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# Money, Banking, and Financial Institutions

# Functions of Money

- Medium of exchange
  - Used to buy/sell goods
- Unit of account
  - Goods valued in dollars
- Store of value
  - Hold some wealth in money form
- Money is liquid

# Money Definition

## M1

- Currency
- Checkable deposits
- Institutions offering checkable deposits
  - Commercial banks
  - Savings and loan associations
  - Mutual savings banks
  - Credit unions

## M2

- *M1* plus near-monies
- Savings deposits including money market deposit accounts (MMDA)
- Small-denominated time deposits
- Money market mutual funds (MMMF)

# What “Backs” the Money Supply?

- Guaranteed by government’s ability to keep value stable
- Money as debt
- Why is money valuable?
  - Acceptability
  - Legal tender
  - Relative scarcity

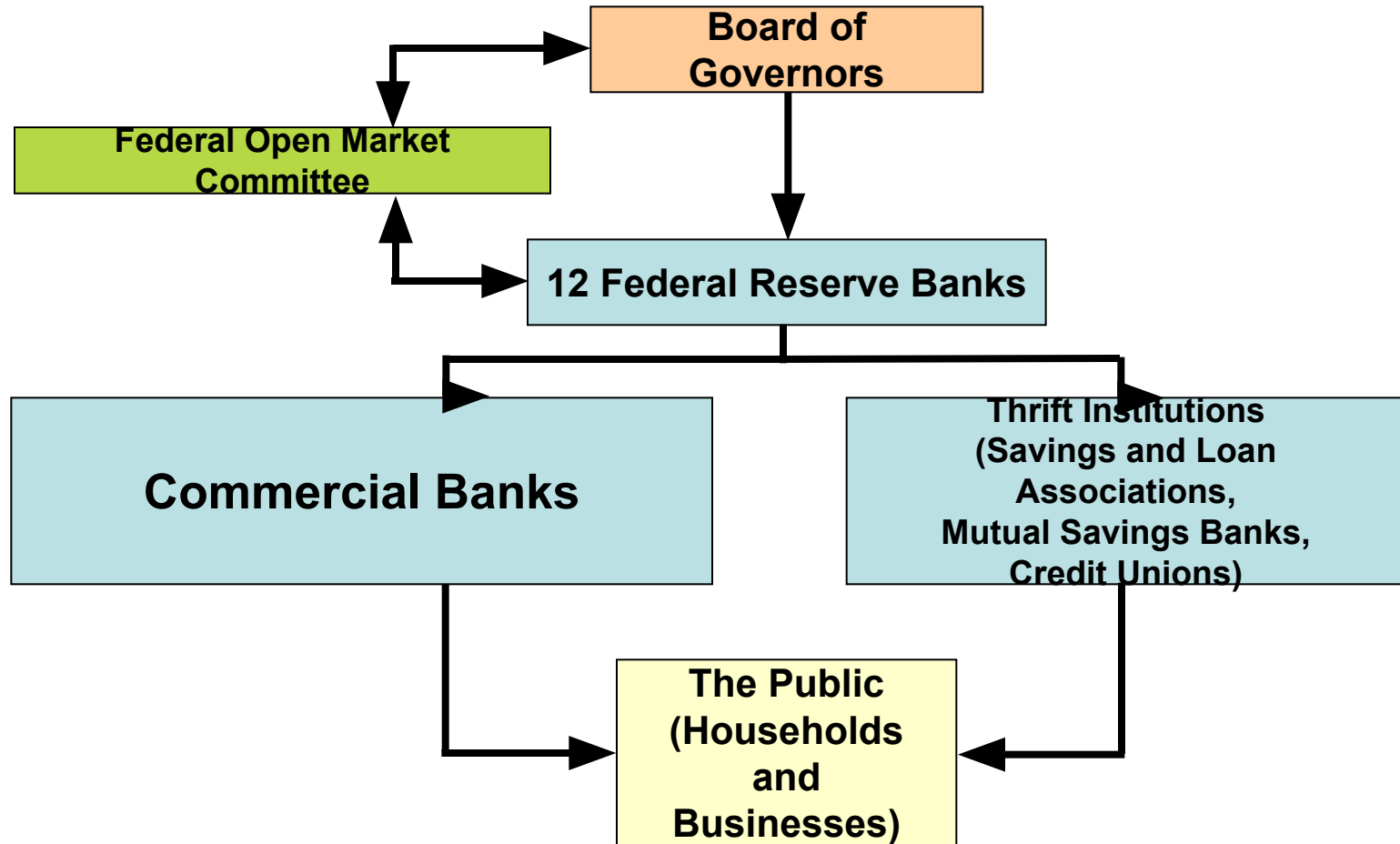
# What “Backs” the Money Supply?

- Prices affect purchasing power of money
- Hyperinflation renders money unacceptable
- Stabilizing money’s purchasing power
  - Intelligent management of the money supply – monetary policy
  - Appropriate fiscal policy

# Federal Reserve - Banking System

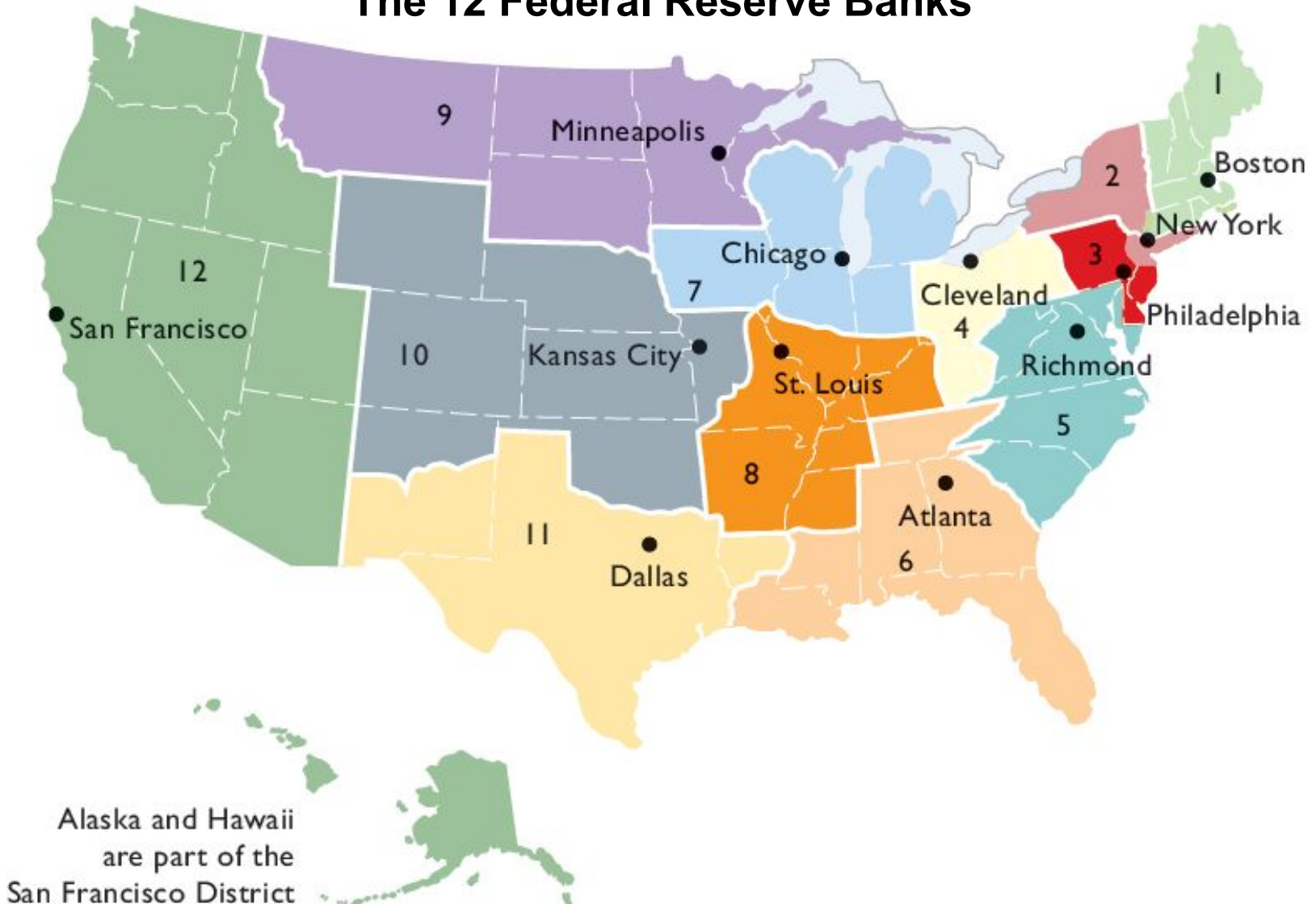
- Historical background
- Board of Governors
- 12 Federal Reserve Banks
  - Serve as the central bank
  - Quasi-public banks
  - Banker's bank

# Federal Reserve – Banking System



# Federal Reserve – Banking System

## The 12 Federal Reserve Banks





# Federal Reserve – Banking System

- Federal Open Market Committee
  - Aids Board of Governors in setting monetary policy
  - Conducts open market operations
- Commercial banks and thrifts
  - 6,800 commercial banks
  - 8,700 thrifts

# Federal Reserve Functions

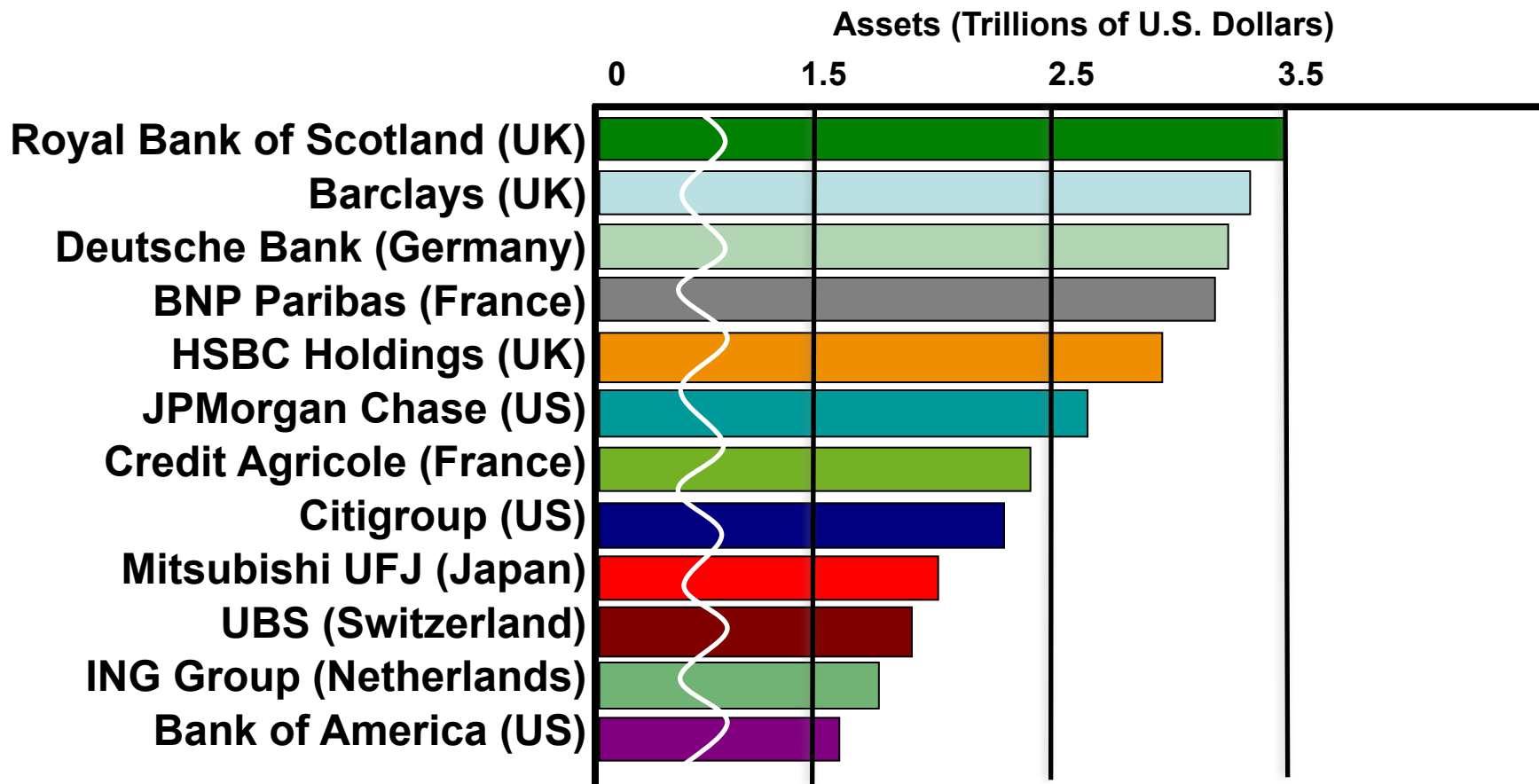
- Issue currency
- Set reserve requirements
- Lend money to banks
- Collect checks
- Act as a fiscal agent for U.S. government
- Supervise banks
- Control the money supply

# Federal Reserve Independence

- Established by Congress as an independent agency
- Protects the Fed from political pressures
- Enables the Fed to take actions to increase interest rates in order to stem inflation as needed

# Financial Institutions

## World's 12 Largest Financial Institutions, 2009



Source: Forbes Global 2000,

<http://www.forbes.com>

# The Financial Crisis of 2007 and 2008

- Mortgage Default Crisis
- Many causes
  - Government programs that encouraged home ownership
  - Declining real estate values
  - Bad incentives provided by mortgage-backed bonds

# The Financial Crisis of 2007 and 2008

- Securitization: the process of slicing up and bundling groups of loans into new securities
- As loans defaulted, the system collapsed
- “Underwater” homeowners abandoned homes and mortgages

# The Financial Crisis of 2007 and 2008

- Failures and near-failures of financial firms
  - Countrywide: second largest lender
  - Washington Mutual: largest lender
  - Wachovia
- Other firms came close

# The Financial Crisis of 2007 and 2008

- Troubled Asset Relief Program (TARP)
  - Allocated \$700 billion to make emergency loans
  - Saved several institutions from failure



# The Financial Crisis of 2007 and 2008

- The Fed's lender-of-last-resort activities
  - Primary Dealer Credit Facility
  - Term Securities Lending Facility
  - Asset-Backed Commercial Paper Money Market Mutual Fund Liquidity Facility
  - Commercial Paper Funding Facility

# The Financial Crisis of 2007 and 2008

- Money Market Investor Funding Facility
- Term Asset-Backed Securities Loan Facility
- Interest Payments on Reserves