Chapter 15

Money Creation

- Banks create money by:
  - Fractional Reserve System
  - Checking account balances are part of the money supply

- When we get a checking account, we put some money in the bank

  → The bank can now use that money to create more checking accounts

- A checking account is just as liquid as a dollar bill → you can cash out anytime

- The Fractional Reserve System allows banks to loan out the money you put in a checking account

  → With this, the bank can get interest
  - Banks only must keep a fraction of the money that is deposited: about 0.3%

- Each time, money is loaned out and money is created

  → This is why checking accounts account for 50% of M1

- The Money Multiplier (M)

$$M = \frac{1}{Reserve\ Ratio}$$

How much the bank should save

This is also equal to the Multiplier:

Multiplier = 1/MPS

  - Congress determines the Reserve Ratio