

Micro vs. Macro

- **Microeconomics:**
The study of how individual households and firms make decisions, interact with one another in markets.
- **Macroeconomics:**
The study of the economy as a whole.

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Money



Money

- Do we **need** money?

■ Barter systems

■ Double coincidence of wants

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What Money Is, and Why It's Important

- **Money**
 - an “immediate good” that people use to buy g&s from other people
 - reduces search time (waste of resources!)

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What Money Does...Functions

- as defined by what it does*
- Medium of exchange: an item buyers give to sellers when they want to purchase goods
 - Unit of account: the yardstick people use to post prices and record debts
 - Store of value: an item people can use to transfer purchasing power from the present to the future
 - Standard of deferred payment: an item used not only as a medium of exchange today, but also to purchase today and pay for in the future.

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Kinds of Money

Commodity money:
“money” is a commodity with intrinsic value (e.g. gold)

Representative Commodity Money:
“money” that represents a commodity (e.g. US\$ from WWII to 1973)

_____:
“money” without _____ value, used as money because of govt decree (e.g. the current US\$)

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The Money Supply

- The **money supply** (or **money stock**): the _____
- What should be considered part of the money supply?
 - 1) _____: paper bills & coins in circulation
 - 2) _____ checkable deposits)
 - 3) _____

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Measures of the U.S. Money Supply

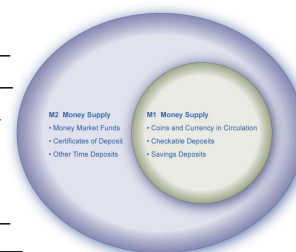
- **M1**: _____

M1 = _____

- **M2**: _____ plus _____

M2 = _____

(federalreserve.gov)

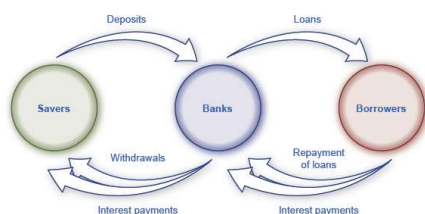


Liquidity

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The Banking System

- Banks as _____



- Banks _____

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How Banks Create Money

- In a _____, banks keep a fraction of deposits as _____, and use the rest to make loans.
- Based on the _____
- Reserves are typically in the form of _____ and _____.

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Bank T-account

- **T-account**: a _____ that shows a bank's assets & liabilities.

BANK	
Assets	Liabilities
What the bank _____: reserves, loans, ...	What the bank _____: deposits

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A More Realistic Balance Sheet

- _____: the resources a bank obtains by issuing equity to its owners
 - Also: bank's assets minus liabilities
- _____: the use of _____ to supplement existing funds for investment purposes

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A More Realistic Balance Sheet

MORE REALISTIC NATIONAL BANK			
Assets		Liabilities	
Reserves	\$ 200	Deposits	\$ 800
Loans	\$ 700	Debt	\$ 150
Securities	\$ 100	Capital	\$ 50

_____ = the ratio of assets to bank capital

Interpretation: for every \$ _____ in assets,
 \$ _____ is from the bank's owners,
 \$ _____ is financed with borrowed money.

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A More Realistic Balance Sheet

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* Suppose bank assets _____ by 5%, from \$1000 to \$1050.

This increases bank capital from \$50 to \$100, _____ owners' equity.

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A More Realistic Balance Sheet

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Assets		Liabilities	
Reserves	\$ 200	Deposits	\$ 800
Loans	\$ 700	Debt	\$ 150
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* Suppose a bank's assets decrease by 5%, bank capital falls _____.

If bank assets decrease more than 5%, bank capital is _____ and bank is _____.

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Leverage & the 08-09 Financial Crisis

- Banks suffered losses on mortgage loans and mortgage-backed securities due to widespread defaults.
- Many banks became insolvent:
 U.S. bank failures: 27 in 2000–2007
 166 in 2008–2009
- _____ - banks with too little _____, reduce lending
- Fed & Treasury injected \$

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Leverage Amplifies Profits and Losses

- _____:
- a govt regulation that specifies a minimum amount of capital,
- intended to ensure banks will be able to pay off depositors and debts;
- a _____.

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