Chapter 10 Money and Commercial Banking

1. Concepts
   1. A self-sufficient economy is called autarky economy.
   2. The economy that people exchange goods and services directly without money is a barter economy.
   3. When people concentrate their effort on a particular work, specialization occurred. And people became interdependent. To maintain the current living standard, people MUST trade.

* 1. A situation in which one person’s desire must mutually match the desires of the other is double coincidence of wants.  
       
       
       
       
     Example: which of the following people have double coincidence of wants?

|  |  |  |
| --- | --- | --- |
| Adam | has 3 pairs of shoes | wants 1 jacket |
| Brace | has 1 jacket | wants 1 chair |
| Chris | has 1 chair | wants 2 jackets |
| Denise | has 1 jacket | wants 3 pairs of shoes |

* 1. Money – anything that people accept in exchange for goods and services.
  2. Three functions of money
     + Medium of exchange

When money is exchanged for good and services, it serves as medium of exchange. (buying and selling)

* + - Unit of account

When money is used to measure the value of a product, it serves as unit of account. (price tag, book keeping)

* + - Store of value

Money allows value to be held over time. (Deposits, savings…)

* 1. Types of money
     + Commodity is used as medium of exchange - commodity money. It has intrinsic value.
     + Paper money is backed by gold – Gold standard.  
       Paper money and coin that the government decrees as money fiat money.  
       It has no intrinsic   
       value.

1. Money supply – amount of money circulating in the economy.

How to measure money supply (MS)?

* 1. M1 (transaction money)

M1 = currency +

Demand deposits + checkable deposits +Traveler’s checks

* 1. M2 (broad money)

M2 = M1 +

Saving deposits +

small time deposits + Money Market Mutual Funds.

1. How commercial banking developed from goldsmith
   1. Goldsmith
   2. Balance sheet of a bank

**Fractional Reserve Banking**

* 1. Reserve ratio -   
     the ratio of deposits the bank are legally required to hold as cash in the vault or as deposits at the Federal Reserve Banks

**Balanced sheet for all banks**

1. Money creation

How much would money supply increase if you deposit $1000 into a bank, given that the reserve ratio is 20%?

* 1. Money multiplier = 1/reserve ratio
  2. Changes in money supply = (money multiplier)(initial deposit)