Money and Banking

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- Meaning of Money

- Function of Money

- Evolution of the Payments System

Meaning of Money

Money: *ANYTHING* that is **generally** accepted in *payment* for goods or services or in the *repayment* of debts. (also referred to as the **money supply**):
- currency (dollar bills and coins)
- checking account deposit
- savings deposit

DIFFERENT

Wealth: the *total* collection of pieces of property that serve to store value

Income: *flow* of earnings per *unit of time* (a flow concept)

- **Medium of Exchange** (*lubricant* of the economy):
    - Eliminates the trouble of finding a double coincidence of needs (reduces transaction costs)
    - Promotes specialization

- A medium of exchange must
    - be easily standardized (no ambiguity on its value)
    - be widely accepted
    - be divisible
    - be easy to carry
    - not deteriorate quickly

Functions of Money, Cont'd

- **Unit of Account**:
  - used to measure value (or price) in the economy
  - reduces transaction costs (by reducing the # of prices being used in exchange)

  Example: In a moneyless economy, how many prices are used for exchange if there are 10 goods? What about in an economy with money? (Hint: use the *combinations*)

- **Store of Value**:
  - used to save purchasing power over time.
  - other assets also serve this function (securities, real estates, arts, jewelries, etc.)
  - money is the most *liquid* of all assets but loses value during inflation

Evolution of the Payment System

Commodity Money: metals and other valuable commodities

Fiat Money: paper currency (convertible to non-convertible, gold standard, Bretton Woods system)

Checks: *pros*: reduces transportation cost, can be written in any amount, help to prevent theft; *cons*: less liquidity, processing cost
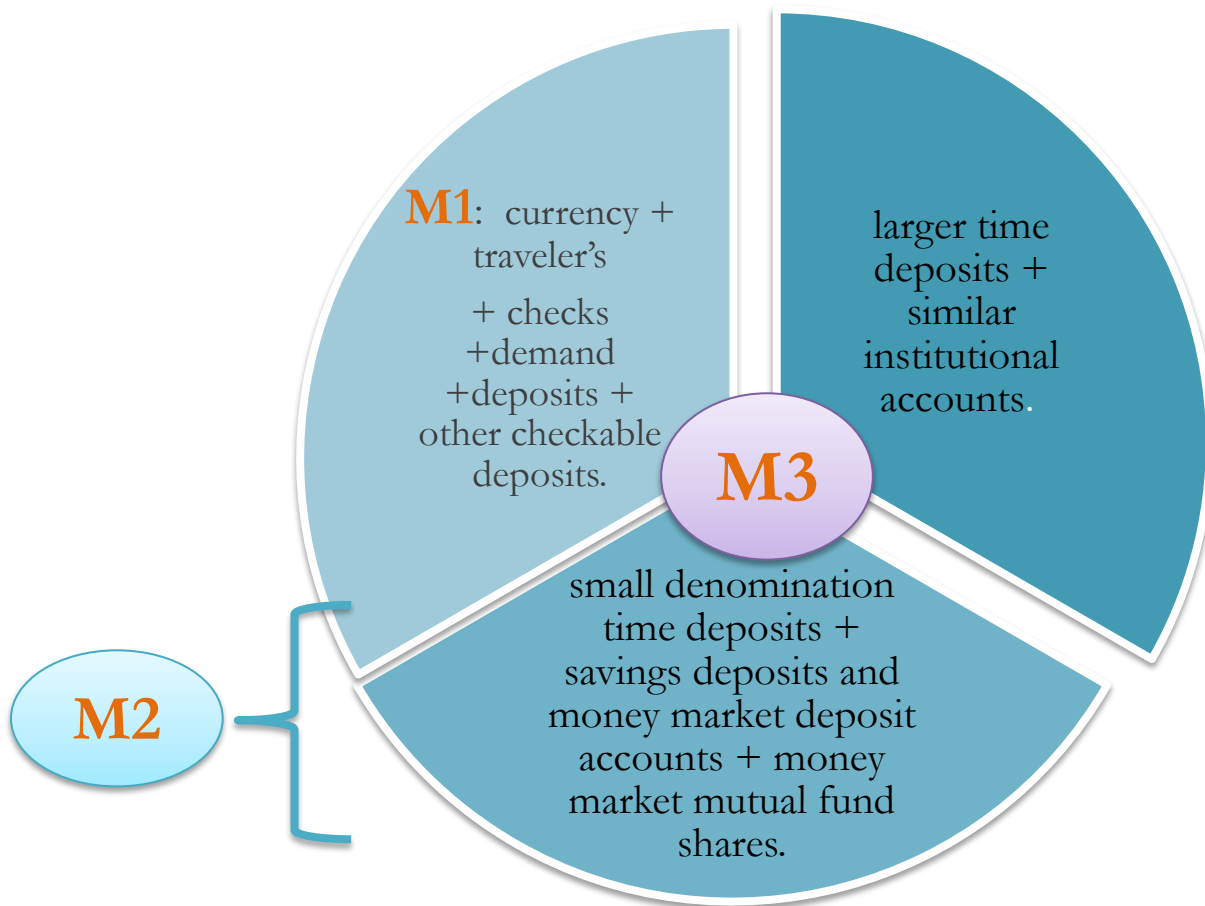
Electronic Payment: online payments

E-money: Debit card, Stored-value card(smart card), E-cash(Paypal, alipay)

Measuring Money

M1: currency + traveler's

+ checks +demand +deposits + other checkable deposits.

larger time deposits + similar institutional accounts.

M3

M2

small denomination time deposits + savings deposits and money market deposit accounts + money market mutual fund shares.

M0(base money)=currency+ deposits in the central bank

Table 1 Measuring Money in the US

Measures of the Monetary Aggregates

	Value as of May 16, 2011 ($ billions)
M1 = Currency	958.8
+ Traveler's checks	4.6
+ Demand deposits	573.1
+ Other checkable deposits	399.0
Total M1	1,935.5
M2 = M1	
+ Small-denomination time deposits	848.3
+ Savings deposits and money market deposit accounts	5,530.4
+ Money market mutual fund shares (retail)	688.4
Total M2	9,002.6

Source: www.federalreserve.gov/releases/h6/hist.

Figure 1 US M1 and M2 Growth Rate
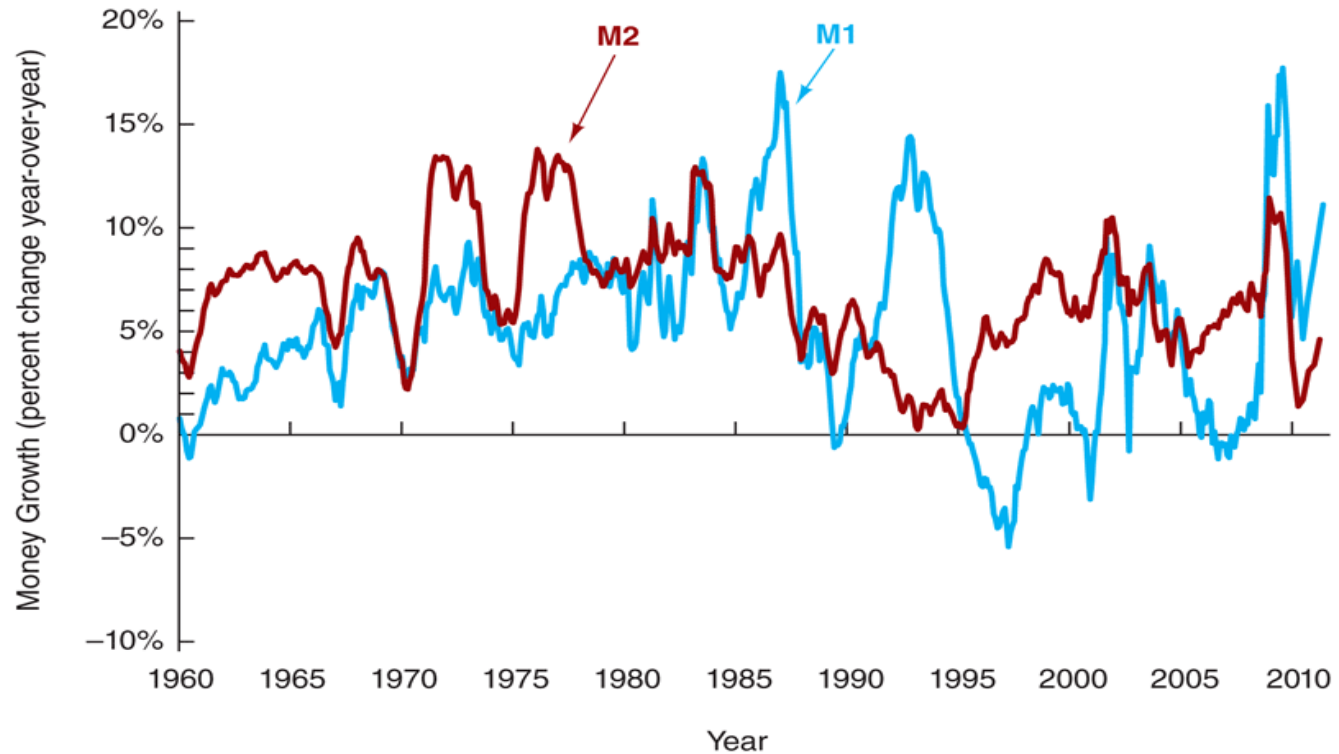
M1 and M2 can move in opposite directions, thus suggesting the importance of choosing appropriate monetary measure for policy makers.

Table 1 Money Supply of China (2013)
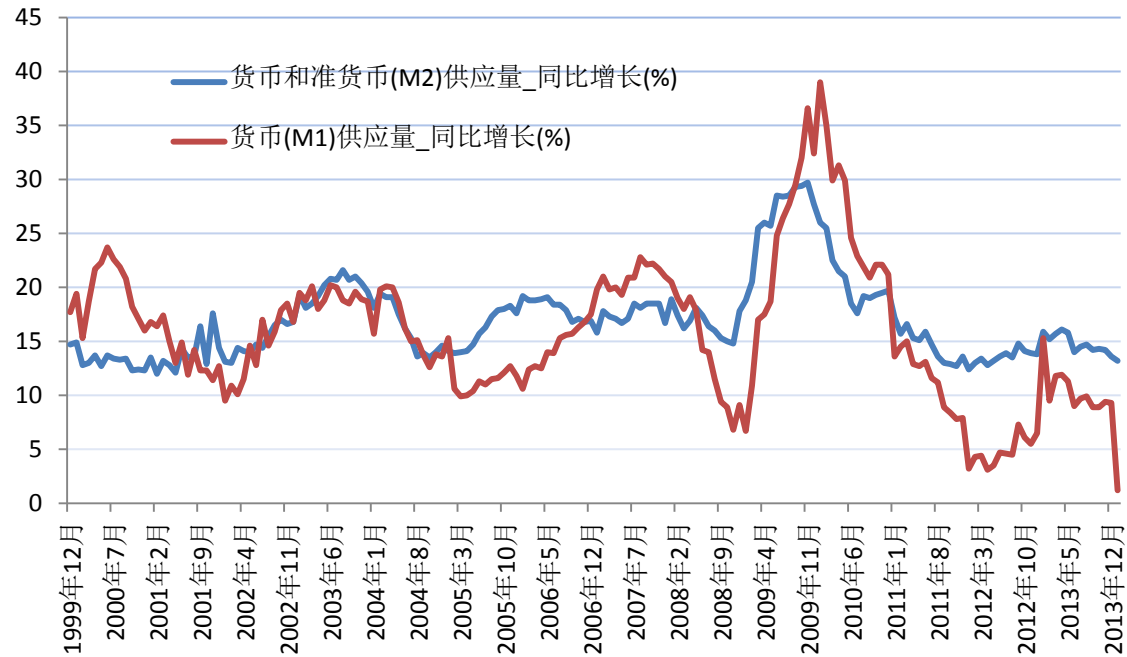
货币供应量统计表

2013年09月 单位:亿元人民币

	余　额	余额比同期%
货币和准货币(M2)	1106509.15	13.59
货币(M1)	337260.63	9.26
流通中货币(M0)	58558.31	7.13
单位活期存款	278702.31	9.72
准货币	769248.52	15.59
单位 定期存款	232718.63	18.77
个人存款	467030.51	13.53
其他存款	69499.38	19.45

注：货币供应量已包括住房公积金中心存款和非存款类金融机构
在存款类金融机构的存款

The exact means of measuring money differ across countries.

Figure 1 US M1 and M2 Growth Rate

Data source: National Bureau of Statistics of China

For China, the M1 and M2 growth rate can be quite difference as well.