

## Chapter 3

### What Is Money?



# Meaning of Money

- Money (money supply)—anything that is generally accepted in payment for goods or services or in the repayment of debts; a stock concept
- Wealth—the total collection of pieces of property that serve to store value
- Income—flow of earnings per unit of time



# Functions of Money

- Medium of Exchange—promotes economic efficiency by minimizing the time spent in exchanging goods and services
  - ◆ Must be easily standardized
  - ◆ Must be widely accepted
  - ◆ Must be divisible
  - ◆ Must be easy to carry
  - ◆ Must not deteriorate quickly
- Unit of Account—used to measure value in the economy
- Store of Value—used to save purchasing power; most liquid of all assets but loses value during inflation



# Evolution of the Payments System

- Commodity Money
- Fiat Money
- Checks
- Electronic Payment
- E-Money



**TABLE 1 Measures of the Monetary Aggregates**

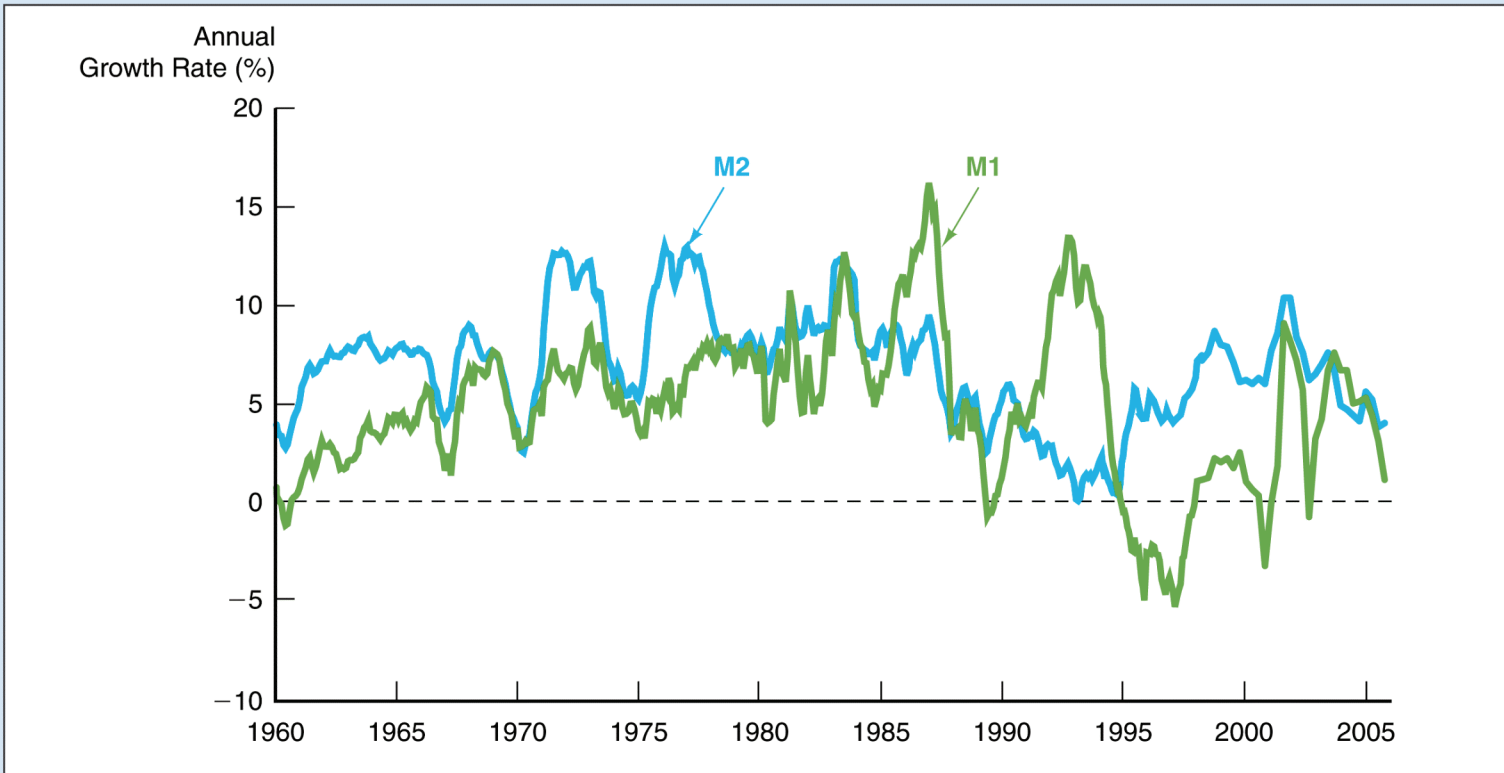
	Value as of December 2005 (\$ billions)
M1 = Currency	725.2
+ Traveler's checks	7.3
+ Demand deposits	338.8
+ Other checkable deposits	<u>317.8</u>
Total M1	1,389.1
M2 = M1	
+ Small-denomination time deposits	968.8
+ Savings deposits and money market deposit accounts	3626.5
+ Money market mutual fund shares (retail)	<u>723.9</u>
Total M2	5,319.2

Source: [www.federalreserve.gov/releases/h6/hist](http://www.federalreserve.gov/releases/h6/hist).



# How Reliable are the Money Data?

- Revisions are issued because:
  - ◆ Small depository institutions report infrequently
  - ◆ Adjustments must be made for seasonal variation
- We probably should not pay much attention to short-run movements in the money supply numbers, but should be concerned only with longer-run movements



**FIGURE 1** Growth Rates of the M1 and M2 Aggregates, 1960–2005

Sources: Federal Reserve *Bulletin*, p. A4, Table 1.10, various issues; Citibase databank;  
[www.federalreserve.gov/releases/h6/hist/h6hist1.txt](http://www.federalreserve.gov/releases/h6/hist/h6hist1.txt).

**TABLE 2****Growth Rate of M2: Initial and Revised Series, 2005  
(percent, compounded annual rate)**

Period	Initial Rate	Revised Rate	Difference (Revised Rate – Initial Rate)
January	6.1	2.7	–3.4
February	2.5	3.6	1.1
March	5.9	3.6	–2.3
April	–1.0	1.1	2.1
May	–1.0	1.6	2.6
June	7.2	4.9	–2.3
July	1.4	3.7	2.3
August	7.3	5.5	–1.7
September	6.9	5.5	–1.4
October	7.0	5.3	–1.7
November	4.7	3.9	–0.8
December	7.0	5.1	<u>–1.9</u>
Average	4.5	3.9	–0.6

Source: Federal Reserve Statistical Release H.6: [www.federalreserve.gov/releases/h6](http://www.federalreserve.gov/releases/h6).