

CHAPTER
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Functions of Money

What Backs the
Money Supply

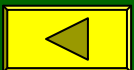
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Money and Banking

FUNCTIONS OF MONEY

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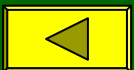
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- Medium of Exchange
- Unit of Account
- Store of Value

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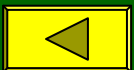
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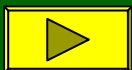
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MONEY SUPPLY



Definition...

Currency

- *Token Money*
- *Federal Reserve Notes*
- *Intrinsic Value*



Checkable Deposits

- *Commercial Banks*
- *Thrift Institutions*

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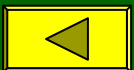
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MONEY SUPPLY

$$M2 = M1 \text{ Plus...}$$

Near-monies

Savings Deposits

- Money Market Deposit Accounts (MMDAs)

Smaller Time Deposits

Money Market Mutual Funds
(MMMFS)

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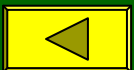
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MONEY SUPPLY

$$M3 = M2 \text{ Plus...}$$

Large Time Deposits

Illustrated...

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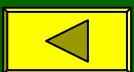
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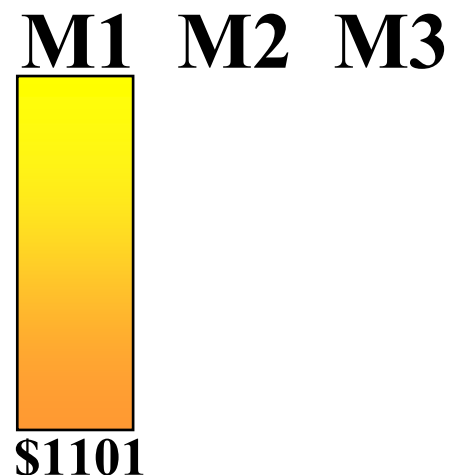
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MONEY SUPPLY

Currency (coins & paper money)
plus **Checkable deposits**
equals ***M1***



2000 Data
(billions of dollars)

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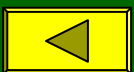
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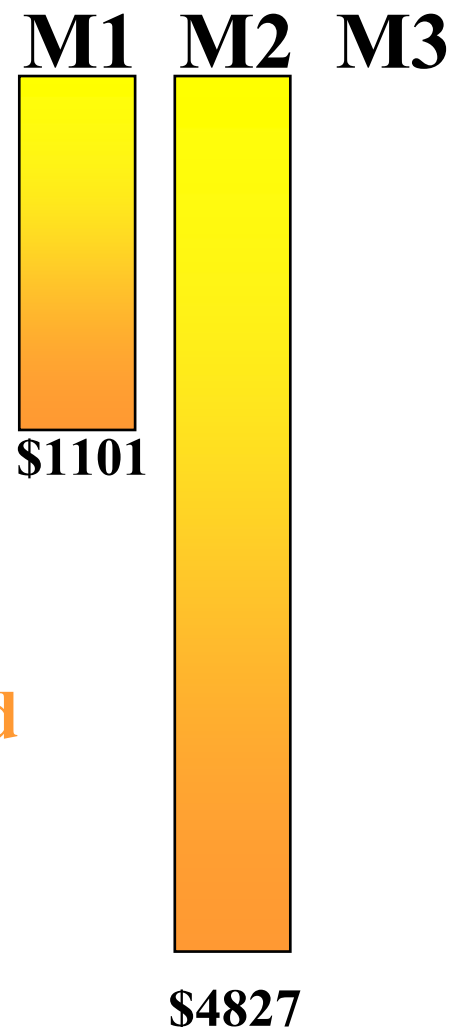


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MONEY SUPPLY

Currency (coins & paper money)
plus **Checkable deposits**
equals ***M1***

plus **Savings deposits,**
including **MMDA's**
plus **Small time deposits**
plus **Money market mutual fund**
(**MMMF**) balances
equals ***M2***



2000 Data
(billions of dollars)

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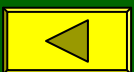
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MONEY SUPPLY

Currency (coins & paper money)

plus **Checkable deposits**

equals ***M1***

plus **Savings deposits,**

including **MMDA's**

plus **Small time deposits**

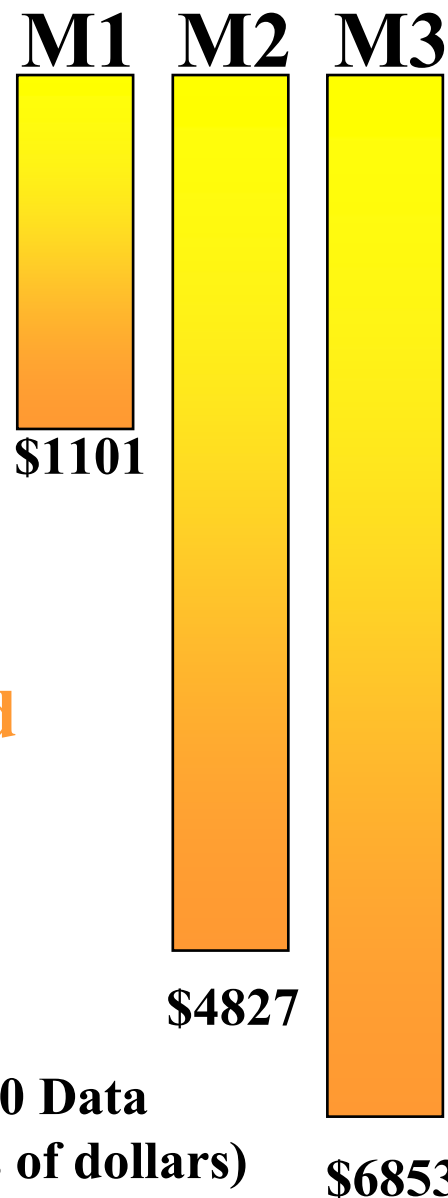
plus **Money market mutual fund**

(MMMMF) balances

equals ***M2***

plus **Large time deposits**

equals ***M3***



2000 Data
(billions of dollars)

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WHAT ABOUT CREDIT CARDS?

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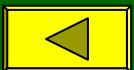
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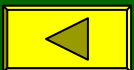
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WHAT BACKS THE MONEY SUPPLY?

Money as Debt

Value of Money

- Acceptability
- Legal Tender
- Relative Scarcity

Money and Prices

- Value of the Dollar
- $D = 1/\text{Price Level}$

Inflation and Acceptability

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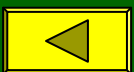
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WHAT BACKS THE MONEY SUPPLY?

*So, What Backs the
Money Supply?*

Stable Value!

through...

- **Appropriate Fiscal Policy**
- **Intelligent Management
of the Money Supply**

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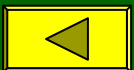
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THE DEMAND FOR MONEY

Transactions Demand, D_t
*varies directly with nominal
GDP*

Asset Demand, D_a



*varies inversely with the
interest rate*

illustrated...

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THE DEMAND FOR MONEY

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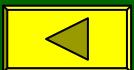
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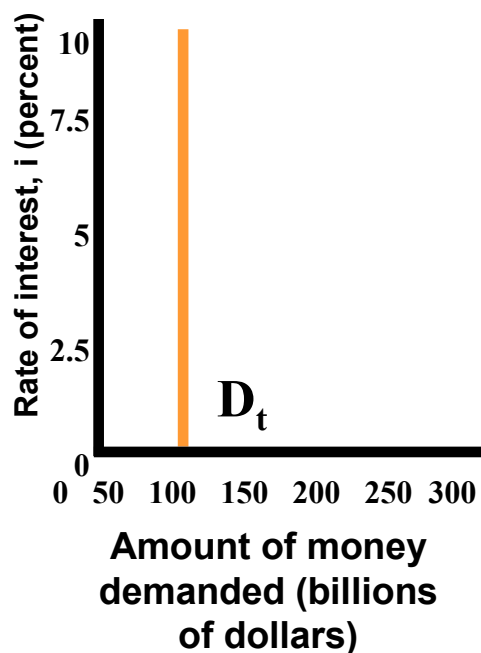
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Transactions
Demand, D_t +



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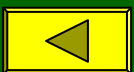
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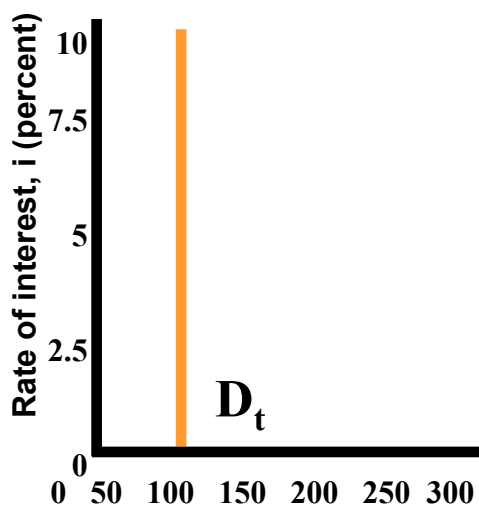
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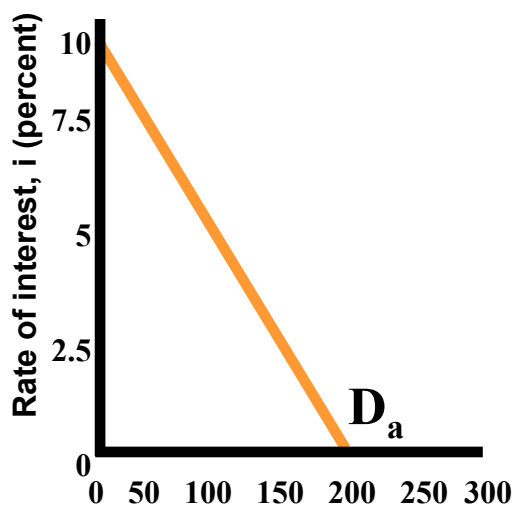


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$$\text{Transactions Demand, } D_t + \text{Asset Demand, } D_a =$$



Amount of money
demanded (billions
of dollars)



Amount of money
demanded (billions
of dollars)

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THE DEMAND FOR MONEY

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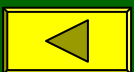
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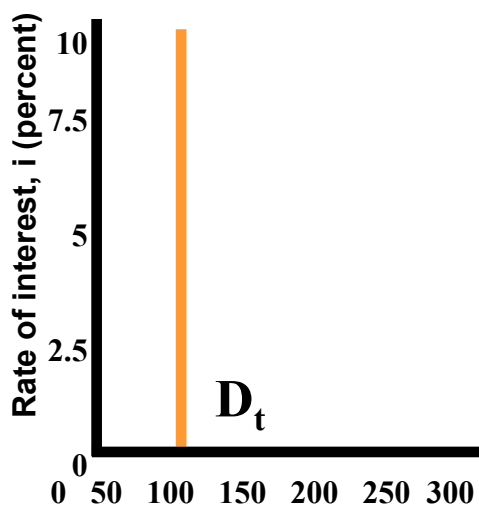
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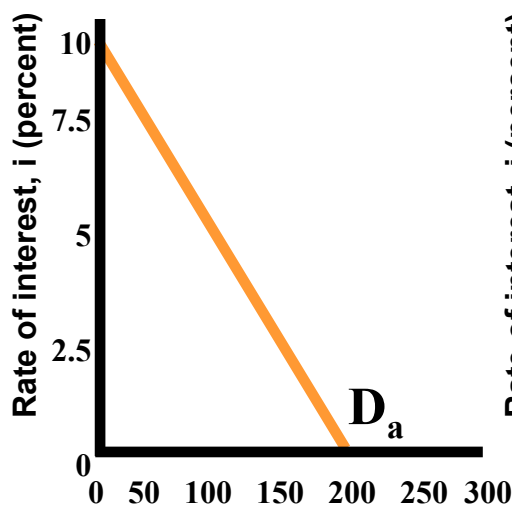


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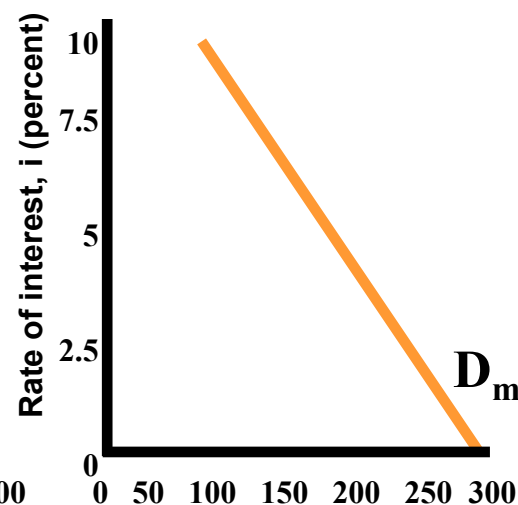
$$\text{Transactions Demand, } D_t + \text{Asset Demand, } D_a = \text{Total demand for money, } D_m$$



Amount of money
demanded (billions
of dollars)



Amount of money
demanded (billions
of dollars)



Amount of money
demanded (billions
of dollars)

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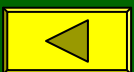
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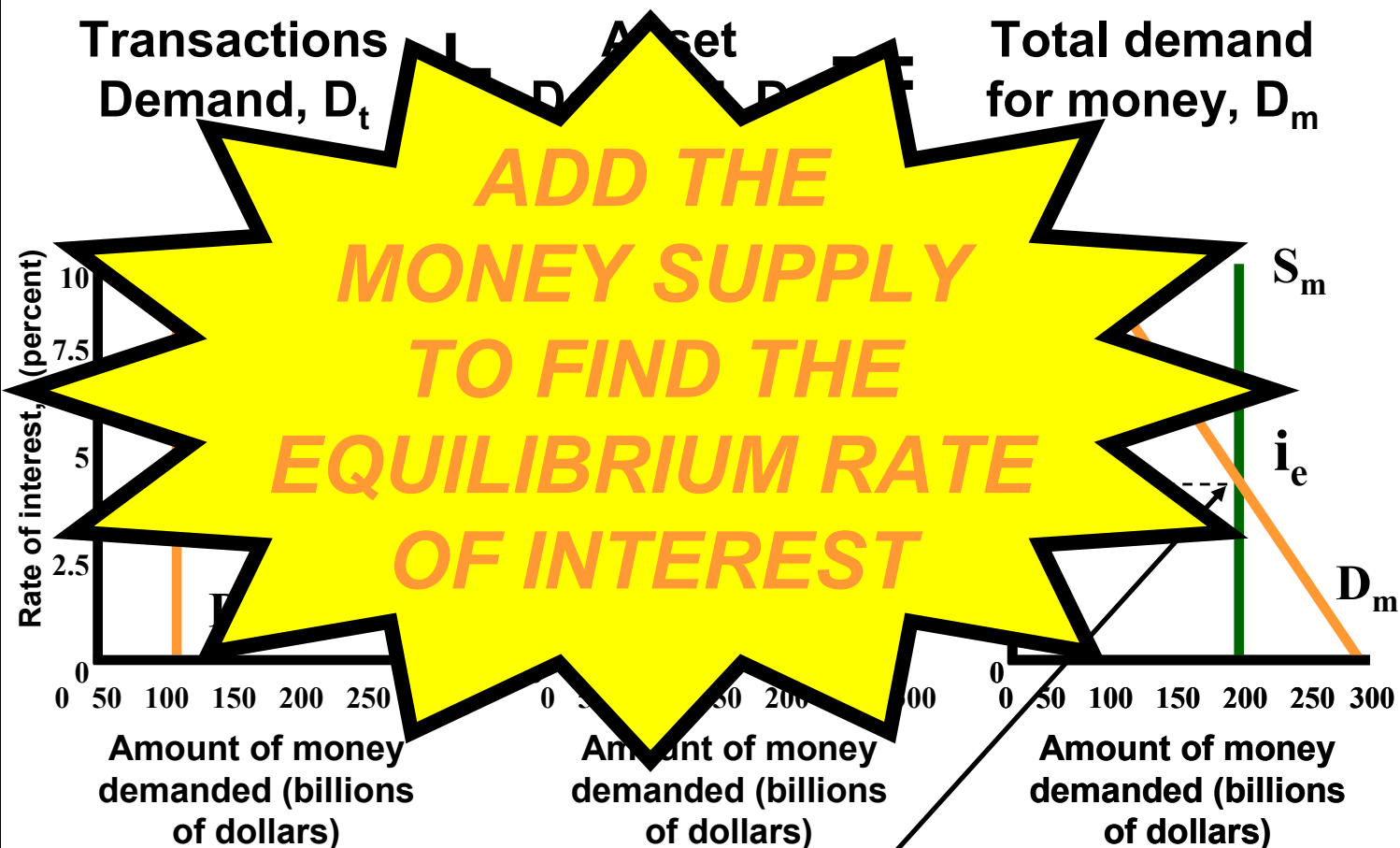
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Equilibrium Interest Rate

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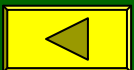
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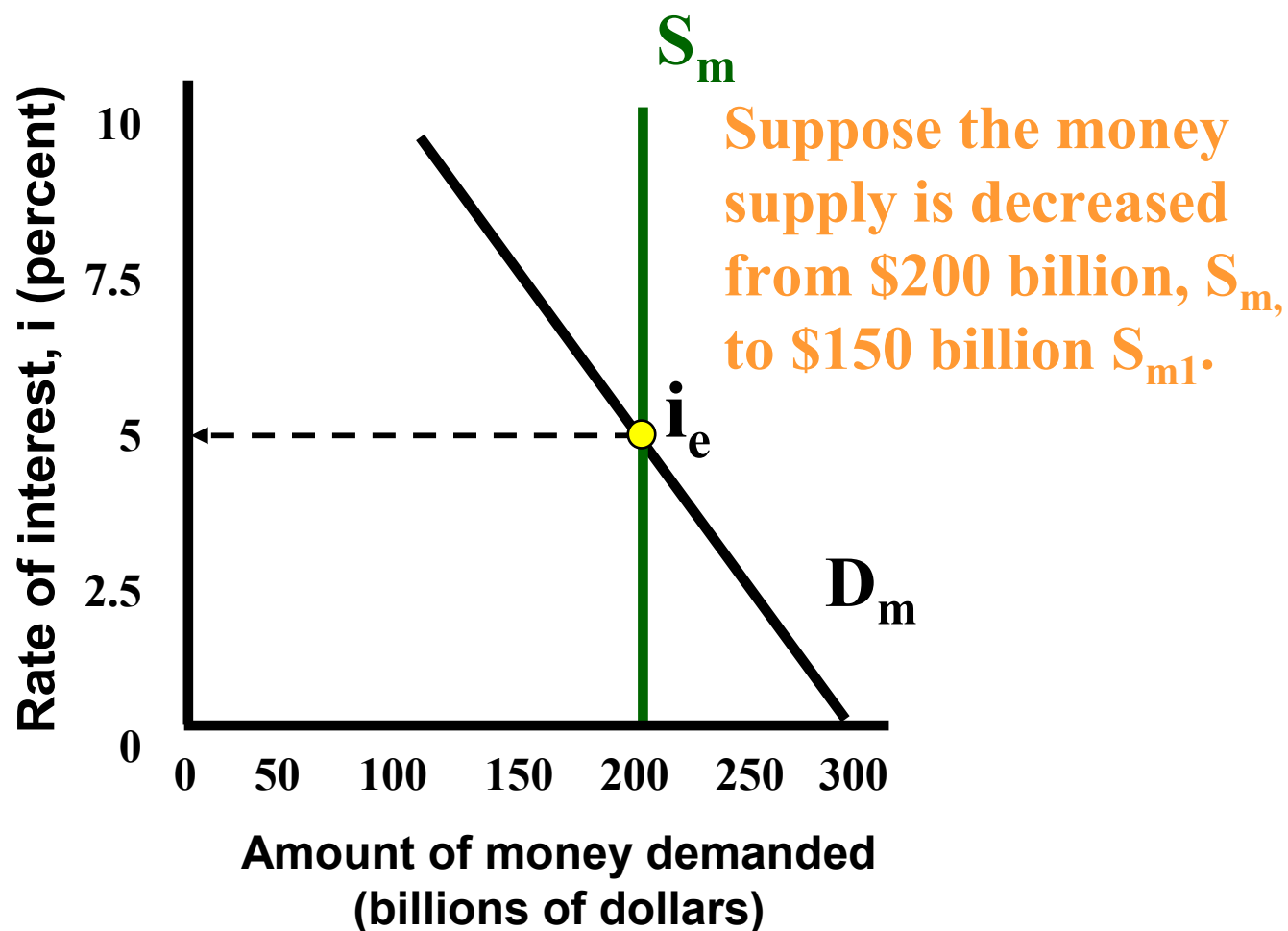
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THE MONEY MARKET



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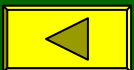
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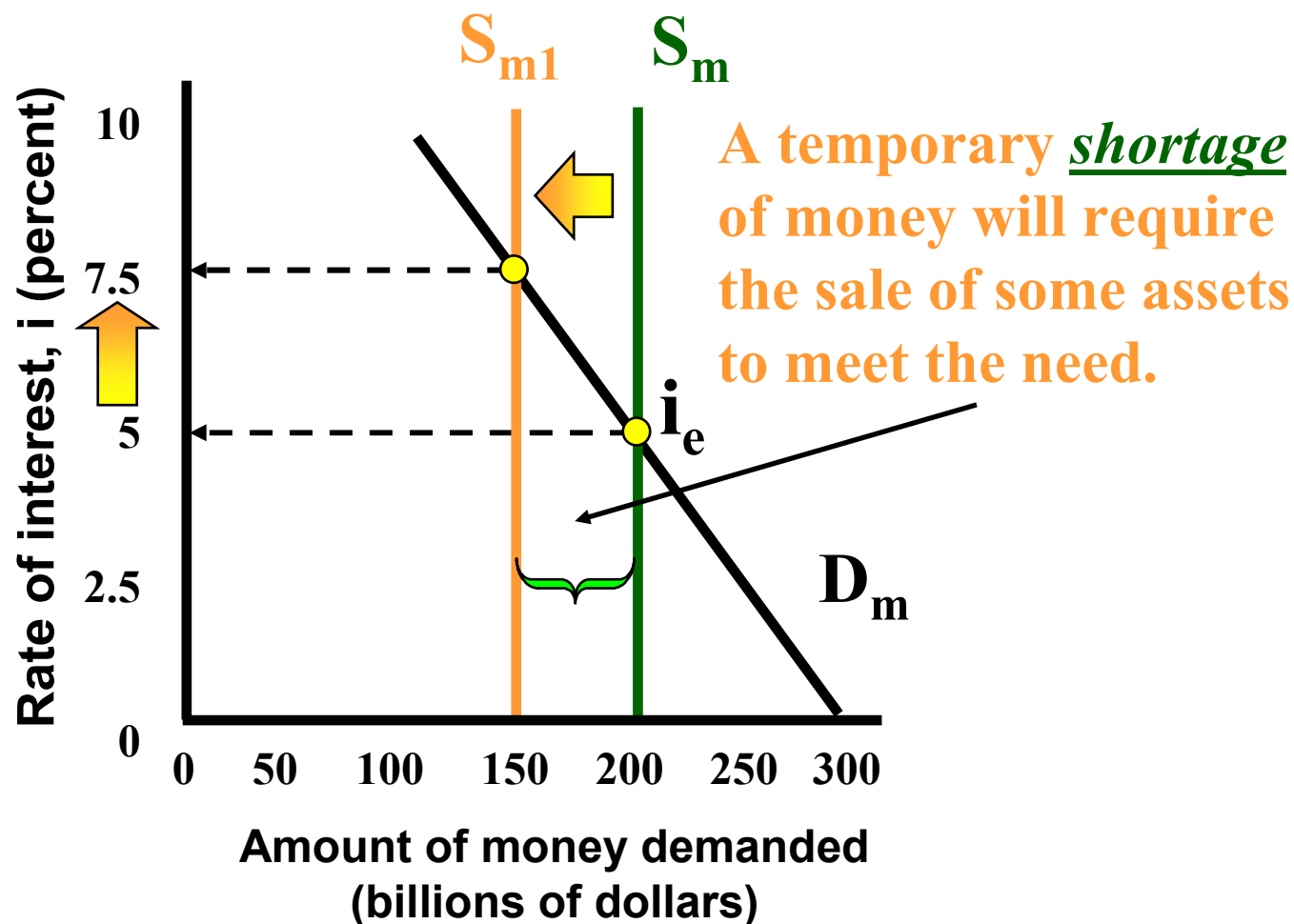
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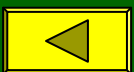
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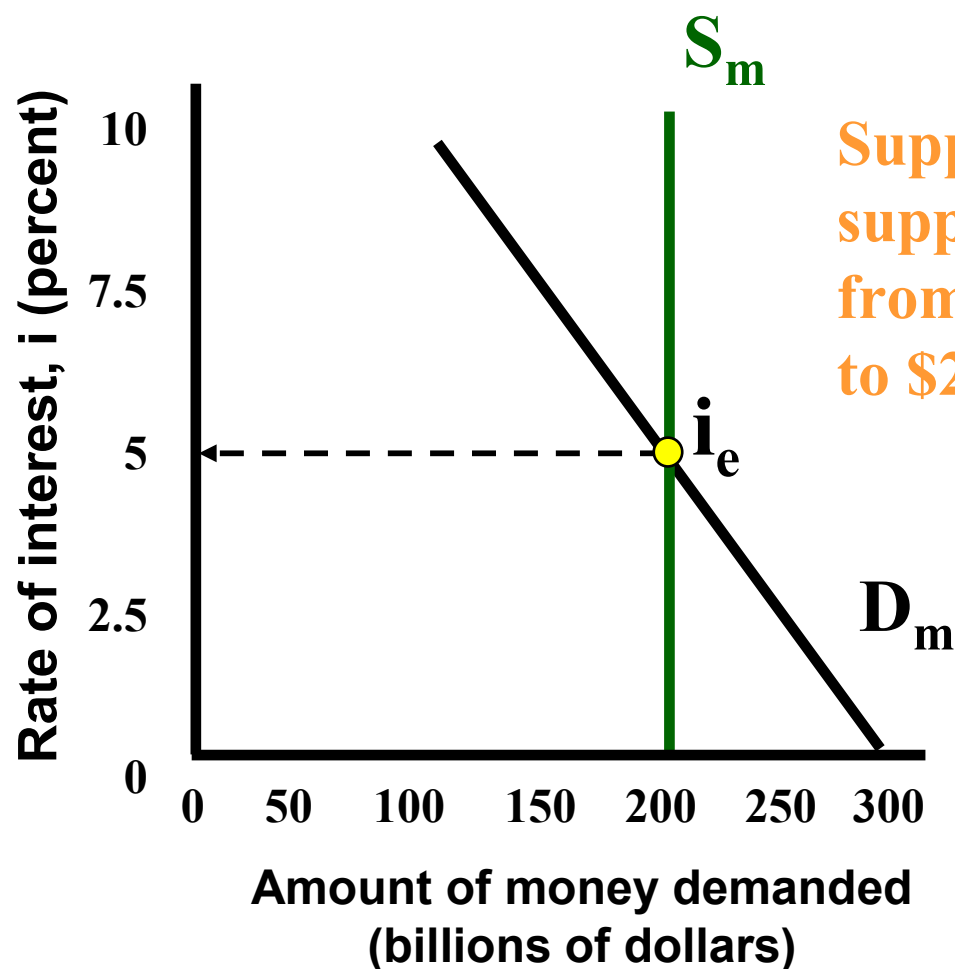
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THE MONEY MARKET



Suppose the money supply is increased from \$200 billion, S_m , to \$250 billion S_{m2} .

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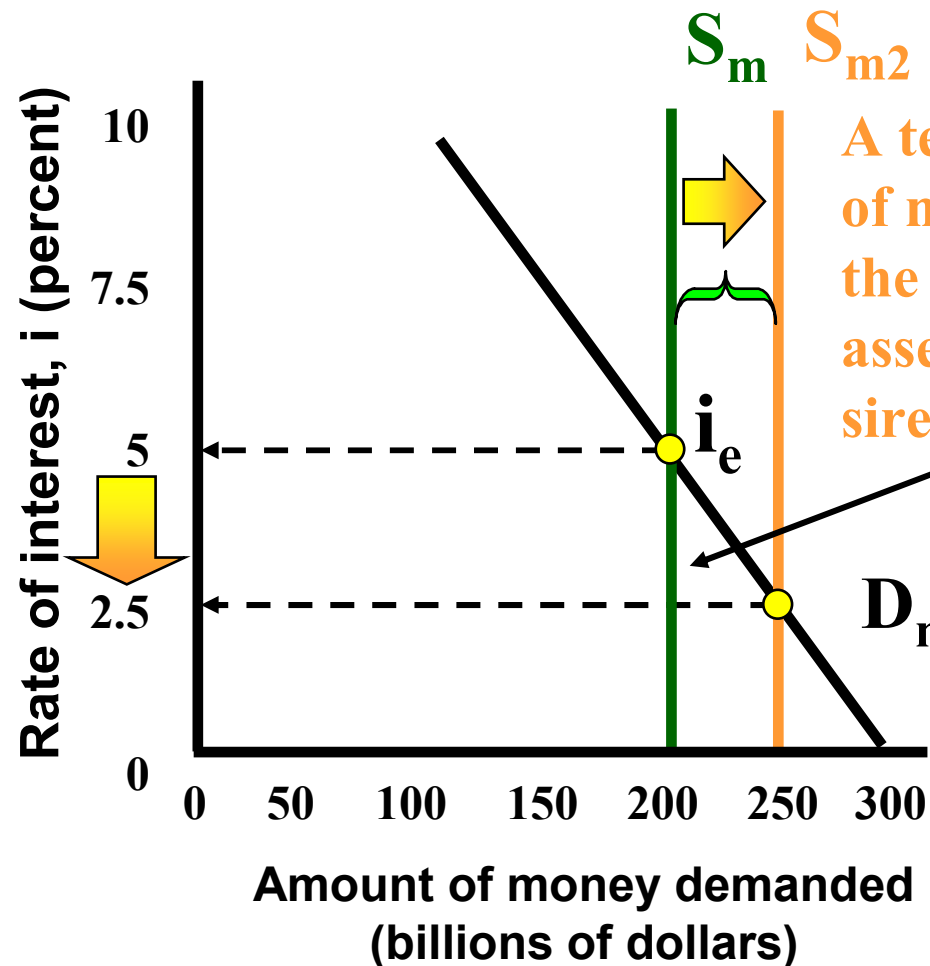
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THE MONEY MARKET



A temporary surplus of money will require the purchase of some assets to meet the desired level of liquidity.

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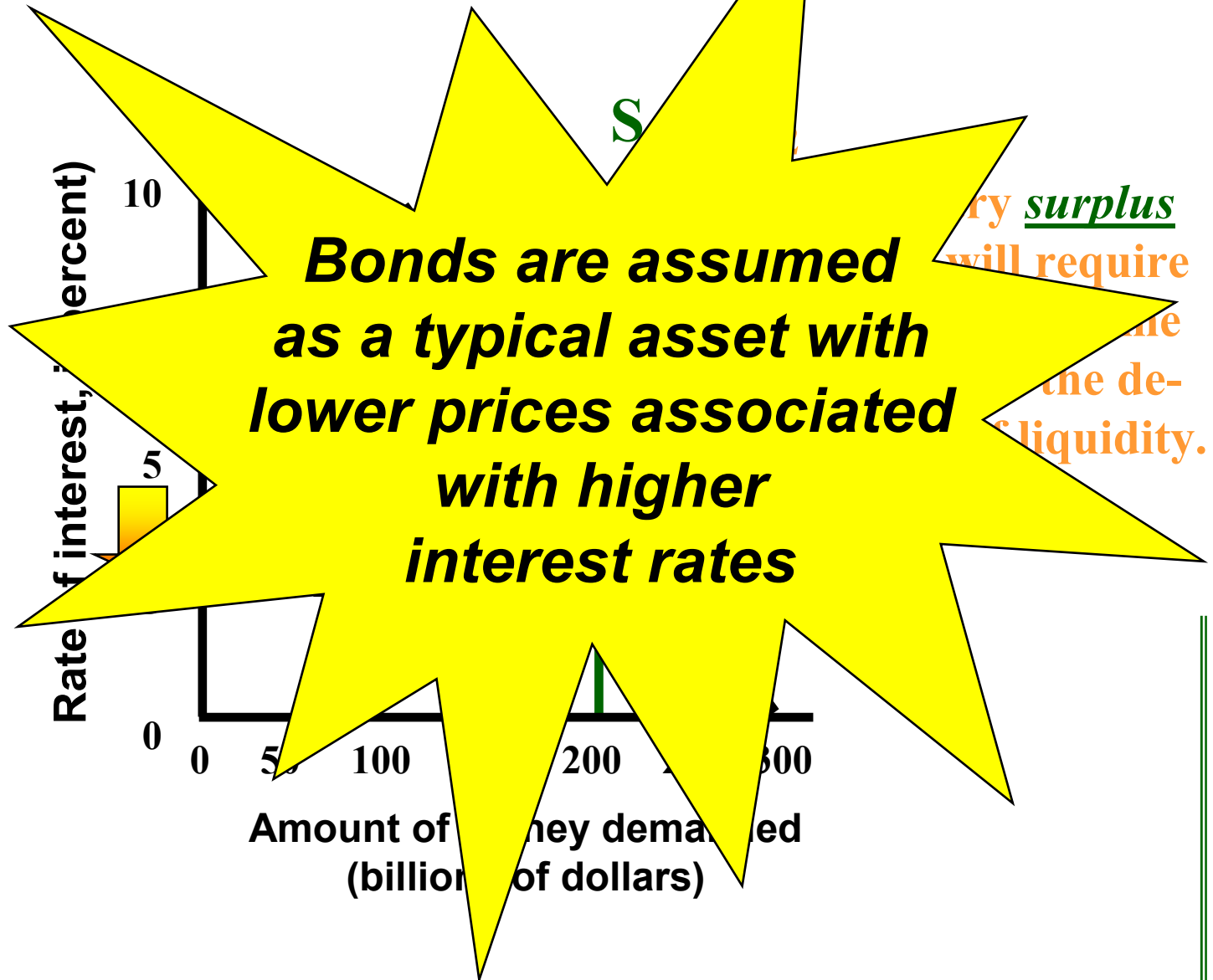
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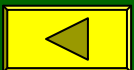
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THE FEDERAL RESERVE AND THE BANKING SYSTEM

Centralization and Public Control

- Board of Governors
- Assistance & Advice
 - Federal Open Market Committee
 - Three Advisory Councils
- The 12 Federal Reserve Banks
 - Central Bank Role
 - Quasi-Public Banks
 - Banker's Banks
- Commercial Banks & Thrifts

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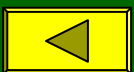
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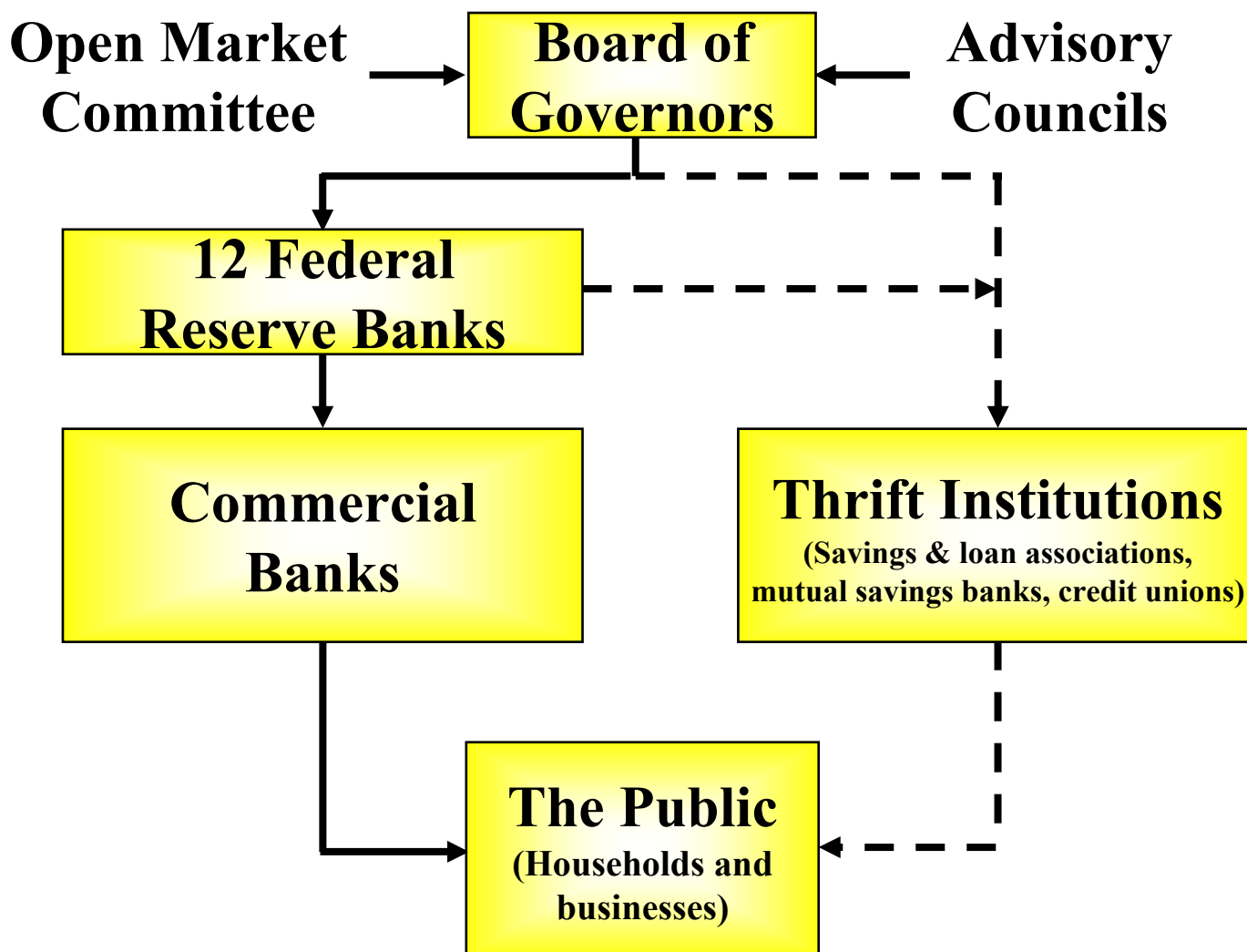
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THE FEDERAL RESERVE AND THE BANKING SYSTEM



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- Issuing Currency
- Setting Reserve Requirements & Holding Reserves
- Lending Money to Banks & Thrifts
- Providing for Check Collection
- Acting as Fiscal Agent
- Supervising Banks
- Controlling the Money Supply

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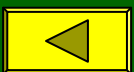
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FED Functions & the Money Supply

Federal Reserve Independence

Recent Developments

- Relative Decline of Banks and Thrifts
- Financial Services Industry
- Consolidation Among Banks and Thrifts
- Globalization of Financial Markets
- Electronic Transactions

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Federal Reserve Independence

Recent Developments

- Real ... and



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Conclusions

... banks and

• Organization of Financial Markets

- Electronic Transactions

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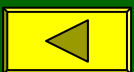
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KEY TERMS

medium of exchange

unit of account

store of value

M1, M2, M3

token money

Federal Reserve Notes

checkable deposits

commercial banks

thrift institutions

near-monies

savings account

money market deposit
account (MMDA)

time deposits

money market mutual fund
(MMMF)

legal tender

transactions demand

asset demand

total demand for money

money market

Federal Reserve System

Board of Governors

Federal Open Market
Committee (FOMC)

Federal Reserve Banks

financial services industry

electronic transactions

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Coming up next...

How Banks and Thrifts Create Money



Chapter 14