Financial Sector Outline

I. Roles of Money
   A. Medium of exchange
   B. Store of value
   C. Unit of account

II. Definition of Money
   A. M1
   B. M2
   C. M3

III. Financial Assets
   A. Loans
   B. Bonds
   C. Stocks

IV. Time Value of Money
   A. Having a dollar today is worth more than having a dollar a year from now
   B. present values – using interest rates to compare future benefits and costs allows economist to compare the value of dollars received and paid out at different times

V. Banking and Money Creation
   A. Reserves
      1. Currency in bank vault
      1. reserve ratio
      2. required reserve ratio
         a. reserves banks are required by law to hold
         b. prevents a run on the bank
         c. allows FED to control the lending ability of banks
   B. Banking regulations
      1. FDIC
      2. Capital Requirements
      3. reserve requirements
      4. discount window – FED lends money to banks
   C. Banks create money
      1. loan excess reserves
      2. money multiplier – indicates the amount of money created by bank loans

VI. Bank T-account
   A. Financial spreadsheet
      1. assets – economic resources
      2. liabilities - debts

VII. Fed
   A. Federal reserve system
   B. Structure
      1. Chairman
      2. board of governors
      3. 12 federal reserve banks

C. Functions
   1. provide financial services
   2. Supervise and regulate banking institutions
   3. maintain the stability of the banking system
   4. conduct monetary policy
D. Monetary Policy Tools
   1. reserve requirements
   2. discount rate
   3. open market operations

VIII. Demand for money
   A. Opportunity cost of keeping cash
   B. Money Demand Curve
      1. Movement along the curve – caused by change in interest rate
      2. shifting the money demand curve
         a. change in aggregate price level
         b. changes in real GDP
         c. changes in technology
         d. changes in institutions
   C. Money supply Curve
      1. vertical lone
      2. set by FED
      3. increase money supply moves curve right
      4. decrease money supply moves curve left

IX. Real versus Nominal Interest Rate
   A. Real Interest Rate = Nominal interest rate – inflation rate

X. Loanable Funds Market
   A. Brings together buyers and sellers
   B. interest rate on the vertical axis
   C. dollar amounts on the horizontal axis
   D. demand curve
      1. downward sloping
      2. rate of return
      3. business will borrow if the rate of return is equal to or greater than the interest rate
   E. Supply Curve
      1. the amount of money that is made available for loans
      2. people will lend only when interest rates are high enough to make them willing to give up current consumption
   F. Equilibrium
   G. Shift in demand
      1. change in perceived business opportunities
      2. change in government borrowing
   H. Shift in Supply
      1. Change in private saving behavior
      2. change in capital inflows