Chapter 1: Why Study Money, Banking, and Financial Markets?

A: Why Study Money? Because it is linked to everything we do, almost.

Def: **Money (or the money supply)** - Anything that is generally accepted in payment for goods & services or in the repayment of debts.

1: Money and Inflation

Def: **Aggregate Price Level (Price Level, (P))** - The average price of goods and services in an economy.

Def: **Inflation** - a continually, rising price level

Def: **Inflation rate (π)** - the rate of change of the price level,

$\pi_t = (P_t - P_{t-1})/ P_{t-1}$ footnote 1, p. 5

Def: **Monetary Theory** - theory that relates the money supply to economic growth and the price level

2. Money and Business Cycles

Def: **Aggregate Output** - GDP, the final goods and services produced in an economy during the year.

Def: **Unemployment Rate** - the percentage of the available labor force that is unemployed.

Def: **Business Cycles** - the ups and downs of the aggregate output of an economy (real GDP)

See Figure 1.3: Notice the drop in the M^s right preceding every recession. Careful, also not that a sharp drop in the money supply does not necessarily mean a recession.

Def: **Recessions** - two or more quarters of negative real GDP

Def: **Interest rate** - the cost of borrowing or the price paid for the rental of funds.

3. Conduct of Monetary Policy

Def: **Monetary Policy** - the management of money and interest rates

4. Budget Deficits and Monetary Policy

Def: **Budget Deficit** - excess of government expenditures over tax revenues, a deficit must be financed by borrowing.

B: Why Study Banking?

Def: **Banks** - financial institutions that a) accept deposits and b) make commercial loans

Banks

a) provide a channel for linking those who want to save with those who want to borrow (invest),
b) are important in the determination of the money supply,
c) are a source of financial innovation.

Def: **Financial Intermediation** is the creation of financial securities and their transfer from issuers to investors (borrowers)

Def: **Financial Intermediaries** are institutions such as credit unions, savings banks, insurance companies, pension funds etc. and banks.

Def: **Financial securities** are IOUs issued by borrowers because they spend more than they make in income or revenue.

Def: **Financial Markets** are markets in which securities are transferred. They promote economic efficiency by channeling funds from those who have extra funds to those who desire those funds.

The **bond** market: Larger than the stock market, it determines interest rates and price of bonds.

The **stock** market: The equity or ownership market is the place which determines the market value of public companies. These are actual claims on a company's earnings or profits.

Foreign exchange market: Is the market which determines the price of one country's currency in terms of another's (or **foreign exchange rate**).

B. Indicators and Measures of the Goals of any Macroeconomy

A. What are the three major economic goals of any economy?

1. Full Employment
2. Economic Growth
3. Price Stability

B: What is an **indicator** of our achievement of each of these goals?

1. Employment rate, Unemployment rate, non-farm payroll
2. Gross Domestic Product (GDP), Industrial Production
3. Consumer Price Index, Producer Price Index, Gross Domestic Product deflator (implicit price deflator)