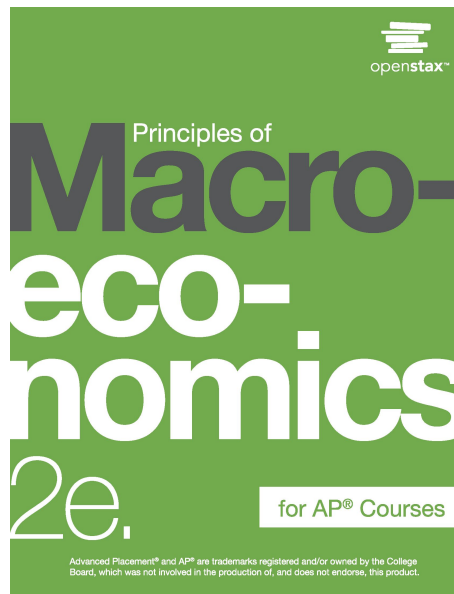


PRINCIPLES OF MACROECONOMICS 2e for AP Courses

Chapter 13 Money and Banking PowerPoint Image Slideshow



CH.13 OUTLINE

Cowrie Shell or Money?



- Is this an image of a cowrie shell or money?
- The answer is: Both.
- For centuries, people used the extremely durable cowrie shell as a medium of exchange in various parts of the world.

(Credit: modification of work by “prilfish”/Flickr Creative Commons)



13.1 Defining Money by Its Functions

Functions for Money

Commodity versus Fiat Money

Commodity versus Fiat Money, Continued



A Silver Certificate and a Modern U.S. Bill



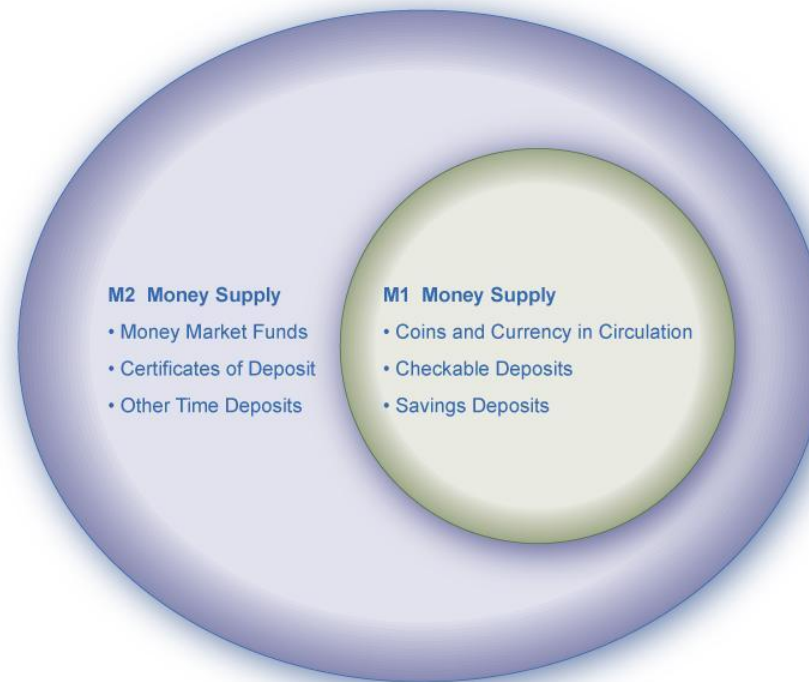
- Until 1958, silver certificates were commodity-backed money - backed by silver, as indicated by the words “Silver Certificate” printed on the bill, pictured at bottom.
- Today, The Federal Reserve backs U.S. bills, but as fiat money (inconvertible paper money made legal tender by a government decree). (Credit: “The.Comedian”/Flickr Creative Commons)

13.2 Measuring Money: Currency, M1, and M2

M1 Money

M2 Money

The Relationship between M1 and M2 Money



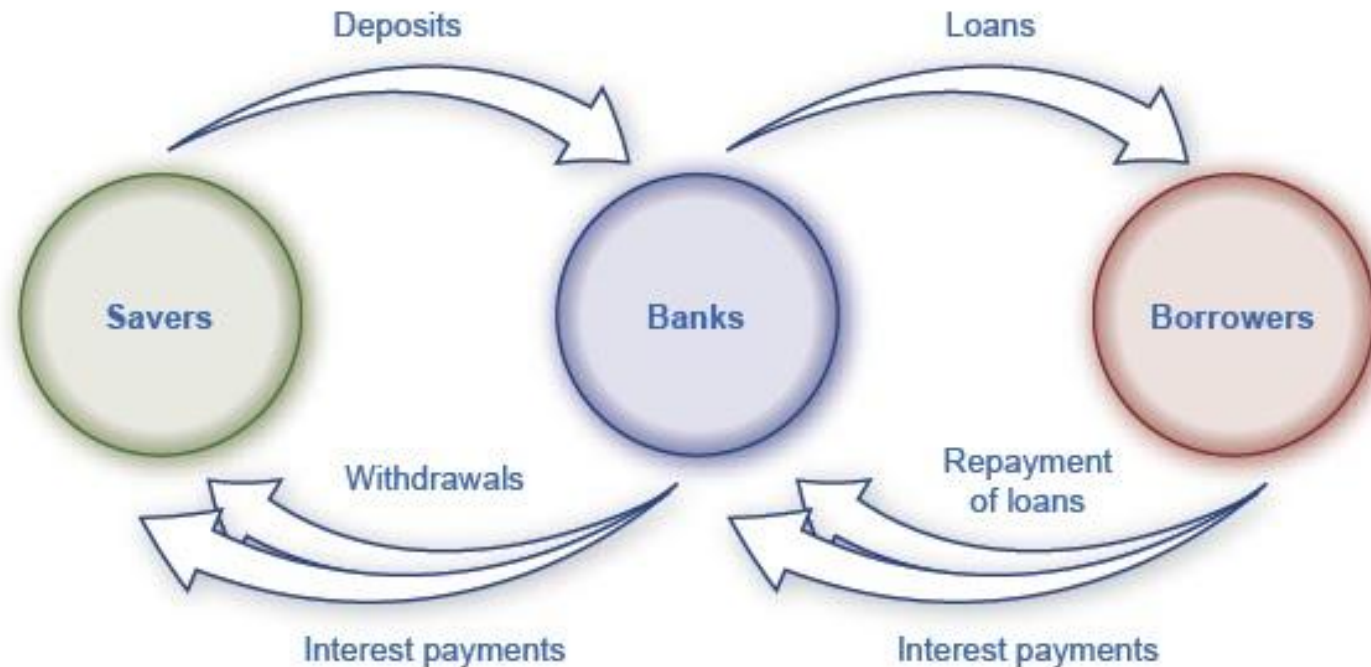
- M1 and M2 money have several definitions, ranging from narrow to broad.
- M1 = coins and currency in circulation + checkable (demand) deposits + savings deposits.
- M2 = M1 + money market funds + certificates of deposit + other time deposits.

Where Does “Plastic Money” Fit In?

13.3 The Role of Banks

Banks as Financial Intermediaries

Banks as Financial Intermediaries, Illustrated



- Banks act as financial intermediaries because they stand between savers and borrowers.
- Savers place deposits with banks, and then receive interest payments and withdraw money.
- Borrowers receive loans from banks and repay the loans with interest.
- In turn, banks return money to savers in the form of withdrawals, which also include interest payments from banks to savers.

A Bank's Balance Sheet

A Bank's Balance Sheet

| Assets | | Liabilities + Net Worth | |
|-----------------------------------|-------------|-------------------------|--------------|
| Loans | \$5 million | Deposits | \$10 million |
| U.S. Government Securities (USGS) | \$4 million | | |
| Reserves | \$2 million | Net Worth | \$1 million |

- This figure shows a hypothetical and simplified balance sheet for the Safe and Secure Bank.
- **T-account** - a balance sheet with a two-column format, with the T-shape formed by the vertical line down the middle and the horizontal line under the column headings for “Assets” and “Liabilities”.
- The “T” in a T-account has:
 - the assets of a firm, on the left
 - its liabilities, on the right.

Reserves and Bankruptcy

How Banks Go Bankrupt

13.4 How Banks Create Money, Part 1

Singelton Bank Balance Sheet

| Assets | | Liabilities + Net Worth | |
|----------|--------------|-------------------------|--------------|
| Reserves | \$10 million | Deposits | \$10 million |

Singelton Bank Balance Sheet

| Assets | | Liabilities + Net Worth | |
|----------------------------|-------------|-------------------------|--------------|
| Reserves | \$1 million | Deposits | \$10 million |
| Loan to Hank's Auto Supply | \$9 million | | |

How Banks Create Money, Part 2

First National Balance Sheet

| Assets | | Liabilities + Net Worth | |
|----------|---------------|-------------------------|---------------|
| Reserves | + \$9 million | Deposits | + \$9 million |

- Singleton Bank issues Hank's Auto Supply a cashier's check for the \$9 million.
- Hank deposits the loan in his regular checking account with First National Bank.
- The deposits at First National Bank rise by \$9 million and its reserves also rise by \$9 million.
- Bank lending has expanded the money supply by \$9 million.

First National Balance Sheet

| Assets | | Liabilities + Net Worth | |
|----------|---------------|-------------------------|---------------|
| Reserves | \$90,000 | Deposits | + \$9 million |
| Loans | \$8.1 million | | |

- Now, First National Bank must hold some required reserves (\$900,000) but can lend out the other amount (\$8.1 million) in a loan to Jack's Chevy Dealership.

How Banks Create Money, Part 3

Second National Balance Sheet

| Assets | | Liabilities + Net Worth | |
|----------|-----------------|-------------------------|-----------------|
| Reserves | + \$8.1 million | Deposits | + \$8.1 million |

- If Jack's Chevy Dealership deposits the loan in its checking account at Second National, the money supply just increased by an *additional \$8.1 million*.
- Making loans that are then deposited into a demand deposit account increases the M1 money supply.
- This money creation is possible because there are multiple banks in the financial system.
 - They are required to hold only a fraction of their deposits,
 - loans end up deposited in other banks,
 - which increases deposits and the money supply.

The Money Multiplier and a Multi-Bank System

Cautions about the Money Multiplier

Cautions about the Money Multiplier, Continued

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