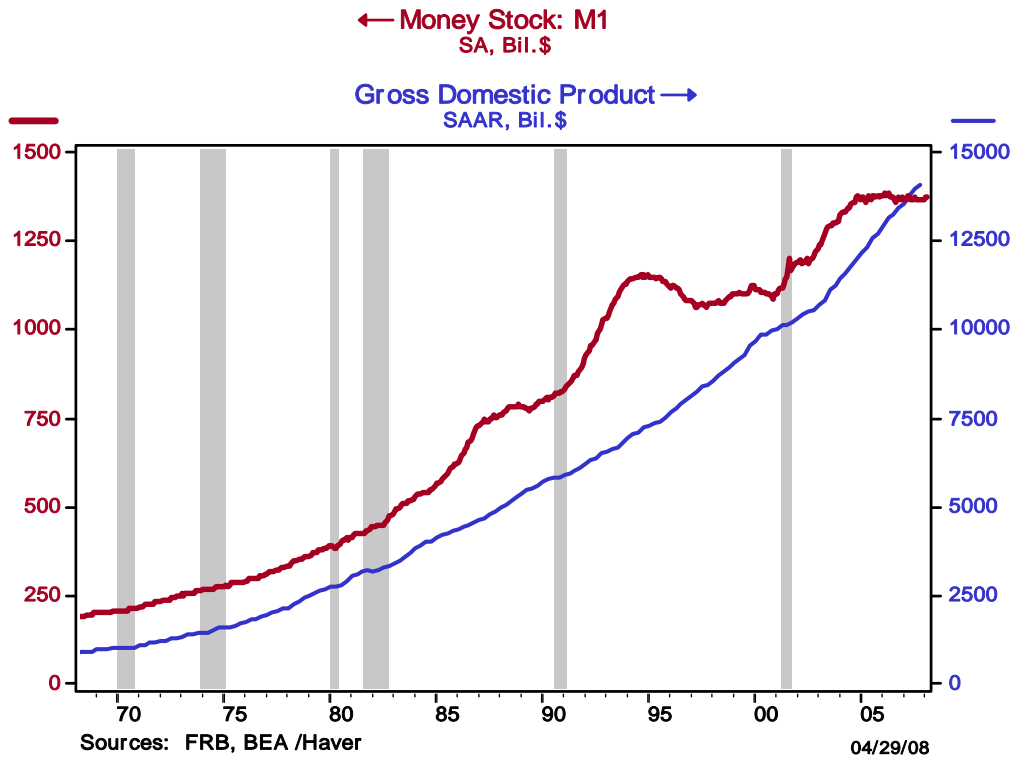


What is the Importance of the Money Supply?

The supply and availability of money is believed to drive the economy by affecting interest rates, credit availability, and consumer spending. The supply of money is important because the money markets interact with the goods markets in arriving at levels of GDP and prices. Economists generally discuss two types of money:

- M1: currency/coin in the hands of the public and checkable deposits (checkbook money in commercial banks and other checking writing thrift/savings institutions).
- M2: “Near Money” consisting of savings deposits, money markets deposits, time deposits under \$100,000, and money market mutual funds.

Generally the GDP and the money supply move together. The shaded areas in the diagram below are recessions.



The Federal Reserve System determines the course of monetary policy, including variations in interest rates, changes in credit availability, changes in the money supply, and purchases and sales of securities by the Federal Reserve System. The Fed attempts to control the level of overall liquidity (i.e., the availability of money and levels of interest rates) in the economy in order to promote economic growth, reduce unemployment, and maintain price stability. The newspapers typically provide significant coverage to the Federal Reserve’s Federal Open Market Committee (FOMC) on a monthly basis. Lower interest rates generally make additional liquidity available to housing and investment markets. The converse is true for higher rates.