

Chapter 3

What Is Money?

Meaning of “Money”

- Common uses of the word “money”
 - currency (banknotes and coins)
 - wealth (all property that serves to store value)
 - income (the flow of earnings per unit of time)
- Economists’ meaning of “money” is *stock*
 - anything that is generally accepted in payment for goods and services
 - not the same as wealth or income

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Functions of Money

1. *Medium of exchange* = used to pay for goods and services
 - it reduces transaction costs (vs. a barter economy)
 - a commodity can be used as money if:
 - is easily standardized
 - is widely accepted
 - is divisible
 - is easy to carry
 - does not deteriorate quickly

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Functions of Money (cont.)

2. *Unit of account* = prices are expressed in terms of the same unit,
 - allows the comparison of goods in terms of cost (price)
 - reduces transaction costs – no need for pairwise prices
3. *Store of value* = allows the intertemporal transfer of purchasing power
 - not that much in case of (hyper)inflation

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Evolution of Payment Systems

- precious metals like gold and silver – heavy, so hard to transport
- paper currency (fiat money) – easy to steal
- checks – not that fast to travel to different locations (so funds are not immediately available), costly to process
- electronic means of payment – online bill-pay
- electronic money: debit cards, stored-value cards (e.g., prepaid phone cards), smart cards, e-cash

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Federal Reserve’s Monetary Aggregates

- Monetary Aggregates, most liquid first:
 - *M1* = assets that can be clearly used as medium of exchange (like-cash assets, checking accounts)
 - *M2* = adds onto M1 assets on which checks can be written or other assets that can be turned into cash fast and at very little cost (e.g., savings accounts)
 - *M3* = adds onto M2 less liquid assets

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Federal Reserve's Monetary Aggregates – Example

Table 1 Measures of the Monetary Aggregates

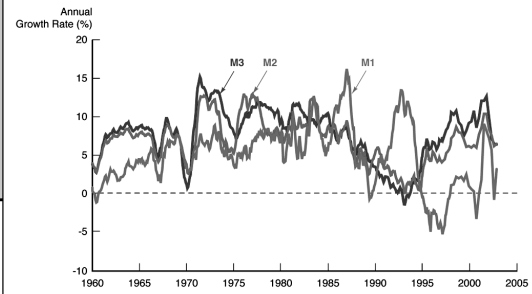
	Value as of December 2002 (\$billions)
M1 = Currency	626.5
+ Traveler's checks	7.7
+ Demand deposits	290.7
+ Other checkable deposits	281.2
Total M1	1,206.1
M2 = M1	
+ Small-denomination time deposits and repurchase agreements	1,332.3
+ Savings deposits and money market deposit accounts	2,340.4
+ Money 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	911.7
+ Eurodollars	341.1
Total M3	8,528.2

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

Note: The Traveler's checks item includes only traveler's checks issued by non-banks, while traveler's checks issued by banks are included in the Demand deposits item, which also includes checkable deposits to businesses and which also do not pay interest.

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Growth Rates of Fed's Monetary Aggregates



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How Reliable Are M2 Money Data: Data Revisions

Table 2 Growth Rate of M2: Initial and Revised Series, 2002
(percent, compounded annual rate)

Period	Initial Rate	Revised Rate	Difference (Revised Rate – Initial Rate)
January	2.2	5.4	3.2
February	6.8	8.7	1.9
March	-1.4	0.2	1.6
April	-4.0	-2.6	1.4
May	14.8	15.4	0.6
June	7.6	7.1	-0.5
July	13.6	11.0	-2.6
August	9.9	8.6	-1.3
September	5.1	5.7	0.6
October	10.9	8.3	-2.6
November	10.2	8.0	-2.2
December	2.8	2.8	0.0
Average	6.5	6.5	0.0

Source: Federal Reserve Statistical Release H.6: www.federalreserve.gov/releases/h6.

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