Ch 13 and some of 14 Money and financial institutions

I. **Money**

a. Money is what money does

b. ***Three functions***

i. Medium of exchange (see qualities 'd')
ii. Store of value (see 'e')
iii. Measure of value (see 'f')

c. Historically, Money has been

i. Wampum (Native American money)
ii. Gold
iii. Silver
iv. Copper

d. *Qualities money should have*:

i. Stability: Value remain similar day to day
ii. Portability: Light enough to carry
iii. Durability: Reasonable life expectancy of material
iv. Uniformity: Equal denominations have equal value
v. Divisibility: Able to divide into parts
vi. Recognizability: Hard to counterfeit\

e. People should be able to save money with the expectation that it will still have a similar value later

f. Money should allow us to set a value on a product in terms everyone can understand

II. **Money Supply**

a. Total amount of money in circulation in a country at a given time

b. Measurement of Money supply

i. M1

1. **Currency** (cash)
2. Traveler's checks
3. Demand Deposits (common checking accounts)
4. Other checkable deposits (Commercial banks, savings and loans, credit unions, etc)

ii. M2

1. All of M1
2. Savings accounts (under $100,000)
3. Money market accounts
4. CD's
5. Other easily liquidated assets

iii. M3

1. All of M1 and M2
2. Large-denomination savings accounts (over $100,000)
3. Large CD's (over $100,000)

c. Most of the money supply is electronically stored

III. Banking

a. **Bank**: Financial institution that accepts demand deposits and makes commercial loans

b. Savings and Loans, Savings Banks, and Credit Unions only deal with consumers (not commercial businesses) and are called **Thrift Institutions**

c. *Offer services*:

i. Accepting and holding deposits (insured up to $100,000)
ii. Making loans
iii. Collecting and transferring funds

d. **Fractional reserve Banking:** Banking practice that takes in deposits and loans out a portion of the deposits in the form of loans

e. **Reserves**: Banks required to keep a portion of deposits on hand (do not loan out)

f. **Reserve Ratio**: Amount banks required to keep expressed as a percentage of total deposits

g. Banks, through loans, can *create money*

i. When people take out a loan, the bank 'creates' the money and gives it to the person

        ii. The money in the loan is used by borrower and added to the money supply through M1
    h. Deposits and loans can multiply the money supply many times
        i. **Deposit Multiplier**: Each deposit and loan creates more money: What is not part of the Reserve Ratio is loaned out, thus adding to the money supply
        ii. The deposit Multiplier is: 100 divided by the reserve ratio
        iii. If reserve ration is 20 %, the deposit multiplier is 5 (100/20=5)
    i. Money supply is reduced in the same manner (next chapter…)

IV. Federal Reserve System (FED)

    a. The FED is the nation's central bank
        i. *Responsibilities include issuing paper currency*
        ii. *Collecting and clearing checks*
        iii. *Holding the banking system's reserves*
        iv. *Regulating the money supply*
        v. *Supervising and regulating the banking industry*
    b. 12 Banks

V. Value of Money

    a. **Purchasing power** = value of money
    b. Inflation and deflation is the adjusting of the value of money
        i. *Inflation = value of dollar decreases (prices up)*
        ii. *Deflation = value of dollar increases (prices down)*
    c. **Demand-pull inflation**
        i. Demand for goods/services increases faster than ability to satisfy demand cause increase in prices
        ii. Example: war time causes nation's resources to shift to war machines and the production of everyday goods decreases; the demand for goods remains, but production is slowed
    d. **Cost-push inflation**
        i. Increase in cost of production causes increase in prices
        ii. Caused by:
            1. Increase in cost of raw materials (ex: OPEC crisis)
            2. **Wage-price spiral** – labor unions increase wages that outpace productivity – prices raised to make up cost (results in increase in cost of living, thus more wages demanded, thus higher prices, and so on – this is called an **inflationary spiral)**
            3. **Price-Wage spiral** – Businesses, ignoring competition, increase prices. This triggers demand for wage increases and begins another spiral.
    e. *Those who suffer from inflation the most*
        i. *People on relatively fixed incomes (retired people)*
        ii. *Savers (investments with fixed interest rates that do not match inflation)*
        iii. *Lenders (loans with fixed rates)*
        iv. *Business firms (uncertainty makes prediction difficult)*
    f. *Those who benefit*
        i. *Those who can increase income (use times of inflation to increase cost more than inflation rate: ex: jewelers)*
        ii. *Borrowers (take out fixed loans at low rates!)*
        iii. *Government (Taxes increase as income increases: more people in higher tax brackets – called* **Bracket creep)**