - August 2013, Volume 15, Number 2, 177 - 179
UDC: 33 eISSN 2217-9232

Book review
UDC: 336.71/.76(049.32)
doi: 10.5937/ekonhor1302173S

MONEY, BANKING, AND FINANCIAL MARKETS

Cecchetti, S. G., & Schoenholtz, K. L. (2011). (The 3rd Edition) New York, NY: McGraw-Hill Education, ISBN 978-0-07-122068-2, 673

Dragan Stojkovic*
Faculty of Economics, University of Kragujevac, Kragujevac, Serbia

In their book titled: *Money, Banking, and Financial Markets,* authors Stephen G. Cecchetti (an economic advisor and the chairman of the Monetary and Economic Department at the Bank for International Settlements), and Kermit L. Schoenholtz (a professor of New York University, the Economic Department of the Leonard N. Stern School of Business), clearly and substantially showed the basic elements of the financial system and investigated the key effects it has on a broader social community.

The purpose of the book is to make the reader familiar with the principles which the financial market is based on and according to which it functions in contemporary conditions. More importantly, it demonstrates the way of the application of the essential principles of money and banking when creating financial and economic arrangements. It is characterized by a large number of examples presented in a contrived way and in detail so that it can be said to be intended for a wide variety of readers, students in particular.

Having in view a broad spectrum of the topics elaborated in the book, the authors structured it into five wholes providing answers to the following important questions:

- What is money and how is it used?
- What is a financial instrument and how is it valued?
- What is a financial market and how does it operate?
- What is a financial institution and why do we need one? and
- What is a central bank and how does it function?

The first part of the book is titled *Money and the Financial System* (pp. 43-110) and consists of the three chapters (Chapters 1, 2 and 3). The first chapter opens with a discussion on the basic elements of the financial system and highlights the fact that the financial system consists of money, financial instruments, financial markets, financial institutions, regulatory agencies and a central bank. Within this chapter, the authors also point out the five important principles of money and banking which run through as the basis from the beginning to the end of the book; these are: time has a value, a risk requires compensation, information is key when making a decision, a market determines prices and the allocation of resources and a stable improvement of welfare. The second chapter analyzes money, both in theory and in practice. In order to understand the essence of the function of money in a national economy, a shorter analysis has been

* *Correspondence to:* D. Stojkovic, Faculty of Economics, University of Kragujevac, Dj. Pucara 3, 34000 Kragujevac, Serbia; e-mail: dstojkovic@kg.ac.rs

carried out of its characteristics and its contemporary definition has been provided. At the beginning of the third chapter, there is an analysis of the utilization of financial instruments. Their characteristics and evaluation are discussed. This chapter also discusses the role and structure of financial markets and financial institutions.

In the second part of the book, titled *Interest Rates, Financial Instruments and Financial Markets* (pp. 111-298), there is a detailed description of financial instruments and the financial theory needed to understand them. There are seven chapters (Chapters 4, 5, 6, 7, 8, 9 and 10). The fourth chapter begins with an explanation of a future and the current value accompanied by a discussion on interest rates. The fifth chapter contributes to a better understanding of risks. Within this chapter, the definition, measurement, types and sources of risks are considered. Then, in the next five chapters, there are specific discussions on bonds, stocks, derivatives and foreign exchange, supported by a plethora of examples extremely important for the reader to understand them. In the eighth chapter, for example, stock balloons are analyzed and the influence of the stock-exchange anomalies on an economy is investigated. In the tenth chapter, the Big Mac index is presented in the function of the better understanding of the concept of the parity of the purchasing power. From the beginning to the end of the second part of the book, the two ideas have been emphasized: financial instruments enable a transfer of funds from the depositor to the investor, and financial instruments enable a transfer of risk to those who can best cope with such risk.

In the third part of the book, titled *Financial Institutions* (pp. 299-412), the focus of the research is redirected onto financial institutions. This part consists of the four chapters (Chapters 11, 12, 13 and 14). The eleventh chapter includes an economic theory based on the understanding of the role of financial mediators. Through a series of examples, the reader becomes aware of the problems having occurred due to asymmetrical information, as well as of the possibilities of having them solved by financial mediators. In the remaining chapters of the third part of the book, an effort is made to translate theory into practice. The twelfth chapter accounts for a detailed discussion on banking, balance sheets of banks and risks banks are faced with in their operations. The thirteenth chapter provides the reader with a brief outline of the structure of the finance industry, while the fourteenth chapter explains the regulation of the finance sector including a discussion on the regulation of the limitations threatening the financial system as a whole.

The fourth part of the book, titled *The Central Bank, Monetary Policy and Financial Stability* (pp. 413-556), through Chapters 15, 16, 17, 18 and 19, there is an overview of what central banks do and how they work. In this chapter, the methodology of creating and withdrawing money as the basic factor of the achievement of a monetary balance as a condition to achieve the stable functioning of an economy and prosperity in all the spheres of social life. At the beginning of this part of the book, there is a discussion on the role and goals of central banks leading to the principles indicative of how a central bank should be designed. In the sixteenth chapter, those principles are applied to the Federal Reserve and the European Central Bank. The seventeenth chapter shows the balance sheet of the central bank, the process of multiplying deposits and offer of money. The eighteenth and nineteenth chapters encompass the policy of the central bank based on controlling interest rates and the foreign exchange rate. The eighteenth chapter also includes the monetary transmission mechanism and reveals a plethora of unconventional means of monetary policy which became more significant during the financial crisis in the 2007-2009 period. The fourth part is aimed at providing knowledge necessary to understand the present and future changes in the structure of the central bank.

The fifth part of the book is titled *Modern Monetary Economics* (pp. 557-670). It consists of the four chapters (Chapters 20, 21, 22 and 23). This interesting field has been dealt with by numerous authors; however, in this book, the accent is put on essential lessons. The twentieth chapter encompasses a research of the relations between an inflation rate and a monetary growth rate. The twenty-first chapter provides the reader with a complete macroeconomic model indicating short- and long-term effects of a monetary policy, whereas in the last two chapters, the model is used in order to understand the sources of the creation of business cycles and the manners of overcoming them.

On the basis of this review, it can be concluded that the book *Money, Banking, and Financial Markets,* coherently and in a scientifically reasoned manner treats relevant themes from within the field of monetary finance, operating in financial markets and stock exchanges, so it can undoubtedly be useful not only to students but also to all those engaged in the respective problem areas.

Received on 15th July 2013,
after revision,
accepted for publication on 26th August 2013

Dragan Stojkovic is a teaching assistant at the Faculty of Economics of the University of Kragujevac, and teaches the Basics of Stock-Exchange Business and Financial Mediators subjects. He is a PhD student at the Faculty of Economics of the University of Kragujevac. Stock-exchange business is his main field of scientific research.