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## What is money?

- Money is an item commonly used to pay for goods, services, assets, and outstanding debts

- Three functions
  (1) Medium of exchange
    - an asset used to buy and sell goods/services
  (2) Store of value
    - a financial asset that allows people to transfer purchasing power from one period to the next
    - liquid asset → an asset that can be easily and quickly converted to money without loss of value
    - disadvantage of using money as a store of value is if value of a unit of money changes
  (3) Unit of account
    - a unit of measurement used by people to post prices and keep track of revenues and costs

## How the supply of money affects its value

- Money is most modern nations is fiat money → money with no intrinsic value.
  - This money is valuable because it has "legal tender" meaning it must be accepted as payment for debt

[Basically, why has value it just does]

- People demand money because it reduces the cost of exchange

- When supply of money is limited relative to demand, money become more valuable.

[illegible]

## How the FED controls the money supply

(1) the establishment of reserve requirements for banks
- an increase in the reserve requirements will reduce the supply of money

(2) buying and selling US govt securities and other financial assets in the open market
- when the FED buys things, it injects "new money" into the economy in the form of additional currency in circulation and deposits with commercial banks.
- FED creates money out of nothing
- If FED wants to reduce money supply, it sells some of its current holdings of govt securities or other assets.

- Buy bond ⇐ MS (buy = bigger)
- Sell bond → MS (sell = smaller)

(3) the volume of loans extended to banks and other financial assets in the open market
- discount rate → the interest rate the FED charges banking institutions for short-term loans
  - DR and MS are inversly related

(4) interest rules on reserve
- this caused banks to reserve more at FED
- interest rate on reserve is inversely related to banks giving out loans to people

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Vocab:

- Demand Deposits → checking account funds

- Required Reserves → the minimum amount of reserves that a bank is required by law to keep on hand to back up its deposits.

- Required Reserve Ratio → the ratio of reserves relative to a specified liability category that banks are required to maintain

- Excess reserves → actual reserves that exceed the legal requirement

- Open Market Operations → buying and selling of govt bonds by Fed

- Federal Funds Rate → the interest rate that one commercial bank charges another for short-term loans

- Monetary base → the sum of currency in circulation plus bank reserves (vault cash and reserves held at Fed)

Questions from Quiz:

- Under current policy, the Fed ties the discount rate to the —— federal funds rate

- If the Fed buys a T-bill from a commercial bank, how will it pay for the T-bill?
  — it will give the bank new reserves