Lecture 4

Lecture 4 will use the following transparencies, plus Figure 1 and Table 1-2 of Chapter 3 of the textbook

Functions of Money

• Medium of Exchange

• Unit of Account (important for quoting prices, writing contracts)

• Store of Value

• Standard of Deferred Payment
The Value of Money

• Value of money (in terms of goods): inverse of the price level

• Real return on money between one period to the next: ratio of next period price level to the current price level ( = the inflation rate)

Features of Money

Whatever serves as money should be

• Easy to carry

• Hard to counterfeit

• Durable

• Divisible

• Be stable in value
The Evolution of Money

• Commodity Money System (typically precious metals)
  - 1 dollar is a fixed amount of gold
  - if paper dollar exist, they can be converted into gold

• Fiat Money System
  - 1 dollar is a piece of paper issued by the government
  - it is a claim to nothing at all
  - it is a legal tender

Non-Cash Payments

• Checks
• Direct debit transactions
• Debit cards
• Wire transfers (Fedwire, CHIPS) among banks
• Automatic clearinghouses (ACH)
• e-money (stored-value cards; e-cash/checks)
Measuring Money

- Money definitions frequently change with financial innovation
- Narrow and broad money supply series do not move together closely
- Short run money data are inaccurate in short run (bank reporting deadlines; seasonal adjustment)

-> money supply data hard to interpret in the short run when policy decision must be made)
-> most central banks have given up formulating targets for the money supply