Achievable

AP MACROECONOMICS DUMP SHEET

Unit 4: Financial assets, money, and banking

Financial assets

- **Bonds** are debt; **stocks** are equity (ownership)
- **Liquidity:** how easily an asset turns into usable cash. Cash and demand deposits are the most liquid
- Less liquid or riskier assets must pay more
- **Opportunity cost of holding money:** the interest it could have earned
- **Rates ↑ → prices of existing bonds ↓.** Rates ↓ → prices ↑. Longer bonds move more. On an FRQ, state the direction

Nominal and real interest rates

$$\text{Real rate} = \text{nominal rate} - \text{inflation rate}$$

- **Looking ahead:** nominal = real + expected inflation. Expected inflation ↑ → nominal rates ↑
- **Looking back:** realized real rate = nominal − actual inflation. Unexpected inflation lowers it
- Loan at 10%, 2% expected, 5% actual: expected real rate 8%, realized 5%, so the borrower gains

What counts as money

$$MB = C + R \qquad M = C + D$$

- **Functions:** medium of exchange, unit of account, store of value, standard of deferred payment
- **Monetary base** MB: currency + bank reserves
- **M1:** currency + checking + savings + other highly liquid deposits
- **M2:** M1 + small (under $100,000) short-term deposits + retail money market mutual funds
- **Not money:** credit cards, debt, cryptocurrencies
- Savings accounts moved into M1 in 2020, so older resources differ

Banks and the money multiplier

Assets	Liabilities
Reserves	Deposits
Loans, securities	Equity (bank capital)

$$M = m \times MB \qquad m_{\max} = \frac{1}{rr}$$

- **Required reserves** = rr × deposits. **Excess reserves** = reserves − required reserves; banks can lend these
- $rr = 0.10$: a new $100 deposit needs $10 held, leaving $90 excess. $m_{\max} = 10$, so new money can reach $90 × 10 = $900
- Actual $m = M/MB$ is smaller: banks hold excess reserves, and people hold cash