The Banking System

Outline Notes

LEARNING TARGETS

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THE ROLE OF BANKS

Banks are financial intermediaries that use the liquid deposits of its customers to finance loans for individuals and firms.

1)

2)

3)

BANK RUNS

A **bank run** is when many depositors, due to a fear of a bank failure, rush to withdraw their money. When multiple bank runs occur, it is called a **panic**.

1)

2)

3)

4)

5)

BANK REGULATION

In order to prevent bank runs and other financial catastrophes, the U.S. banking system is regulated by a central bank known as the Federal Reserve.

1) Deposit Insurance

2) Capital Requirements

3) Reserve Requirements

4) Discount Window

HOW BANKS CREATE MONEY

Banks only keep a portion of deposits as reserves (**fractional reserve banking**). Because excess reserves are loaned out, money gets "created."

1) **Stage One**

2) **Stage Two**

3) **Stage Three**

4) **Stage Four**

5) **Subsequent Stages**

#	Currency in Circulation ($)	Checkable Deposits ($)	Total Money Supply ($)
1			
2			
3			
4			
5			
T			

THE MONEY MULTIPLIER

The **money multiplier** calculates the maximum change in checkable deposits due to an increase or a decrease in the amount of excess reserves.

1) **Money Multiplier Formula**

A)

B)

C)

D)

2) **How Much Money Gets Created?**

A)

B)

MONEY SUPPLY VS. MONETARY BASE

The money multiplier calculates the maximum increase in the money supply. In reality, this increase is much smaller because people hold money as currency.

1) **The Money Supply**

A)

B)

2) **The Monetary Base**

A)

B)

3) **The Money Multiplier Revisited**

A)

B)