

Econ 1A. Chapter 11: Note 1.

1. **Money** today in the world is called **fiat money** (i.e., objects that are money because **the law decrees or orders them to be money**). The objects that we use as money are (1) **currency**, and (2) **deposits**.
 - a. **Currency**: the bills and coins. Bills are money because the government declares them so with the words “**This note is legal tender for all debts, public and private.**”
 - b. **Deposits**: Deposits at banks and other depository institutions such as banks, savings and loan associations (S&L). Deposits are money because they can be converted into currency and used to settle **debts**.
2. The following *financial assets or tools are not money*: (1) currency in a bank is not money; (2) deposits are money but checks are not; (3) credits, debit cards, E-Checks are not money.
3. **Official Measures of Money**: The money stock that can freely be exchanged for goods and services.

06/30/2013. Federal Reserve Board

M1	2,523	100%.
Currency and traveler’s check	1,127	44.7%
Checkable deposits	1,396	55.3%
M2	10,600	100%.
Currency and traveler’s check	1,127	10.6%
Checkable deposits	1,396	13.2%
Saving deposits	6,857	64.7%
Time deposits	568	5.4%
Money market fund and other deposits	652	6.1%.

M1 = currency held **outside** banks and traveler’s checks + checking deposits owned by individuals and business

M2 = M1 + savings deposits + time deposits + money market mutual funds and other deposits.

4. All of M1 is money. Some of saving deposits in M2 are not *means of payments*, but can be quickly and easily converted into currency or checking accounts (means of payment), thus they are counted as money.
5. A **depository institution** is a financial firm that takes *deposits* from households and businesses and makes *loans* to other households and businesses. **These deposits are components of M1 and M2.** The objective of a depository institution is to make *maximum profit from deposits and loans*.

6. The financial institution's business is summarized in **its balance sheet**

(1). **The balance sheet is a statement of a firm's financial position as of a given date, listing assets, liabilities and net worth to the owners of this firm).**

(2). **Balance Sheet: Commercial Banks (6/30/2008)**

Assets		Liabilities	
Cash	\$100	Deposits	\$1,000
Loan1	200		
Loan2	800		
		Own Capital	100
Total	\$1,100		\$1,100

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(3). **Basic Accounting Equation: Assets = Liabilities + Net Worth.**

Assets: Valuable properties or rights owned by the firm (bank).

Liabilities: Money or obligations owed by the firm (bank).

Own capital and other (Net worth): Net value of the firm (bank) to its owners.

Own capital and other (Net worth) = Assets – Liabilities.

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(4). On 11/30/12, Bank A provides the following deposits and assets to the public.

\$320 in checkable deposits, \$896 in saving deposits, \$840 in small time deposits, \$990 in loans to business, \$400 in outstanding credit card balance, \$634 in government securities, \$2 in currency, and \$30 in its reserve account in the Fed.

For simplicity, assume that own capital = 0.

(a) Write down the balance sheet for Bank A.

(b) Calculate the bank's total deposits, deposits that are part of M1, and deposits that are part of M2.

(c) Calculate the bank's loans, securities, and reserves.

Answer: (a).

Balance Sheet: Bank A (11/30/2012)

Assets		Liabilities	
Cash	\$ 2	Checkable Deposits	\$320
Reserves at Fed.	30	Saving Deposits	896
Loans	990	Small Time Deposits	840
Credit Card	400		
Securities	634		
		Own Capital	0
Total	\$2,056		\$2,056

(b) total deposits = \$320 + \$896 + \$840 = \$2,056. Deposits are part of M1 (checkable deposits) = \$320. Deposits that are part of M2 include all deposits = \$2,056.

(c) Loan = \$990 + \$400 = \$1,390. Securities = \$634. Reserves = \$2 + \$30 = \$32.