Money, Prices, and Financial Intermediaries

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The Banking System and the Allocation of Saving to Productive Uses

- The banking system helps diversification by spreading the wealth of an individual savor on many borrowers and the risk of many borrowers over many savers
  - Financial Intermediaries: firms that extend credit to borrowers using funds raised from savers
  - Brings together savers looking for good investments and borrowers with worthwhile projects

Money and Its Uses

- Money: any asset that can be used in making purchases
  - Medium of Exchange: an asset used in purchasing goods and services
  - Barter: the direct trade of goods or services for other goods or services
  - Allows people to specialize in producing certain goods and services
  - Unit of Account: a basic measure of economic value
  - Store of Value: an asset that serves as a means of holding wealth
- M1: the sum of currency outstanding and balances held in checking accounts
- M2: all the assets in M1 plus some additional assets that are usable in making payments but at greater cost or inconvenience than currency or checks
- Credit card balances are never counted as money, since they are merely obligations to pay others

Commercial Banks and the Creation of Money

- The money supply is the currency and the deposit balances in the banks
- Bank Reserves: cash or similar assets held by banks for the purpose of meeting depositor withdrawals and payments
  - 100% Reserve Banking: a situation in which banks' reserves equal 100% of their deposits
  - Not counted as money supply
- Bank deposit balances are counted as money supply
- Reserve-Deposit Ratio: bank reserves/deposits
  - Fractional-Reserve Banking System: a banking system in which bank reserves are less than deposits so the reserve-deposit ratio is less than