

# Chapter 12

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Last Word

# 12



# Money and Banking

Key Terms



End Show



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## Chapter Objectives

- **The Functions of Money and the Components of the U.S. Money Supply**
- **What “Backs” the Money Supply, Making Us Willing to Accept It?**
- **The Makeup of the Federal Reserve and the U.S. Banking System**
- **The Functions and Responsibilities of the Federal Reserve**

Key Terms



End Show



# Chapter 12

# Money Defined

- The Functions of Money
  - Medium of Exchange – readily acceptable, used for buying and selling, convenient, replaces barter, encourages specialization
  - Unit of Account – measures the relative worth of goods and services, provides standardization of value in the economy
  - Store of Value – transfers purchasing power from present to future (spend OR save)

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# Money Defined

- M1 (smallest calculation of the money supply)
  - Currency + Checkable Deposits
- Currency
  - Coins (Token Money)
  - Paper Money (Federal Reserve Notes)
- Checkable Deposits (checking accounts)
  - Commercial Banks (B of A, Citibank)
  - Thrift Institutions (Savings & Loans, Credit unions)
- A Qualification
  - Government, Federal Reserve, and Banks Excluded from *M1* (otherwise it would be double-counting)

Key Terms



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# Money Defined

- M2 (M1 + near-monies)
  - Near-Monies – highly liquid financial assets or accounts that can be easily converted to cash
  - Savings Deposits - Including Money Market Deposit Accounts (MMDA)
    - Interest bearing accounts, withdrawals may be limited
  - Small Time Deposits (CDs less than \$100,000) can be withdrawn after maturity
  - Money Market Mutual Funds (MMMF) money deposited in collective investments by individuals

Key Terms



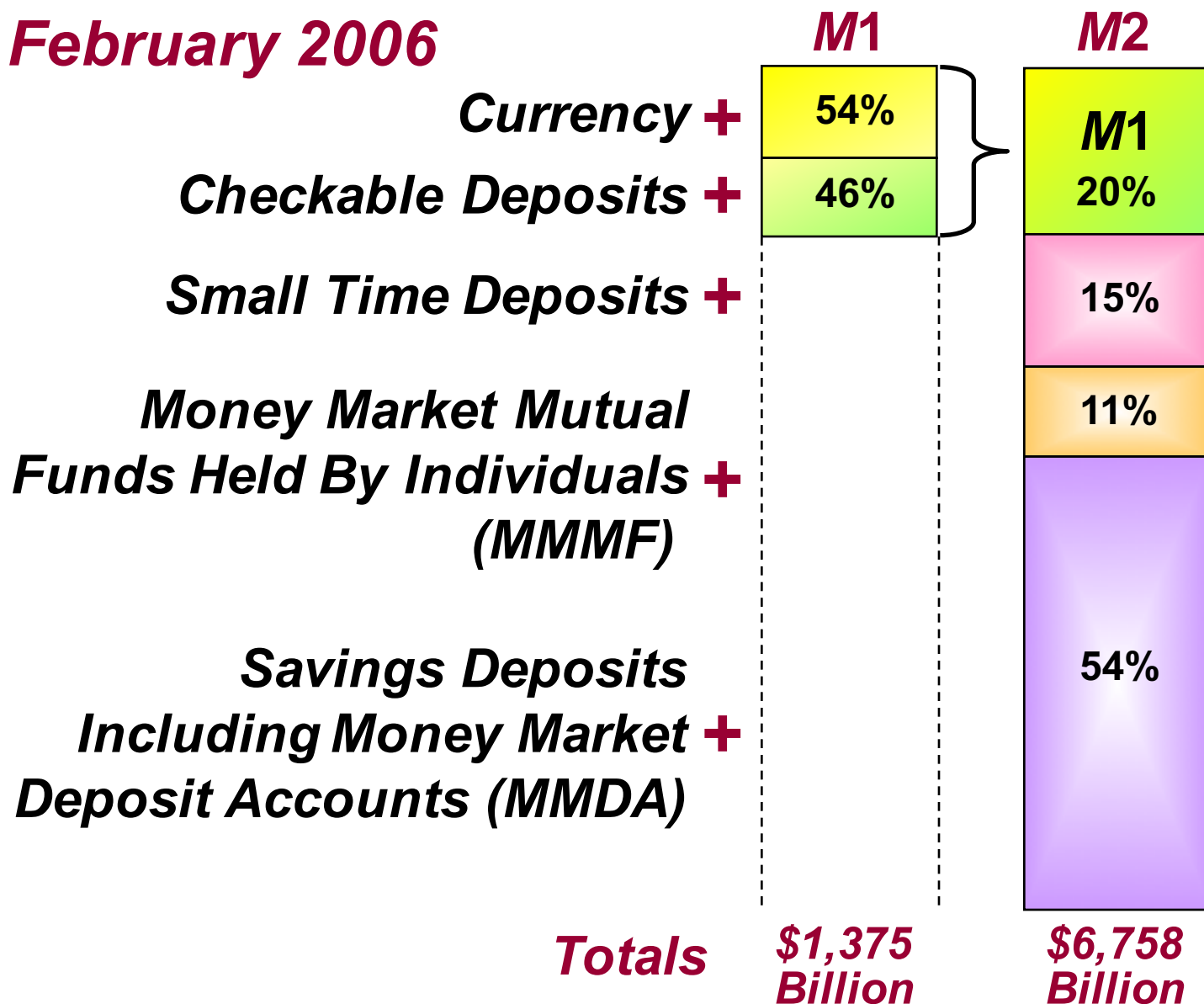
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# Money Defined

**February 2006**



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# Money Defined

- Money Definition ***MZM***
  - **Money Zero Maturity** (immediately available at zero cost)
- ***MZM = M2 – small time deposits + MMMF held by businesses***
  - **Slightly Larger than M2**
  - February 2005 **M2** was \$6,758 Billion and **MZM** was \$6,934 Billion

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# Money Supply

- **Are Credit Cards Money?** NO! They are small loans that are paid by the money in your checking accounts
- **What “Backs” the Money Supply?** Faith in the US Government & Economy!
- **Stable Value of Money**
  - **Acceptability** – everyone accepts \$!
  - **Legal Tender** – the US Gov has designated \$ as our currency
  - **Relative Scarcity** – supply and demand
- **Money as Debt** – most “money” is actually a debt or a promise to repay

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# Money Supply

- Money and Prices (Purchasing Power of the Dollar)      $\$V = 1/P$ 
  - *As the price level  $\uparrow$  (inflation) the value of \$  $\downarrow$ , as the price level  $\downarrow$  (deflation), the value of \$  $\uparrow$ , if the price level is 1 (CPI 100) the value of \$ is constant.*
- Stabilizing Money's Purchasing Power
  - Intelligent Management of the Money Supply (NO extreme inflation OR deflation!)
  - Monetary Policy (Fed controls the money supply and interest rates)
  - Appropriate Fiscal Policy (taxing and spending legislation)

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# Federal Reserve System

- Historical Background – established in 1913 to provide consistent, stable monetary policy throughout the US
  - 12 Federal Reserve (District) Banks
- Board of Governors – 7 members, appointed by President with senate approval, 14 year terms
- Federal Open Market Committee (FOMC)
  - 12 members (board of governors + pres of NY Bank and 4 other bank Pres)
  - Open Market Operations – buying and selling of gov securities

Key Terms



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# Federal Reserve System

## *Framework of the Federal Reserve System and the Relationship to the Public*

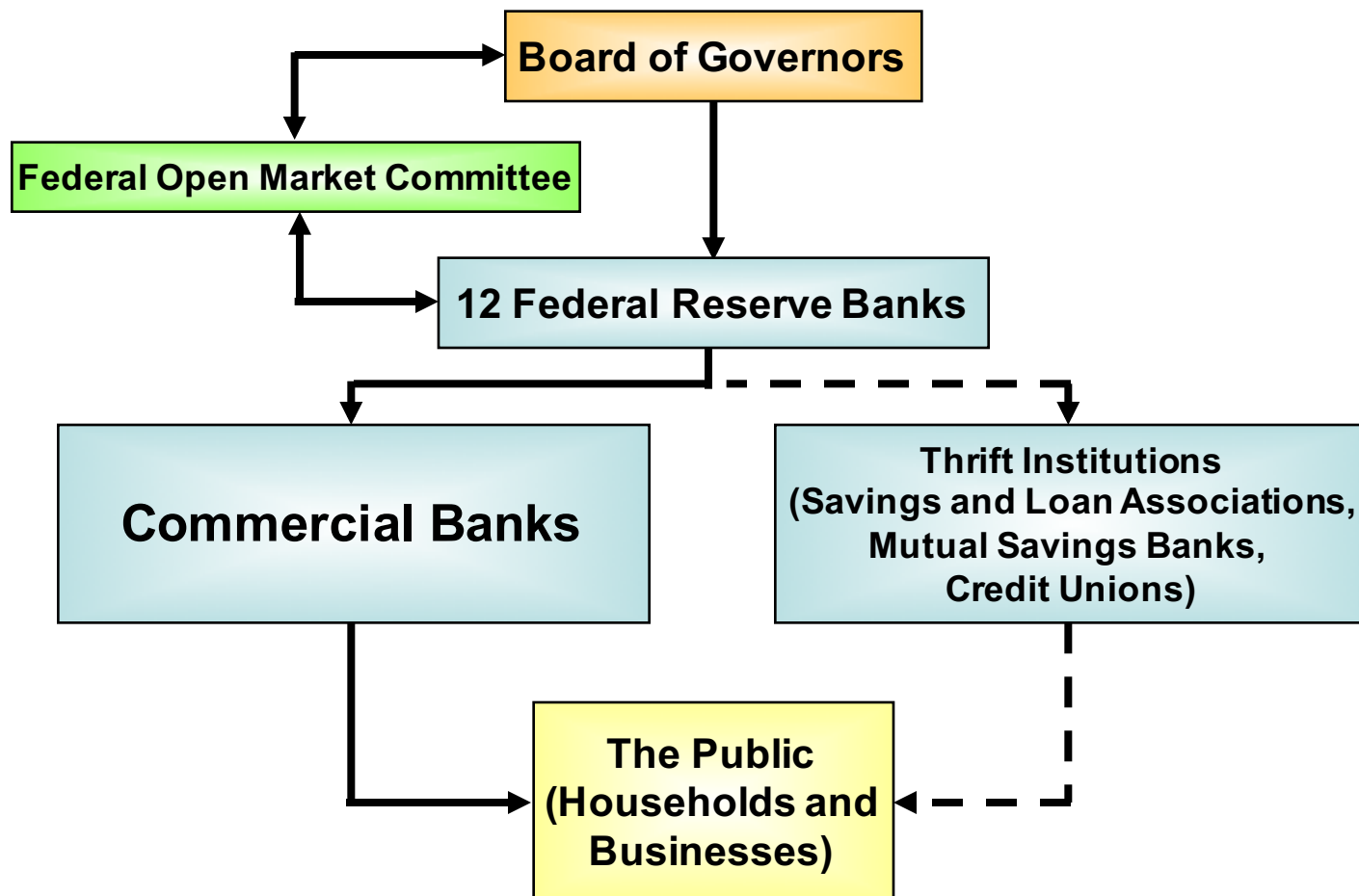
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# Federal Reserve System

## *The 12 Federal Reserve Banks*

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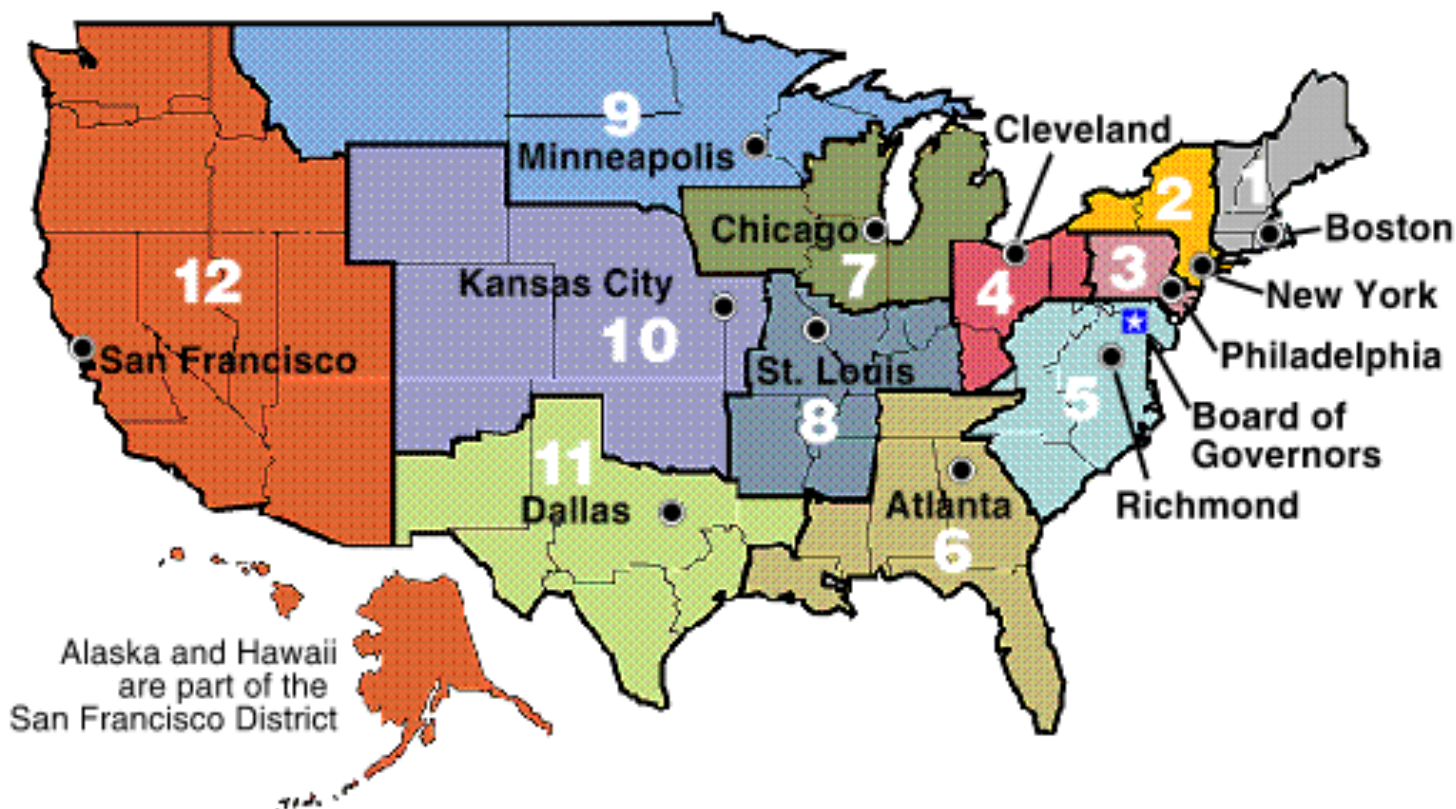
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Source: Federal Reserve Bulletin

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# Federal Reserve System

## *The 12 Federal Reserve Banks*

- Private and Public Control – our system is based on both
- Central Bank – 12 district banks make up our “central bank” which influences private banks
- Quasi-Public Banks – private “member banks” buy shares in their district bank yet must follow policies of the Fed
- Banker’s Banks - the Federal Reserve Banks are the “Bank of the Banks”, banks go to the Fed for the same services the we go to private banks for (loans, savings, etc)
- Commercial Banks and Thrifts – regulated and backed by the Fed

Key Terms



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# Federal Reserve System

## *Fed Functions and the Money Supply*

- Issuing Currency – the Fed authorizes the printing of the \$ (Bureau of P & E prints \$)
- Setting Reserve Requirements – sets the % of deposits that banks must hold “on reserve”
- Lending Money to Banks and Thrifts
  - Discount Rate – the rate the Fed charges banks for loans
- Check Collection – Fed controls check clearing by adjusting the reserves (deposits) of each bank

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# Federal Reserve System

- Fiscal Agent for U.S. – the Fed is the bank of the US Gov (accepts tax revenue as deposits, pays interest, buys and sells bonds, etc)
- Supervising Banks – the Fed oversees member banks, enforces regulations, investigates fraud
- Controlling the Money Supply – the Fed regulates the money supply, and therefore sets (indirectly) interest rates = **MONETARY POLICY!**

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# Federal Reserve System

## *Fed Functions and the Money Supply*

- Federal Reserve Independence – the Fed was designed to be independent from political pressures
- Recent Developments
  - Relative Decline of Banks and Thrifts – (↑ MMMF, ↑ pension funds, ↑ ins./securities)
  - Consolidation Among Banks and Thrifts (Mergers)
  - Convergence of Services Provided by Financial Institutions (less regulation, mergers)
  - Globalization of Financial Markets
  - Electronic Payments (online banking, debit cards, credit cards, PayPal, etc)

Key Terms



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# Financial Institutions



## GLOBAL PERSPECTIVE

### *World's Largest Financial Institutions*

*2005 Assets (Millions of U.S. Dollars)*

• Barclays (U.K.)	\$1,587,061
• UBS (Switzerland)	1,519,399
• Citigroup (U.S.)	1,494,037
• ING Group (Netherland)	1,369,546
• Mizuho Financial (Japan)	1,325,227
• Allianz Worldwide (Germany)	1,300,648
• Bank of America (U.S.)	1,291,795
• HSBC Group (U.K.)	1,274,219
• BNP Paribus (France)	1,227,951
• JPMorgan Chase (U.S.)	1,198,942
• Deutsche Bank Group (Germany)	1,134,826
• Royal Bank of Scotland (U.K.)	1,119,901

Source: Forbes Global 2000

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# Financial Institutions

## *Major U.S. Financial Institutions*

- **Commercial Banks**
- **Thrifts**
- **Insurance Companies**
- **Mutual Fund Companies**
- **Pension Funds**
- **Securities Firms**

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# The Global Greenback



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## U.S. Currency Circulating Abroad

- Russians \$40 Billion
- Argentineans \$7 Billion
- Polish \$6 Billion
- **U.S. Profits from Dollars Leaving**
- **Black Markets and Illegal Activities**
- **Seeking Stable Purchasing Power**
  - Soviet Union Collapse
  - Brazil Inflation Issues
  - Asian Market Exchanges

Key Terms



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# The Global Greenback



- **Financial Risks**
  - Exchange-Rate Risk
  - Upside Opportunity
- **Global Greenback a Positive Economic Force**
- **Results in Increased Output and Income Globally**

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## Key Terms

- medium of exchange
- unit of account
- store of value
- M1
- token money
- Federal Reserve Notes
- checkable deposits
- commercial banks
- thrift institutions
- near-monies
- M2
- savings account
- money market deposit account (MMDA)
- time deposits
- money market mutual fund (MMMF)
- MZM
- legal tender
- Federal Reserve System
- Board of Governors
- Federal Reserve Banks
- Federal Open Market Committee (FOMC)
- financial services industry
- electronic payments

Key Terms



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## Next Chapter Preview...

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# Money Creation



# Chapter 13!

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