

31

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

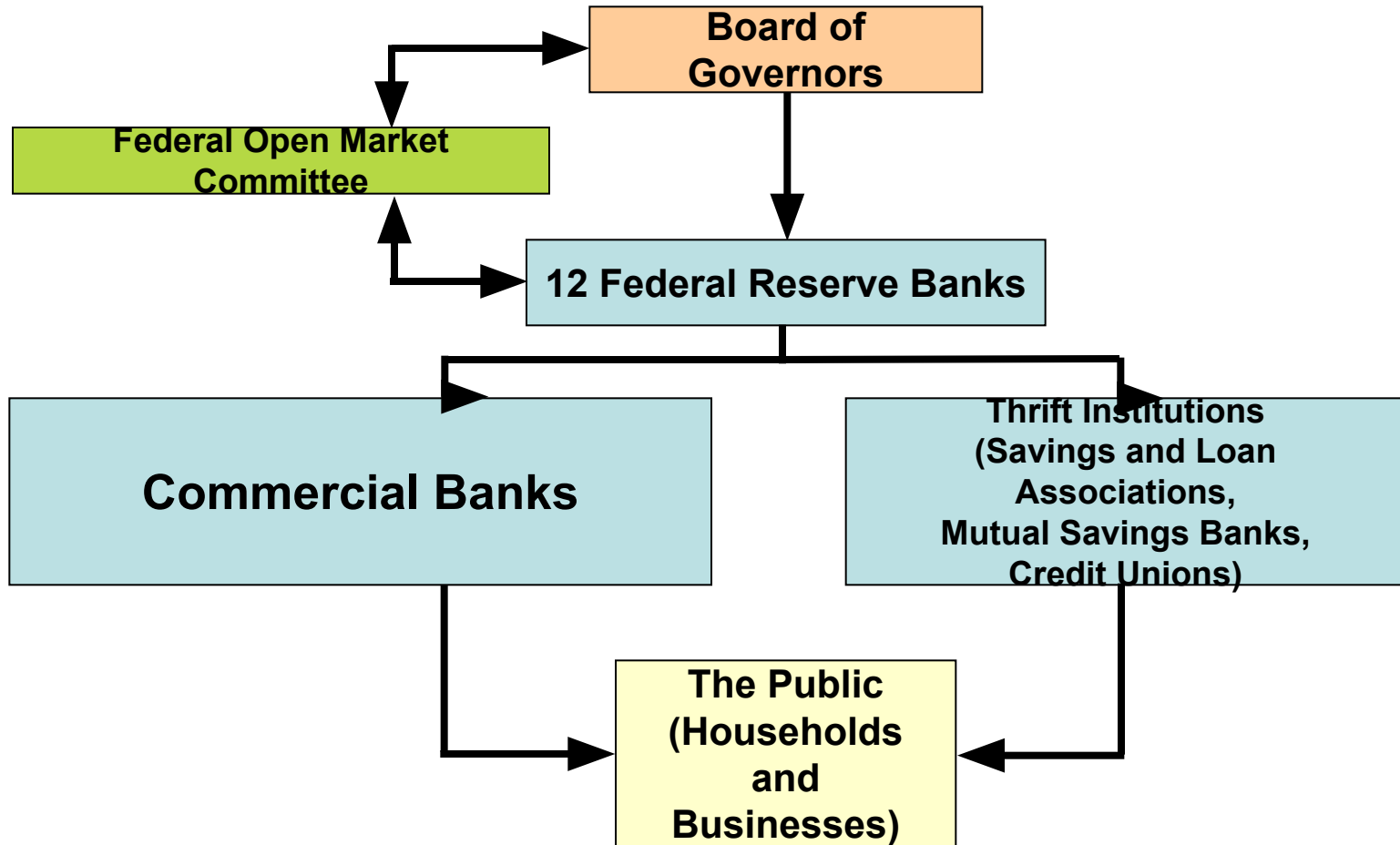
What “Backs” the Money Supply?

- 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

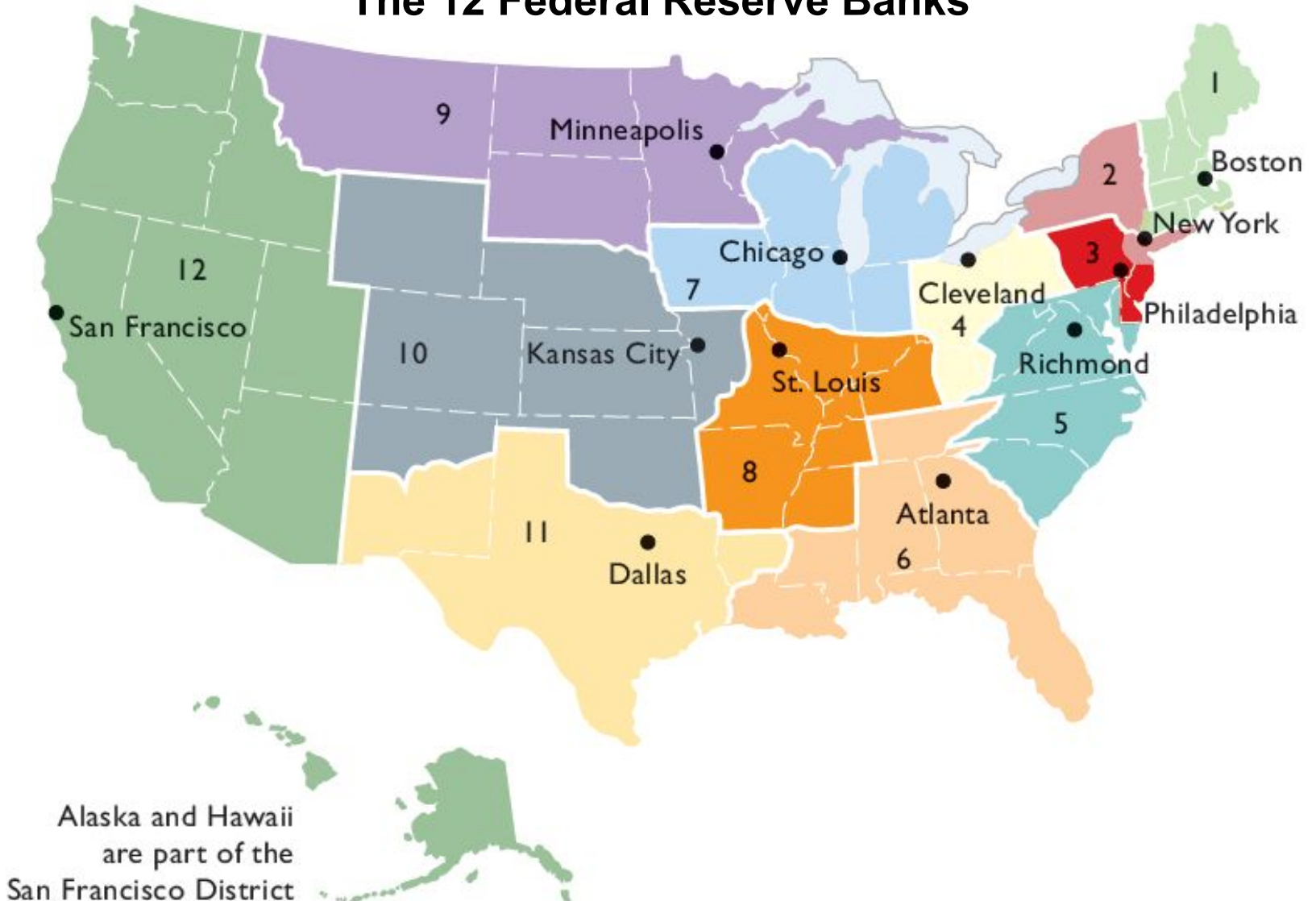
- Historical background
- Board of Governors
- 12 Federal Reserve Banks
 - Serve as the central bank
 - Quasi-public banks
 - Banker's bank

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

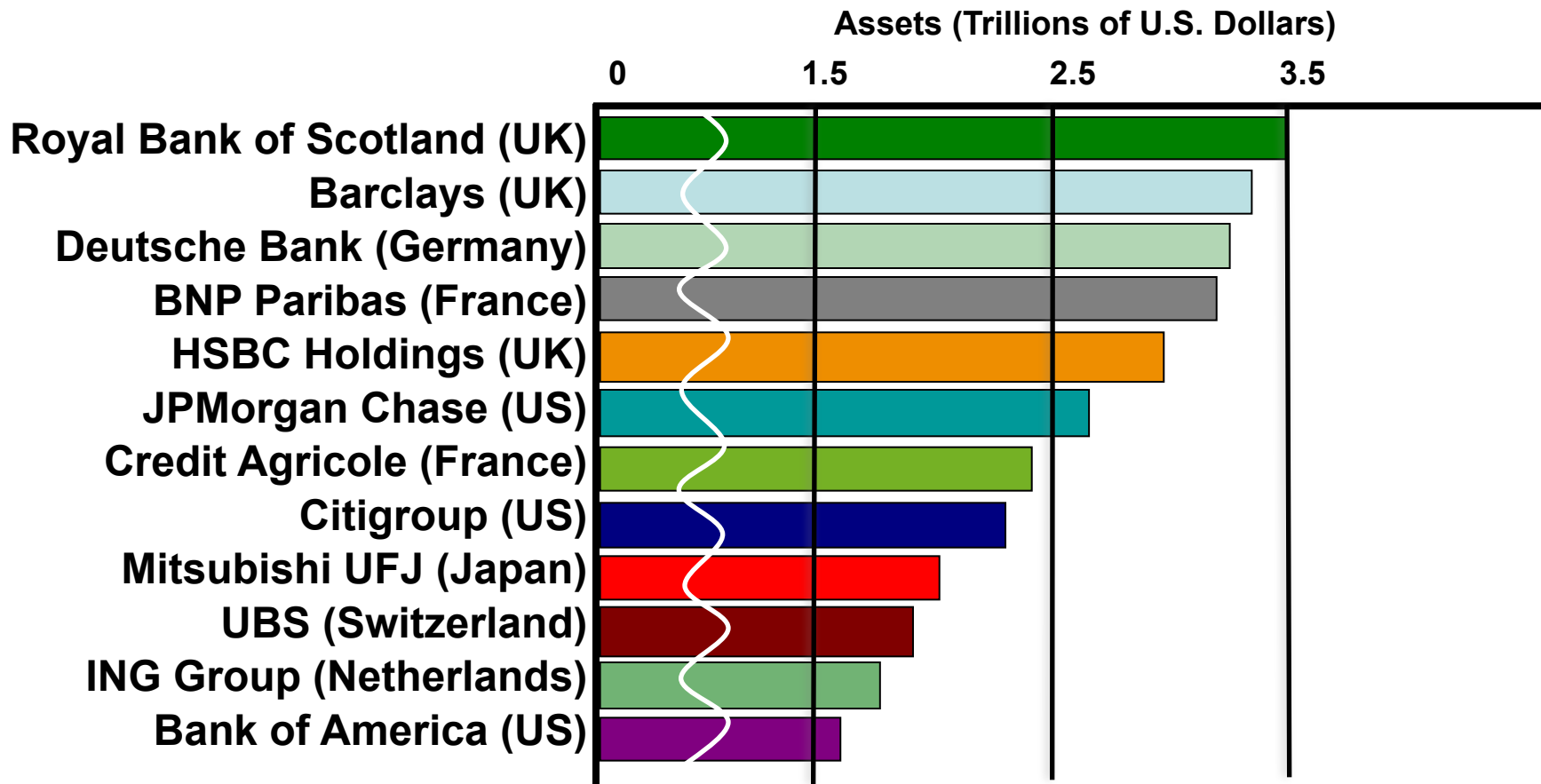
- Issue currency
- Set reserve requirements
- Lend money to banks
- Collect checks
- Act as a fiscal agent for U.S. government
- Supervise banks
- Control the money supply

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