Review Sheet

Topics Covered (Monetary System, Unemployment)

Monetary System

Functions of Money - Medium of Exchange, Unit of Account, Store of Value

Fractional Reserve Banking

Money Supply = Money Multiplier x Reserves (or base money as we established in the lecture)

Money Multiplier = $\frac{1}{R}$, where R is a reserve ratio.

Reserve Ratio = Ratio of Reserves to Deposits.

Leverage Ratio = Ratio of Assets to Bank Capital (Owner's stake in the bank).

Federal Funds Rate = A rate at which the banks borrow from (and lend to) each other funds overnight (to fulfill the reserve requirements)

Open Market Operation (Buying and Selling of Bonds to change money supply)

The Fed → Buys Bonds From The Market → Pumps Money Into The Market → Money Supply Increases

The Fed → Sells Bonds To The Market → Takes Money Out of The Market → Money Supply Decreases

Unemployment

Types of Unemployment

Frictional - Due to search frictions(Recall our example of someone leaving a job at Microsoft to join Amazon after a month)

Structural - Due to wages being more than equilibrium wage (Due to some policy changes, like effects of unions, minimum wage etc.)

Cyclical - Due to business cycles (during recessions and expansions)

Natural Rate of Unemployment - Unemployment in the economy even if everything is going well.

$$Unemployment\ Rate = \frac{Number\ of\ people\ unemployed}{Size\ of\ the\ Labor\ Force} \times 100$$

$$Labor\ Force\ Participation\ Rate = \frac{Size\ of\ the\ Labor\ Force}{Adult\ Population} \times 100$$

Size of the Labor Force = Number of People Employed + Number of People Unemployed