

EC132.02

Principles of Macroeconomics

Boston College

Thursday, April 4

Announcements and Reminders

Aplia homework on Ch 28, Unemployment, due tomorrow, Friday, April 5, at 9am.

Aplia homework on the first two parts of Ch 29, The Monetary System, due next Friday, April 12, at 9am.

BLS report on the Employment Situation for March 2013 released tomorrow, Friday, April 5, at 8:30am.

Announcements and Reminders

Second midterm exam: next Thursday, April 11,
10:30 – 11:45am.

Last names beginning with:

A or B: Higgins 263

C through S: Devlin 008

T through Z: Lyons 202

Announcements and Reminders

Second midterm exam: next Thursday, April 11,
10:30 – 11:45am.

Closed book exam, between 6 and 12 questions
(short-answer, with multiple parts) covering:

Ch 26 – Saving, Investment, and the Financial System

Ch 28 – Unemployment

Ch 29 – The Monetary System (but only the first two
parts, on The Meaning of Money and The Federal
Reserve System)

Ch 29 The Monetary System

1. The Meaning of Money
 2. The Federal Reserve System
 3. Banks and the Money Supply
 4. The Fed's Tools of Monetary Control
 5. The Federal Funds Rate
 6. Banking and Financial Crises
- Covered on
Second Midterm

The Meaning of Money

Functions of Money:

1. Money is a **medium of exchange** – an item that buyers give to sellers in exchange for goods and services.
2. Money is a **unit of account** – defining the units in which prices are measured.
3. Money is a **store of value** – an object that can be used to carry wealth from the present into the future.

The Meaning of Money

Liquidity = the ease and speed with which an asset can be converted into the economy's medium of exchange.

By definition, money is the most liquid asset. Stocks and bonds are highly liquid as well. Houses, valuable paintings, antiques are less liquid.

The Meaning of Money

Historically, gold or gold coins served as **commodity money**.

Unlike gold, US dollar bills have little intrinsic value. They are **fiat money**: “this note is legal tender for all debts, public and private.”

Mark Taylor’s book, *Confidence Games: Money and Markets in a World Without Redemption*, presents a fascinating (but not easy!) analysis of these issues.

The Meaning of Money

In the US, what should count as money?

1. Certainly **currency**, paper bills and coins.
2. Probably checks as well. **Demand deposits** is the official name for bank deposits that can be accessed on demand by writing a check.
3. Maybe **savings deposits**, which don't offer check-writing privileges but do allow funds to be withdrawn anytime.
4. Maybe also **money market mutual funds**, which offer limited check-writing privileges.
5. Maybe also **time deposits** (also called CDs or certificates of deposit). The funds can't be withdrawn immediately, but since most CDs mature within three to six months they are fairly liquid.

The Meaning of Money

M1 =

Currency

+ Demand Deposits (checking accounts that don't pay interest)

+ Traveler's Checks

+ Other Checkable Deposits (checking accounts that pay interest, sometimes called NOW or Negotiable Order of Withdrawal Accounts)

M2 =

M1

+ Savings Deposits

+ Money Market Mutual Funds

+ Small (under \$100,000) Time Deposits

The Meaning of Money

US Money Supply Measures, December 2012

Note: All figures in billions of dollars.

Currency	1090.9
Traveler's Checks	3.8
Demand Deposits	901.7
OCDs	443.7
TOTAL M1	2440.1

TOTAL M1	2440.1
Savings Deposits	6694.5
Small CDs	632.6
MMMFs	635.1
TOTAL M2	10402.4

Regardless of whether you look at M1 or M2, a large fraction of the money supply consists of deposits issued by banks, not currency issued by the government.

Also, there is more than \$4000 in currency per adult in the US!

Ch 29 The Monetary System

1. The Meaning of Money
2. The Federal Reserve System
3. Banks and the Money Supply
4. The Fed's Tools of Monetary Control
5. The Federal Funds Rate
6. Banking and Financial Crises

The Federal Reserve System

The Federal Reserve (Fed) is the **central bank** of the US.

It is the institution responsible for overseeing the banking system and regulating the quantity of money in circulation.

The Federal Reserve System

The Federal Reserve System consists of:

- The Board of Governors in Washington DC
 - Seven Governors, with 14-year terms
 - Including the Chairperson of the Federal Reserve System, now Ben Bernanke, formerly Alan Greenspan
- Twelve Federal Reserve Banks
 - Located in major cities including Boston and New York

The Federal Reserve System

As the US central bank, the Fed has two jobs:

1. It regulates banks, assists in check processing (clearing), and acts as a bank for banks, taking their deposits and, when other sources of credit dry up, making loans. In this last role, the Fed is said to act as a **lender of last resort**.
2. It regulates the money supply, that is, it conducts **monetary policy**.

The Federal Reserve System

The **Federal Open Market Committee** (FOMC) is the monetary policymaking committee within the Fed.

- Meets every 6 weeks.
- Consists of the 7 Governors and the 12 Reserve Bank Presidents.
- All 7 Governors vote on FOMC decisions.
- A rotating group of 5 Reserve Bank Presidents vote as well, with the President of the Federal Reserve Bank of New York always voting.

The Federal Reserve System

The Fed regulates the money supply through **open market operations**.

When the Fed wants to increase the money supply, it uses newly-printed Federal Reserve notes to buy US Government bonds held by private savers.

When the Fed wants to decrease the money supply, it sells those US Government bonds back to private savers and withdraws from circulation the Federal Reserve notes that those savers pay with.