

Topic 15 – Money and Banking

I. Money

1. Definition

Money is any asset that is regularly used as a _____ .

Commodity Money

Fiat Money

2. Uses of Money

- Medium of Exchange

- Unit of Account

- Store of Value

3. How Much Money Exists in the Economy?

Liquidity: The ease with which an asset can be converted into an economy's primary

_____ .

More Liquid

Less Liquid



Measuring the Money Supply:

M1

M2

M3...

Where's all the cash?

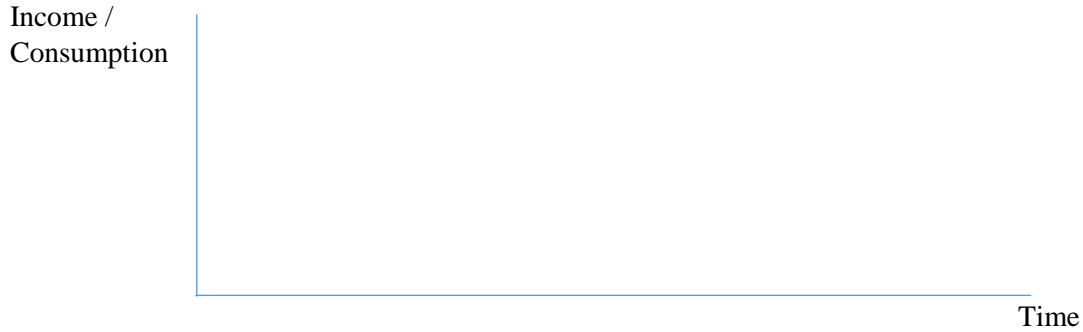
II. Banking

Big Question – How does the Financial System Work?

1. Banks as Financial Intermediaries

Fractional Reserve Banking System:
Banks hold _____ of deposits in reserve, loaning out rest.

2. Saving and Borrowing



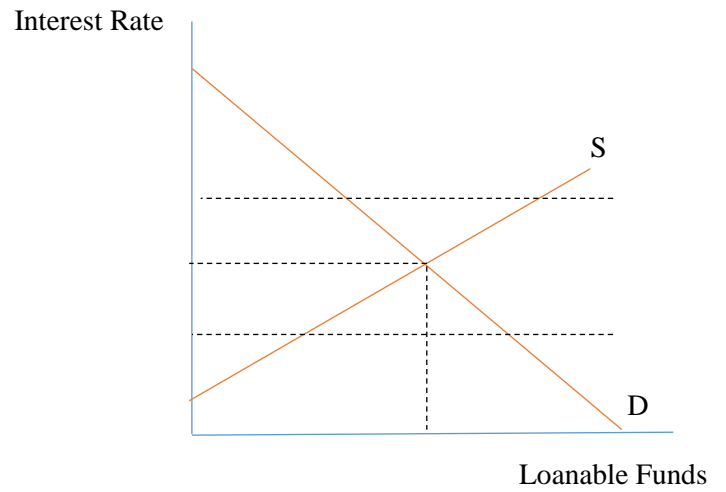
3. Market for Loanable Funds

Price

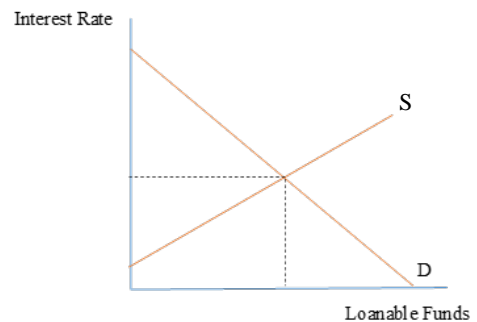
Demand

Supply

Efficiency



Example: What do you expect to happen to interest rates as baby boomers retire?



4. The Federal Reserve Bank

Example: Suppose you printed up \$1,000 in new currency in your basement and deposit it in the bank. If the reserve ratio is 10%, how much new money will be created as a result?

Deposits:Reserves:Loanable Funds:

New Money =

$$\text{Money Multiplier} = \frac{1}{rr}$$

$$\Delta MS = MM \cdot \Delta \text{Deposits}$$

Example: Suppose your friend decided it would be cool to burn some money. (Note this is illegal.) She sets a \$100 bill on fire. If the reserve ratio is 5%, how much money will be destroyed as a result?

VI. What Determines the Value of Money?

1. A Brief History of the International Monetary System

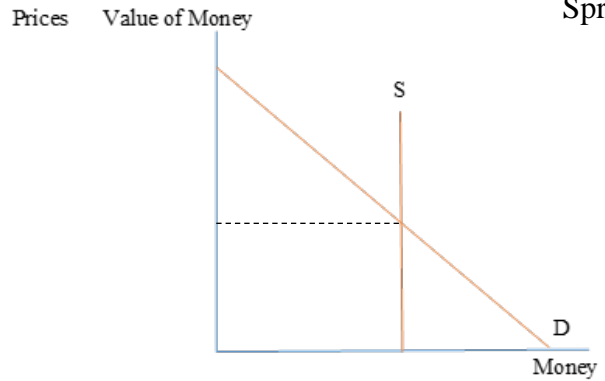
Gold Standard:

Bretton Woods System:

Today's System:

2. Money Supply and Money Demand

Supply of Money



Demand for Money

What shifts Money Demand?

-
-
-

3. How does the Federal Reserve Impact Money Supply?

i. Classic Tools

-
-
-

ii. New Tools (Since 2008)

-
-
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iii. Interest Rate Targeting

Bonus Question: Why is the price of Bitcoin so volatile?

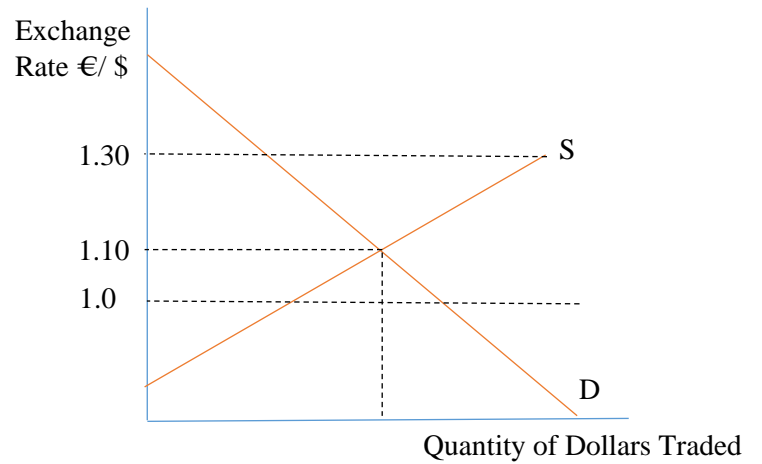
VII. Exchange Rates

Floating Exchange Rates

Sources of Demand for US Currency

-
-
-

Currency Appreciation vs. Depreciation



VIII. Inflation

1. Causes

Quantity Theory of Money:

$$M \times V = P \times Y$$

M –

P –

V –

Y –

Changes in the average price level are caused by changes in _____.

2. Theory of Money Neutrality

3. Short-Term Costs of Inflation

i. Shoe Leather Costs

ii. Menu Costs

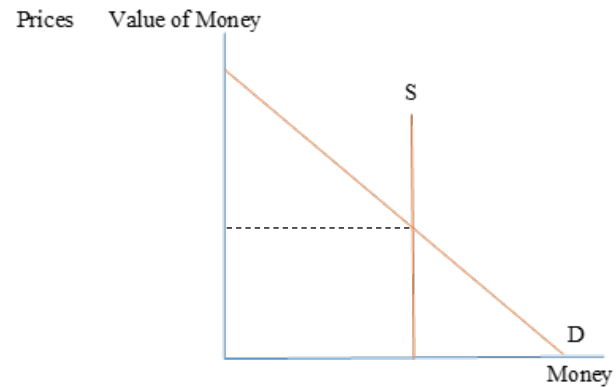
iii. Tax Distortions

iv. Confusion / Relative Price Variability

v. Redistribution of wealth between savers and borrowers

IX. Hyperinflation

1. Definition: Inflation rates exceeding _____ .
2. Cause



3. Example: Venezuela

VI. Assignments

1. Video Assignment due on 11/19/19
2. Problem Set 15 due on Brightspace 11/20/19