

CONCEPT: REQUIRED RESERVES AND THE DEPOSIT MULTIPLIER

- The definition of ***M1*** includes *currency in circulation* and *checking account deposits* in the money supply

□ **Reserves** – deposits that banks have received but not _____

□ **Reserve Ratio** – the amount of deposits that banks have to keep in cash

> Generally, banks only keep a fraction of their deposits in cash

Clutchtopia originally has no banks and the total amount of currency in circulation is equal to \$1,000	Money Supply = _____
First Bank of Clutch opens and the Clutchtopians are so excited that they deposit all \$1,000 in the bank.	Money Supply = _____ <div><div></div><div></div></div>
<p>100-percent-reserve banking – a system where all deposits are held as reserves (Reserve Ratio = _____)</p> <p>Fractional-reserve banking – a system where banks only hold a fraction of deposits as reserves (Reserve ratio _____)</p> <p>Required Reserves – reserves that a bank is legally required to hold (based on mandated reserve ratio)</p> <p>Excess Reserves – reserves held over the legal requirement</p>	
The government in Clutchtopia mandates that banks must hold 10% of deposits in reserves. First Bank of Clutch decides to loan all excess reserves to Johnny Clutch.	Money Supply = _____ <div><div></div><div></div></div>

Johnny Clutch buys his dream car, a 1971 Ford Pinto, from Fast Eddie. Fast Eddie deposits the money at Second Bank of Clutch in his checking account. Second Bank of Clutch loans out their excess reserves.



Money Supply = _____

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Third Bank of Clutch receives a deposit from the Second Bank of Clutch loans.

Money Supply = _____

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• **Money Multiplier** – the amount of money the banking system generates for each dollar of _____

Bank	Increase in Checking Account Deposits
Initial Deposit at First Bank of Clutch	
Second Bank of Clutch	
Third Bank of Clutch	
Fourth Bank of Clutch	
...	
Total Change in Deposits	

$$\text{Money Multiplier} = \frac{1}{\text{Reserve Ratio}}$$

$$\text{Reserve Ratio} = \frac{\text{Reserves}}{\text{Deposits}}$$