Chapter 9- Money, Prices, and Financial Intermediaries

* **Financial intermediaries-** firms that extend credit to borrowers using funds raised from savers
* **Money-** any asset that can be used in making purchases; it has three principal uses: a medium of exchange, a unit of account, and a store of value
* **Medium of exchange-** an asset used in purchasing goods and services
* **Barter-** the direct trade of goods or services for other goods or 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
* **Bank reserves-** cash or similar assets held by commercial banks for the purpose of meeting depositor withdrawals and payments

$$Money supply=Currency held by public+Bank Deposits $$

where $Bank Deposits= \frac{Bank Reserves}{Desired reserve-deposit ratio}$

* **100 percent reserve banking-** a situation in which banks’ reserves equal 100 percent of their deposits
* **Reserve deposit ratio-** bank reserves divided by deposits
* **Fractional reserve banking system-** a banking system in which bank reserves are less than deposits so that the reserve-deposit ratio is less than 100 percent
* **Federal Reserve System (or the Fed)-** the central bank of the United States
* **Monetary policy-** determination of the nation’s money supply
* **Open market purchase-** the purchase of government bonds from the public by the Fed for the purpose of increasing the supply of bank reserves and the money supply
* **Open market sale-** the sale by the Fed of government bonds to the public for the purpose of reducing bank reserves and the money supply
* **Open market operations-** open-market purchases and open-market sales
* **Velocity-** a measure of the speed at which money changes hands in transactions involving final goods and services, or, equivalently, nominal GDP divided by the stock of money

$$Velocity \left(V\right)= \frac{Nominal GDP}{Money Stock (M)}= \frac{P × Y}{M}$$

* **Quantity equation-** money times velocity equals nominal GDP