LGA Personal Finance/Economics Class

*Vocabulary and Notes*

***Money and Banking – March 4, 2014***

Three functions of money

1. A medium of exchange – trade it for goods and services
2. A store of value – hold your wealth in form of money until you are ready to use it
3. A measure of value – a measuring stick used to assign value to a good or service

Types of money \*Anything that people are willing to accept in exchanges or services can serve as money

Coins – metallic forms of money

Currency – includes both coins and paper money

\*Money has value because we are sure that someone else will accept its value as well

**Financial System**

**Types of Financial Institutions**

\*all institutions act to bring savers and borrowers together, give people a safe place to deposit their money and a source for borrowing for loans

Commercial banks – financial institutions that offer full banking services to individuals and businesses

Savings and loan associations (S&Ls) – financial institutions that traditionally loaned money to people buying houses. Today they perform more services of a commercial bank

Credit Unions – work on a not-for-profit basis; often sponsored by large businesses, labor unions, or government institutions; open only to members of the group that sponsors them; low cost benefit

**Keeping the System Safe**

Federal Deposit Insurance Corporation (FDIC) – a federal corporation that insures individual accounts in financial institutions – up to $250,000.

**Federal Reserve System**

\*Known as the Fed, it is the central bank of the United States

\*Where banks borrow money

\*Made of 12 Federal Reserve Districts

Federal Open Market Committee (FOMC) – major policy-making group within the Fed

**Functions of the Fed –**

1. Regulatory Functions
   1. Banking regulations
   2. Consumer credit regulations
2. Acts as Government’s Bank
   1. Holds government’s money
   2. Sells US government bonds and Treasury bills (how government borrows money)
   3. Issues the nation’s currency
3. Conducting Monetary Policy
   1. Monetary policy – involves controlling the supply of money and the cost of borrowing money (credit) according to the needs of the economy
   2. Fed can increase or decrease the supply
   3. Tools to manipulate the money supply
      1. Discount rate – the rate the Fed charges member banks for loans
         1. to stimulate the economy it lowers the rate which encourages banks to borrow money to make loans
         2. to slow the economy, the Fed raises the rate to discourage borrowing, contract the money supply, and raise interest rates
      2. Raise or lower the reserve requirement for member banks (reserve is percentage of a banks money they must keep in Federal Reserve Banks as a reserve against their deposits)
         1. A raised reserve requirement means a bank has less to lend
         2. A lower reserve requirement gives a bank more to lend
      3. Purchase or sell U.S. government bonds and Treasury bills – this is called open market operations
         1. Buying bonds from investors puts more cash in investors’ hands, increasing the money supply
         2. If Fed decides interest rates are too low, Fed can sell bonds

**How Banks Operate**

Checking accounts – allow customers to write checks or use check/debit cards

\*easy access to money, balance usually fluctuates

Savings accounts – accounts where banks pay interest to customers based on how much money they have deposited

\*money will grow more interest the longer it can be left untouched

Certificates of deposit (CDs) – customers loan a certain sum to the bank for a specific period of time and the bank pays interest during that time

\*penalty for taking out money from CD before end of the set time

Loans – a principle activity of banks - Loans can actually increase the supply of money