Notes — Week 8

Michael Brodskiy
Instructor: Mr. Bremer

Period 3

1. Bonds
    - Bonds represent debt
    - Important characteristics:
        - Term
        - Interest rate/risk
        - Tax treatment
2. Stocks
    - Stocks represent ownership in a corporation (*i.e. equity*)
        - How is price set?
            - Supply and Demand
        - Where are they traded?
            - New York Stock Exchange
            - NASDAQ
            - Many More
        - How do we measure <u>market</u> performance?
            - Stock indices
                - S&P 500
                - NASDAQ
                - Dow Jones Industrial Average
    - Making Money With Stocks
        - Capital Gains
        - Dividends
3. Money must function as:

(a) Medium of exchange
    - "Greases the wheels" of transactions

(b) Measure of value or "unit of account"
    - Expresses worth in terms people understand
    - Especially useful to compare value of dissimilar items

(c) Store of Value
    - Can have time between earning and spending

4. Commodity Money
    - Money that has intrinsic value (*i.e. something that can be used for something other than money, like gold or a tomato*)

5. Fiat Money
    - Money that has no intrinsic value

6. Characteristics of Money:
    - Portability
    - Durability
    - Divisibility
    - Divisibility
    - Stability (in value)

7. Modern Money
    - Coins and currency
    - Demand and other checkable deposits
    - Savings and time deposits
    - M_1 = coins and currency in circulation plus checking account balances (Note: vault cash in banks is NOT part of M_1)
    - $M_2 = M_1$ plus money market funds, savings accounts, and certificates of deposit under \$100k
    - M_1 is much more liquid[1] than M_2
    - Things in M_2 are much more interesting-bearing than M_1

8. Responsibilities of the Fed:

[1] A measure of how quickly an asset may be converted to cash

- Check clearing
- Bank regulation and supervision
- Consumer legislation
- Maintaining the currency
- Regulating the money supply
  - Easy money policy — supply grows and stimulates the economy
  - Tight money policy — restricts growth of the money supply

9. How Banks Create Money

   - Banks operate under a *fractional reserve system*
     - Required reserves
     - Excess reserves
   - How much can be created?
     - Money multiplier $= \frac{1}{\text{reserve ratio}}$
     - Maximum amount created $= \frac{1}{\text{reserve ratio}} \cdot \text{deposit}$

10. Be Careful:

    - What is the source of deposit?
      - Existing currency
      - Fed purchase of securities
    - What is being asked?
      - How much will M_1 change?
      - How much will bank reserves change?
      - How much will demand deposit or checking account balances change?
      - $M_1 = \text{reserves} = \text{DD}$
      - Loans$= (1 - RR) \cdot (M_1)$
    - Timeframe
      - "Immediate" or "maximum" amount

11. What could prevent multiple expansion?

    - Banks don't make loans
    - People don't borrow
    - Money leaves the system
      - Spent in Europe
      - Buried in a backyard