LECTURE FOUR – PART TWO

What is Money?

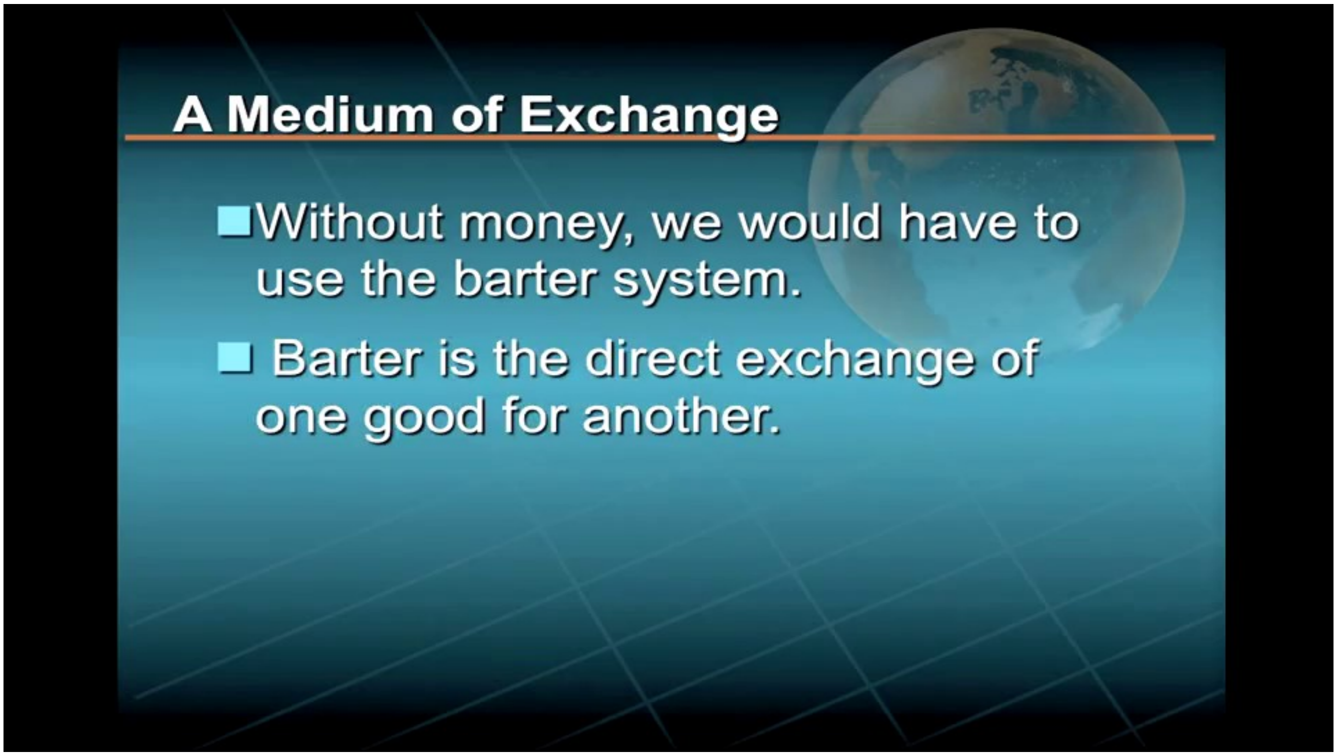
- Money has a much broader definition than the cash in our pockets.
- Money is anything that can be widely used and accepted in exchange for other goods and services.

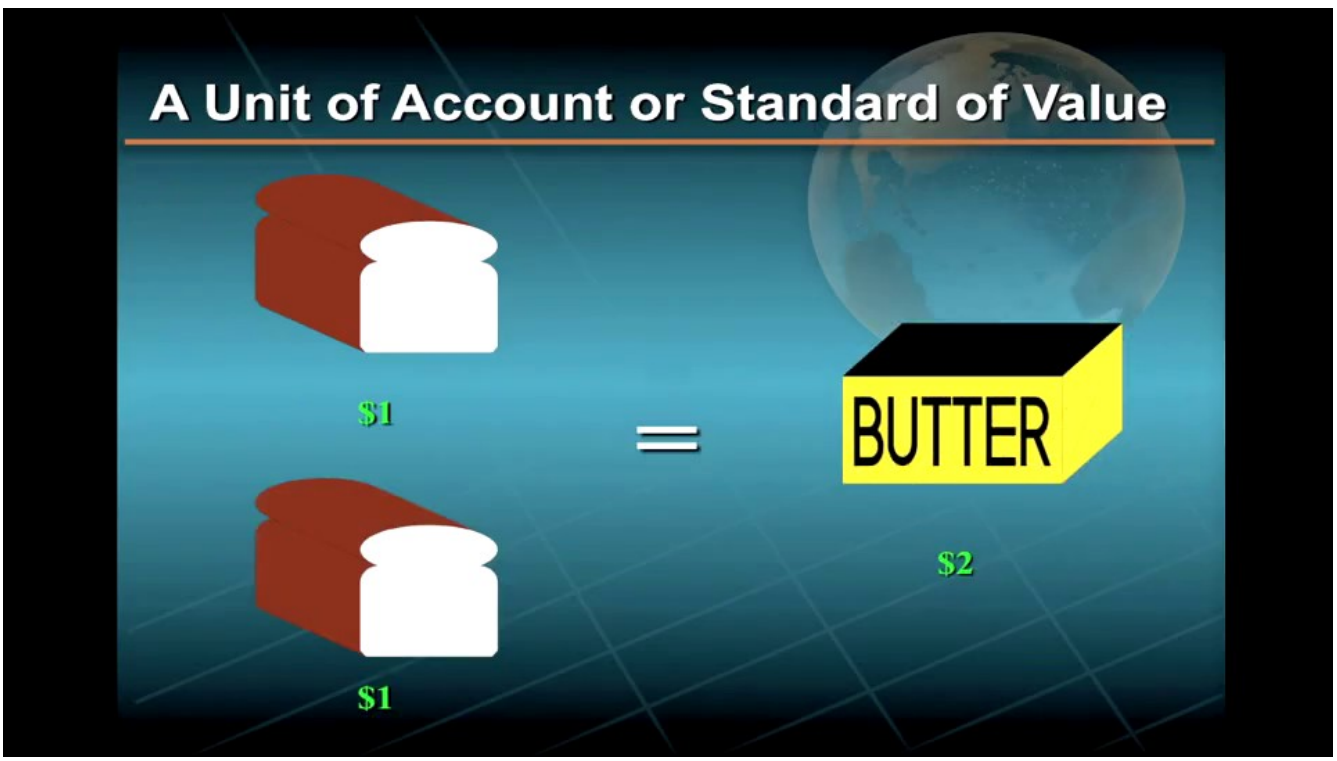
The Three Kinds of Money

- Commodity money:
  - Gold nuggets, silver, beads, grains, and the like.
- Bank money:
  - Checkbooks and bank drafts.
- Fiat or Paper money:
  - Currencies like the U.S. dollar and Japanese yen

The Three Functions Of Money

- Money is the most "liquid" of assets, meaning it is the most readily spendable.
- Money has three major functions
  - A medium of exchange.
  - A standard of volume.
  - A store of value.


A Medium of Exchange
Without money, we would have to use the barter system.
Barter is the direct exchange of one good for another.


A Unit of Account or Standard of Value
$1
=
BUTTER
$2
$1

A Store of Value

- People can hold on to money and spend it later.
- Most methods of holding money do not yield the same monetary returns that you get by storing wealth in the form of less liquid assets like stocks and bonds.
- In the presence of inflation, money can rapidly lose its value!

Measure	Components
M1	Currency in circulation outside of bank vaults Demand deposits at commercial banks NOW and ATS accounts Credit union share drafts Demand deposits at mutual savings banks Traveler's checks (nonbank)
M2	M1 plus: Savings accounts Time deposits of less than $100,000 Money-market mutual funds
M3	M2 plus: Time deposits larger than $100,000 Repurchase agreements Overnight Eurodollars
L	M3 plus other liquid assets, for example: Treasury bills U.S. savings bonds Bankers' acceptances Term Eurodollars Commercial paper.

How is Money Defined?

M1 = Cash + Checking Accounts + Traveler's Checks

M2 = M1 + Savings Accounts + Time Deposits + Money Market Mutual Funds

M3 = M1 + M2 + Short Term Fiscal Assets

Why These Definitions Matter

- Monetary policy uses changes in the money supply to contract or expand the economy.
- To conduct monetary policy effectively, we must have a very good idea of what we are changing when we change the money supply.