I. MEMBERS OF THE BANKING SYSTEM

A. Commercial banks
   1. profit-oriented
   2. activities relevant to our purposes
      a. hold customers' demand deposits
      b. transfer funds for customers
      c. issue loans [a primary source of revenue]

B. Federal Reserve System
   1. our "central bank"
   2. components
      a. Board of Governors
      b. 12 regional Federal Reserve Banks
      c. Open Market Committee
   3. functions include
      a. serve as banker to commercial banks
      b. exercise Monetary Policy

C. "other financial institutions"

II. CREATION OF MONEY BY THE BANKING SYSTEM

A. Preliminaries
   1. Balance sheet
      a. assets: reserves, loans to customers, other
      b. liabilities: deposits by customers, other
      c. process: double-entry
   2. Fractional-reserve system
      a. Required Reserves
      b. Excess Reserves
      c. Required Reserve Ratio
      d. why require reserves in the first place?
   3. Simplifying Assumptions
      a. no cash drain
      b. banks wish to hold no excess reserves
      c. simple required reserve ratio
B. Demonstration of the creation of money through a “monopoly” bank

1. Robinson Crusoe

2. display on balance sheet
   a. initial equilibrium
   b. deposit:
      i. change deposit balance and reserves
      ii. thus changes required reserves and excess reserves
      iii. notion of “Deposit Slack”
   c. thus change ability to issue loans to customers
   d. thus change [again] deposit balances, required reserves and excess reserves
   e. show resultant check, and further changes in deposits, reserves, required reserves and excess reserves

3. observations
   a. what allows the bank to issue new loans
   b. what happens to the Money Supply as a result of these activities
   c. define “Deposit Multiplier” or “Money Multiplier”

C. More realistic demonstration of the creation of money through a “many-bank” system

1. similar balance sheet displays

2. how checks “clear”

3. primary difference: how much any individual member bank can increase its loans to its customers at each step

4. similar multiplier for the entire banking system

D. Examples and exercises