Chapter 14

The Fed

- How the Fed can stabilize the business cycle by changing the money supply

<u>Money Supply</u>:

M1: Most liquid of money

Dollar bills, coins, $\underbrace{\text{checking accounts balances}}_{\frac{1}{2}\text{ of M1}}$

Around $3 trillion now

If the economy is in a recession, spending should go up

Easily spendable

M2: Includes M1, totaling $13 trillion

Savings accounts, savings, retirement

All long-term assets

Harder to spend

- All the Fed can do is change the money supply
- How much money should be out there?
  - ⇨ It is very important and difficult for the Fed to do this
- When we talk about money supply, we mean M2
- How does the Fed control the money supply and at what level?
  - ⇨ The Taylor Rule (John Taylor, economist)
    - The Fed uses this as a guideline
    - Isn't used as a rule, more as a suggestion

- Demand Deposits
  1. A checking account
  2. A deposit that is on demand
  3. NOT a time deposit
  4. You can get that money immediately as soon as it is deposited

5. Plays a crucial role in money supply because it is half of M1

- Banks can create money
    1. Fractional Reserve System
    2. We include checking account balances in M1

- The Federal Open Market Committee
    - Makes the decisions for monetary policy
    - Meets 8 times a year