

Money

FIN 204 Lecture 2.1.

Petar Stankov

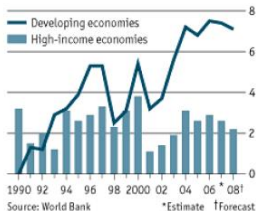
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16 Feb. 2009

A follow-up on a question from the last lecture

Not an obvious disaster

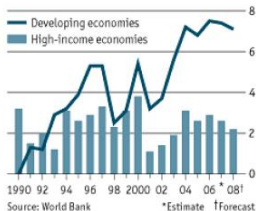
GDP, % increase on previous year



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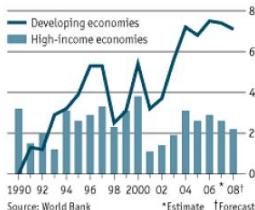


Why?

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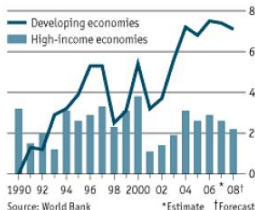
① Fertility rate has fallen dramatically since 1970:

- East Asia and the Pacific: from 5.4 to 2.1
- South Asia: from 6.0 to 3.1
- The World: from 4.8 to 2.6

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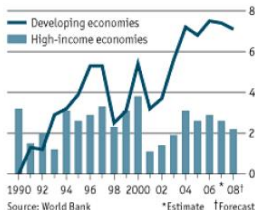
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- 2 Half of mankind (in 40 countries) lives in economies growing at 7%/yr. or more
- 3 Decline in the number of wars and rise in resolved conflicts

Outline

- 1 What is Money?
- 2 Functions of Money
- 3 Measuring Money
- 4 Payment Systems and Their Evolution

What is Money?

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Definition: Personal wealth

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Definition: Income

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Definition: Income

Income is the *flow* of money, interest rate and maturity payments per unit of time.

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 - liquidity

What is liquidity?

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Liquidity is the relative ease and speed with which an asset can be converted into a medium of exchange

Advantages and disadvantages of a higher liquidity:

Advantages

- lower costs of transactions
- ...

Disadvantages

- no interest
- inflation eats it up
(hyperinflation in BG, 1997)

How do we measure money?

Why is measuring money important?

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Measures of the money (money supply): **monetary aggregates**

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Three main monetary aggregates:

- M1
- M2
- M3
- MP3s

What is **M1**?:

What is **M1**?: Currency and assets that can be used directly as a medium of exchange

Table 1 Measures of the Monetary Aggregates

	Value as of December 2002 (\$billions)
M1 = Currency	626.5
+ Traveler's checks	7.7
+ Demand deposits	290.7
+ Other checkable deposits	281.2
Total M1	1,206.1

M2 and M3

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What is **M3**?: Currency and assets that are less liquid – can not be turned into cash with little cost

M2 = M1

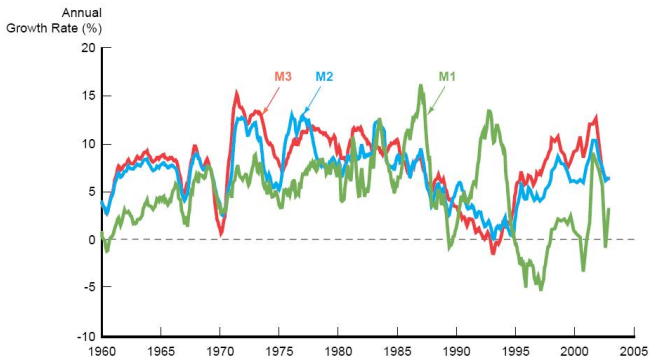
+ Small-denomination time deposits and repurchase agreements	1,332.3
+ Savings deposits and money market deposit accounts	2,340.4
+ Money market mutual fund shares (noninstitutional)	923.7
Total M2	5,802.5

M3 = M2

+ Large-denomination time deposits and repurchase agreements	1,105.2
+ Money market mutual fund shares (institutional)	767.7
+ Repurchase agreements	511.7
+ Eurodollars	341.1
Total M3	8,528.2

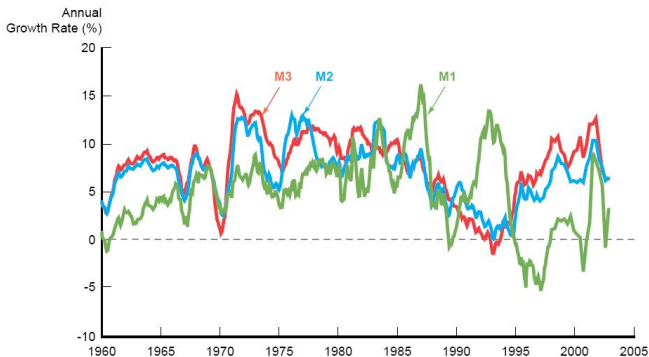
The Growth of Money Over Time

How do the monetary aggregates move over time?



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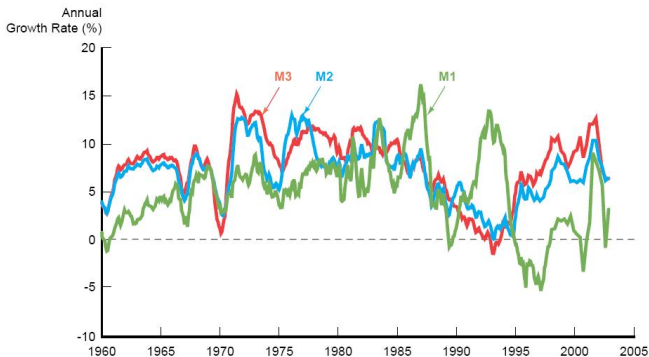
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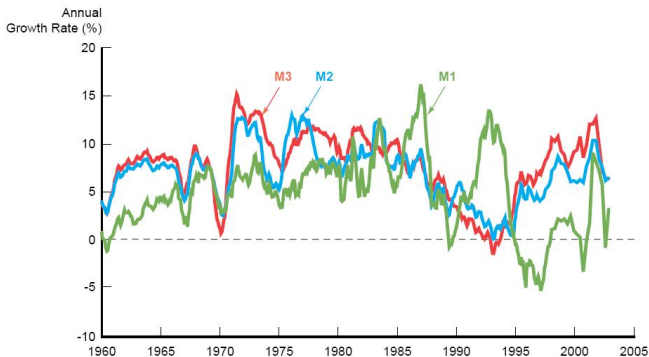
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The Growth of Money Over Time

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- today, the story is more complex
- money (measurement) matters. Why?

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Evolution of the payment system is evolution of money:

- **Commodity money:** precious metals or another valuable commodity
- **Paper money:** a guarantee that the piece of paper was convertible into coins or into a quantity of precious metal
- **Fiat money:** paper money issued by the government that are generally not convertible into precious metals but everyone accepts them as a medium of exchange
- **Checks:** an instruction to the bank to pay a specified amount of fiat money to the holder of the check
- **E-money:** electronic settlement of payment needs

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Can we think of advantages and disadvantages of each form of money?