Econ 522, 02/13/2018

Monetary System

Functions of Money (what it does)

- <u>Medium of exchange</u> = use it to buy stuff

- <u>Store of value</u> = transfers purchasing power from the present to the future; money retains its value over time - you don't need to spend it all as soon as it's received

- <u>Unit of Account</u> = common unit by which everyone measures prices and values

Types of Money

- <u>Fiat Money</u> = no intrinsic value (ex: US currency)

- <u>Commodity Money</u> = has intrinsic value (ex: gold, silver, cigarettes in POW camps)

Money Measures

- Liquidity = ease of use in transactions

- Different measures of money are connected to liquidity

  - C = currency

  - M1 = currency + demand deposits + travelers' checks

  - M2 = M1 + money market + savings deposits + small-time deposits

  - M3 = M2 + large time deposits + repos + Eurodollars + institutional money market

- For money supply models:

  - M = C + D

  - *money supply = currency + deposits*

Controlling the Quantity of Money

- Money supply is the quantity of money available in the economy

- Monetary policy is control over the money supply

  - Conducted by a central bank

  - In the US, the central bank is the Federal Reserve

The Federal Reserve

- Conducts monetary policy.

- <u>Dual mandate</u> (policy goals)

  - Maximum employment + Price stability

- Other roles of the Fed

  - Serves as a bank for banks

  - Regulatory functions

  - Payment system

Federal Open Market Committee (FOMC)

- Meets about every 6 weeks to make monetary policy decisions

- Members are from the Board of Governors and a rotation of regional Federal Reserve Bank presidents

- Current Fed Chair: Jerome Powell

- Prior Chair: Janet Yellen

Monetary Policy Tools

- Open-market operations

- Discount window / lending operations

- Reserve ratio requirements

- Interest of reserves

Banking Systems

- ## 100 Percent Reserve Banking

  - Banks hold all deposits (don't loan any out)

  - Has no affect on the money supply

- ## Fractional Reserve Banking

  - Banks loan out some of their deposits

  - Does affect the money supply