

赤诚图文信息有限公司 策划
ITP 国际出版公司 授权

英文版



经

济

系

列

金融体制与经济

THE FINANCIAL SYSTEM
AND THE ECONOMY

MAUREEN BURTON
RAY LOMBRA



世界财经与管理教材大系



东北财经大学出版社

99
F831.2
47
2

世界财经与管理教材大系
经济系列·英文版

金融体制与经济

The Financial System and the Economy

毛润·博顿
雷·朗伯纳 合著

Maureen Burton
Ray Lombra

东北财经大学出版社

图书在版编目 (CIP) 数据

金融体制与经济: 英文/(美) 博顿 (Burton, M.) 等著 .—大连: 东北财经大学出版社,
1998.3

(世界财经与管理教材大系·经济系列)

ISBN 7 - 81044 - 158 - 2

I . 金… II . 博… III . 金融体制—英文 IV . F830.2

中国版本图书馆 CIP 数据核字 (98) 第 06063 号

辽宁省版权局著作权合同登记号: 图字 06—1998—89 号

Maureen Burton, Ray Lombra: The Financial System and the Economy

Copyright © 1997 by West Publishing Company, an ITP Company

All Rights Reserved. Authorized edition for sale in P.R. China only.

本书英文影印版由 ITP 国际出版公司授权东北财经大学出版社在中国大陆境内独家出版发行,
未经出版者书面许可, 不得以任何方式抄袭、复制或节录本书的任何部分。

版权所有, 侵权必究。

东北财经大学出版社出版

(大连市黑石礁尖山街 217 号 邮政编码 116025)

东北财经大学出版社发行

北京万国电脑图文有限公司制版 朝阳新华印刷厂印刷

开本: 787×1092 毫米 1/16 字数: 1 151 千字 印张: 46.75 插页: 2

1998 年 4 月第 1 版

1998 年 4 月第 1 次印刷

策划编辑: 方红星

封面设计: 韩 波

定价: 75.00 元

ISBN 7 - 81044 - 158 - 2/F·884

出版者的话

但凡成事，均缘于势。得势则事成，失势则事不顺。顺势而行，如顺水行舟；借势而动，如假梯登高；造势而为，如太空揽月。治学、从政、经商、置业，均不可一日失势。势者，长处、趋势也。

今日中国，是开放的中国；当今世界，是开放的世界。改革开放，大势所趋，势不可挡。经济开放、文化开放、政治开放，世界需要一个开放的中国，中国更要融入开放的世界。借鉴国际惯例，学习他人之长，已经到了不可不为之时。

借鉴国际惯例，学习他人之长，已属老生常谈，但学什么、如何学、以何为蓝本为众多志士仁人所关注。可喜的是，由赤诚图文信息有限公司精心策划，ITP、McGraw-Hill及Simon & Schuster等国际出版公司特别授权，东北财经大学出版社荣誉出版的“世界财经与管理教材大系”现已隆重面世！她以“紧扣三个面向，精选五大系列，奉献百部名著，造就亿万英才”的博大胸襟和恢弘气势，囊括经济学、管理学、财务与会计学、市场营销学、商务与法律等财经、管理类主干学科，并根据大学教育、研究生教育、工商管理硕士（MBA）和经理人员培训项目（ETP）等不同层次的需要，相应遴选了具有针对性的教材，可谓体系完整，蔚为大观。所选图书多为哈佛、斯坦福、麻省理工、伦敦商学院、埃维商学院等世界一流名校的顶尖教授、权威学者的经典之作，在西方发达国家备受推崇，被广为采用，经久不衰，大有“洛阳纸贵”之势。

借鉴国际惯例，毕竟只是因势而动；推出国粹精品，才是造势而为。在借鉴与学习的同时，更重要的是弘扬民族精神，创建民族文化。“民族的，才是国际的”。我们提倡学他人之长，但更希望立自己之势。

势缘何物，势乃人为。识人、用人、育人、成人，乃人本之真谛。育人才、成能人，则可造大势。育人、成人之根本在教育，教育之要件在教材，教材之基础在出版。换言之，人本之基础在书本。

凡事均需讲效益，所谓成事，亦即有效。高效可造宏基，无效难以为继，此乃事物发展之规律。基于此，我们崇尚出好书、出人才、出效益！

东北财经大学出版社

1998年4月

*To my husband, Al Gagnon
and my children Susie and David
With special appreciation to George Galbreath
—Maureen Burton*

*To my mom and dad, Elsie and Gene Lombra
—Ray Lombra*



About the Authors

Maureen Burton

Maureen Burton received a BA from the University of Missouri at Columbia in 1971, an MA from California State University, Fullerton, in 1979, and a Ph.D. from the University of California at Riverside in 1986. All were in economics. She taught at Chaffey College from 1984 to 1987 and at Cal Poly Pomona since 1987 where she is a full professor, has been Coordinator of the Graduate Program, and is currently chair of the Economics Department. In addition to other publications, she co-authored an introductory text *Economics* (Harper Collins, 1987) with S. Craig Justice. Her main areas of research include monetary theory and financial markets.

Ray Lombra

Born in Hamden, Connecticut, Ray Lombra received a BA in Economics from Providence College in 1967 and an MA and Ph.D. from Penn State University in 1971. He served as a senior staff economist at the Board of Governors of the Federal Reserve System from 1971–1977 and specialized in financial markets analysis and the formulation and implementation of monetary policy. He joined the faculty of Penn State University in 1977, and has taught money and banking at the undergraduate level and monetary theory and policy at the graduate level for 20 years. He is a winner of the College distinguished teaching award for innovations and instruction and is the author and editor of 5 books and over 80 scholarly publications. Articles on monetary policy, the determination of interest rates, stock prices, and exchange rates, financial innovation, globalization, and expectations formation have appeared in leading journals, including the *Quarterly Journal of Economics*, the *Journal of Money, Credit and Banking*, the *Journal of Monetary Economics*, and the *Review of Economics and Statistics*.

Preface

Financial markets and institutions have undergone significant changes in recent years. Transformations have been driven by technology, innovation, deregulation, competition, and financial crises. The growth of international trade and flexible exchange rates has escalated the development of international currency markets. Financial institutions have entered nontraditional venues on both the liabilities and assets sides of their balance sheets. Laws forbidding interstate banking have been overturned. Market participants have developed creative ways to hedge risks. Controversy continues over monetary policy and the increasing need for international coordination. In the late 1980s, taxpayers and regulators struggled to deal with financial instability brought on by the savings and loan debacle and problems within other intermediaries. All of these anomalies are taking place in a world with competing views regarding the linkages between the real and financial sectors and the formulation and execution of monetary policy.

The Financial System and the Economy covers the traditional material found in a money and banking text and incorporates many of the recent changes and controversies within the financial services industry.

The strength of the text is its clear and engaging writing style and strong intuitive approach. It avoids the encyclopedia approach and seeks a balance between policy, theory, and institutions. Students find it easy to understand and enjoyable to read. The text makes use of many examples and analogies to illustrate how financial innovation, technological and structural changes, and globalization affect the financial environment. Much attention is paid to how and why institutions evolve. Graphs are used sparingly and equations are used even more sparingly.

Each chapter contains many exhibits with case studies and examples that make the material more interesting for students. Exhibit topics include the Lincoln Savings and Loan Scandal, the failure of Continental Illinois, the collapse of Barings Bank and Orange County, California, paying bills over the phone, the current Federal Reserve Board, the use of intermediate targets since 1970, stock index futures and the crash of 1987, a field guide to open market operations, the secondary market in mortgages, the Phillips Curve, and how price expectations are formed.

The text is designed to be used in an introductory undergraduate course in money and banking or financial markets analysis taught in either an economics or finance department. It may also be suitable for use in a financial markets course in an MBA Program.

The Financial System and the Economy contains five parts:

- ◆ Part I consists of a five-chapter introduction. The student is introduced to the economy, money and credit, financial intermediaries, the circular flow, and the Federal Reserve System.

- ◆ Part II (five chapters) covers markets for financial instruments, derivatives and foreign exchange, and how relevant prices including interest rates, derivative prices, and exchange rates are determined.
- ◆ Part III (five chapters) focuses on financial institutions and the forces that shape them. The roles of technology, competition, globalization, and regulations are emphasized in discussing how institutions evolve.
- ◆ Part IV (five chapters) covers monetary theory including the money supply process, the demand and supply of money and credit, and the financial aspects of the behavior of households, firms, government, and the foreign sector. The aggregate demand and supply model is presented and integrated with a complementary model of macro-equilibrium based on the flow of funds between sectors.
- ◆ Part V (four chapters) analyzes monetary policy in an increasingly globalized environment and focuses on the formulation of monetary policy by the Fed Open Market Committee and subsequent execution of the policy directive by the Trading Desk of the New York Fed. The role of the Fed watcher and the growing need for international coordination are also analyzed.

The text is designed to be flexible. After completing Part I, the instructor can emphasize financial markets and prices (Part II), financial institutions (Part III), monetary theory (Part IV), or monetary policy (Part V) depending on the focus of the class. In parts that are not being emphasized, chapters may be skipped.

Special Features

Several other features of *The Financial System and the Economy* deserve mention.

First, Chapters 18 and 19 present unique coverage about the financial aspects of the behavior of households, firms, government, and the foreign sector. Sources and uses of funds statements from the flow of funds accounts for each sector are presented.

Chapter 20 uses the aggregate demand and aggregate supply model, developed without the use of the IS-LM framework, to explain macroeconomic equilibrium. Chapter 20 also presents a model of macroeconomic equilibrium from a flow of funds framework, stressing that the macroeconomy is in equilibrium when the desired net financial investment of surplus sectors is equal to the desired net financial deficits of deficit sectors. The sources and uses of funds for each sector developed in the previous two chapters are integrated into the complete model. Chapter 21 makes the analysis more dynamic by looking at various macroeconomic disturbances and the adjustments over time.

International aspects of financial markets and institutions are mixed throughout the body of the text and in international boxes. In addition, two chapters are devoted to international coverage. Chapter 9 analyzes exchange rate determination and Chapter 24 looks at monetary policy under either fixed or flexible exchange rate systems in an increasingly globalized environment.

In addition to the traditional material covered in the policy section, the text looks in detail at how the Fed Open Market Committee makes decisions and how those decisions are implemented by the New York Fed.

The text contains annotated suggested readings that give the student some idea about how the readings relate to the material in the chapter. In addition,

the suggested readings sections contain internet and world wide web addresses that pertain to financial markets and institutions.

An appendix includes descriptions of materials found on internet and world-wide web addresses relating to financial markets. Students with access to the internet and the world-wide web will be able to obtain information that pertains to the financial sector.

Some chapters have review and analytical questions and problems that direct the student to go to a world-wide web or internet address to locate and analyze financial market data.

Pedagogical Tools

In addition to presenting the material in a clear and concise manner, we have incorporated the following pedagogical tools to enhance the student's understanding.

1. **Learning Objectives** at the beginning of each chapter tell the student where the chapter is heading and what questions will be answered.
2. Three to five **RECAP** sections are dispersed throughout each chapter summarizing analytical material the student should know before moving forward.
3. Twenty-one boxed sections called **Looking Out, Looking Back, or Looking Forward** contain historical and international material as well as projections about the future.
4. Sections called **Cracking the Code** teach students how to read the financial pages of daily newspapers including futures and options prices, and stock, bond, and Treasury bill quotes.
5. **Key Terms** are bold-faced in the text where they are defined, listed at the end of each chapter, and appear as **Margin Definitions**.
6. **Chapter Summaries** are clear and well written.
7. A **Glossary** at the end of the text defines all of the key terms in the text.
8. Annotated **Suggested Readings** direct the student to related materials and include information available on the internet.
9. **Review and Analytical Questions** appear at the end of each chapter. In addition, chapters contain optional questions that instruct the student to obtain information from an internet site.
10. An **Appendix on Internet and World-Wide Web Sites, prepared by Meenakshi Rishi of Ohio Northern University**, contains information about financial markets and institutions. The student is given the type of material included along with the internet address. Many of these internet sites are also mentioned in the Suggested Readings and used in the Review and Analytical Questions.
11. **Answers to Odd-Numbered Review and Analytical Questions** appear at the end of the text.

Supplementary Materials

- ◆ **Study Guide:** Written by Reynold Nesiba of Augustana College in South Dakota, this supplement provides chapter outlines and review questions to reinforce each chapter of the text.
-

- ◆ **Instructor's Manual:** Prepared by Angel Perez, the manual includes chapter outlines, chapter summaries, key terms, solution to all chapter questions, solutions to internet problems, and additional questions for classroom discussion.
- ◆ **Test Bank:** Developed by Melanie Paiste, it contains approximately seventy multiple-choice items per chapter, many of which have been classroom tested by the text authors.
- ◆ **Transparencies:** There are 175 four-color transparencies selected by the author which include key exhibits and chapter objectives.

Acknowledgments

Many people made important contributions to this text. Special thanks go to Bob Horan, the editor at West who was always supportive, creative, and helpful. Without his persistence and dedication, this text would not be published. Others at West also deserve recognition. Sandi Dooling and Janine Wilson, competent professionals, were a pleasure to work with. The text's production editor, Stephanie Syata, did a first rate job. All of them provided immediate answers and assistance and went the extra nine yards to help with this project. We are glad for the opportunity to work with such a fine group of people.

Another person also deserves special recognition. Professor Emeritus George Galbreath spent 40 years teaching money and banking in the California State University System. For this reward, George has hundreds of students who are better people and scholars for having studied under him. He is the epitome of a great university professor. With regards to this text, George read every word of the manuscript and gave invaluable suggestions.

Four other colleagues also gave invaluable help. Drs. Mohammad Safarzadeh and Hamid Falootoom of Cal Poly Pomona gave indispensable computer assistance, Professor James Sutton of Cal Poly Pomona gave research support and Dr. Bryan Taylor gave access to his extensive data base at Global Financial Data in Alhambra, California.

A note of appreciation goes to students, who over the past three years have taken an interest in this text, especially Michael Rowe, Carrie Meile, and Trisha Durk. In addition, I am indebted to Angel Perez, Debbie Bannister, Gabriel Watson, Sebastian Sohn, Bunchon Songsamphant, and Tim Miller for their research assistance. We would also like to thank the following outside reviewers whose comments were greatly appreciated.

Burton and Lombra reviewers

William L. Beaty
Tarleton State University

Gene Boni
County College of Morris

David W. Brasfield
Murray State University

James R. Bruehler
University of Illinois at Urbana—Champaign

Catherine Carey
Western Kentucky University

John E. Charalambakis
Asbury College

Maureen E. Dunne
Framingham State College

Frank Falero
California State University, Bakersfield

James R. Frederick
Pembroke State University

Harry Greenbaum
South Dakota State University

Nell S. Gullett
University of Tennessee at Martin

Bassam E. Harik
Western Michigan University

John J. Hatem
Georgia Southern University

Paul A. Heise
Lebanon Valley College of Pennsylvania

Colleen F. Johnson
Eastern Oregon State College

Richard H. Keehn
University of Wisconsin—Parkside

Robert J. Korbach
University of North Dakota

James W. Lynch
Robert Morris College

Jessica J. McCraw
The University of Texas at Arlington

Michael S. Miller
DePaul University

Athanasios G. Noulas
Seton Hall University

Clifford Nowell
Weber State University

James E. Payne
Eastern Kentucky University

Ronnie J. Phillips
Colorado State University

Meenakshi Rishi
Ohio Northern University

Carol Rowey
Community College of Rhode Island

William C. Schaniel
West Georgia College

M. Scott Shepherd
Southern Illinois University at Edwardsville

Richard M. Simon
Ohio Northern University

K. P. Sridharan
Delta State University

Stacey L. Suydam
Montana State University—Billings

John A. Swiger
Our Lady of the Lake University

Paul M. Taube
The University of Texas—Pan American

Daniel Teferra
Ferris State University

Duncan R. Tye
Western Carolina University

Roy Van Til
University of Maine at Farmington

Samuel C. Webb
Wichita State University

Pamela Whalley
Western Washington University

Laura Wolff
Southern Illinois University at Edwardsville

Brief Table of Contents

PART ONE

Introduction

1	Introduction and Overview	2
2	Money: Some First Principles	24
3	The Role of Money and Credit	44
4	The Financial System and the Economy: An Analytical Perspective	66
5	The Federal Reserve System: An Overview of the Overseer	92

PART TWO

Financial Markets and Prices

6	Financial Markets, Instruments, and Participants	120
7	Interest Rates and Bond Prices: Demystifying the Time Value of Money	146
8	The Structure of Interest Rates	176
9	How Exchange Rates Are Determined	204
10	Futures, Options, and Swaps: Modern Ways to Manage Risk	234

PART THREE

Financial Institutions

11	Financial Intermediaries: Some Specifics	266
12	Commercial Banking: Structure, Regulation, and Performance	294
13	Financial Innovation and Deregulation	326

14	Strains on the Financial System	354
----	---------------------------------	-----

15	Regulations in the 1990s	382
----	--------------------------	-----

PART FOUR

Monetary Theory

16	The Role of the Fed and Depository Institutions in the Money Supply Process	406
17	The Demand for Real Money Balances and Market Equilibrium	442

18	Financial Aspects of Household and Firm Behavior	474
----	--	-----

19	Financial Effects of the Government and Foreign Sectors	504
----	---	-----

20	Aggregate Demand and Aggregate Supply	532
----	---------------------------------------	-----

PART FIVE

Monetary Policy

21	The Challenges of Monetary Policy	552
----	-----------------------------------	-----

22	The Process of Monetary Policy Formulation	590
----	--	-----

23	A Field Guide to Fed Watching and Policy Implementation	614
----	---	-----

24	Monetary Policy Under Fixed and Flexible Exchange Rates and the Need for Global Coordination	638
----	--	-----

Table of Contents

PART ONE

Introduction



Learning Objectives	3
What This Book Is About	4
Economic and Financial Analysis of an Ever-Changing System	4
Finance in Our Daily Lives	6
Introducing the Financial System	8
More on Financial Intermediaries	10
<i>Depository Institutions and Other Types of Intermediaries</i>	12
The Federal Reserve System	13
The Role of Policy: Changing Views	16
Summary of Major Points	19
Key Terms	20
Review Questions	20
Analytical Questions	21
Suggested Readings	21



Learning Objectives	45
Money and Credit Matters	46
The Demand for and Supply of Money	46
How Credit Matters: A First Approximation	52
Money, Credit, and the Economy: A Peek at the Data	54
LOOKING BACK: A Brief History of Currency in the United States	55
Are Money and Credit All That Matter?	60
<i>Money and Credit Flows: First Fiddle or Second Fiddle</i>	60
Summary of Major Points	61
Key Terms	62
Review Questions	62
Analytical Questions	63
Suggested Readings	64



Learning Objectives	25
Conceptualization: A Key Building Block	26
Defining Money	26
The Monetary Aggregates and Domestic Nonfinancial Debt	29
<i>The Money Aggregates</i>	30
<i>Domestic Nonfinancial Debt</i>	32
LOOKING FORWARD: United States Currency to Get New Look	35
<i>The Economy and the Aggregates</i>	36
The Evolution of the Payments System	36
Summary of Major Points	39
Key Terms	40
Review Questions	40
Analytical Questions	41
Suggested Readings	42



Learning Objectives	67
The Trees Versus the Forest	68
Spending, Saving, Borrowing, and Lending	68
<i>A Typical Household</i>	69
<i>A Typical Firm</i>	70
<i>From J.P. and APEI to the Economy as a Whole: Aggregation</i>	71
The Circular Flow of Income, Expenditure, and Funds	73
<i>The Product Market</i>	75
<i>The Factor Market</i>	77
<i>The Financial System</i>	79
Maximization: Plans, Revisions, and Actions	81
Summary of Major Points	84

Key Terms	85
Review Questions	85
Analytical Questions	86
Suggested Readings	87
Appendix 4A Interest Rates: Which Theory Is Correct? Reconciling Stocks and Flows	89

5

Learning Objectives	93
Unraveling the Fed's Mystique	94
Organizational Structure of the System	94
<i>Board of Governors</i>	95
<i>Federal Reserve Banks</i>	95
<i>Fed Open Market Committee (FOMC)</i>	98
The Fed's Functions	100
<i>Formulation and Implementation of Monetary Policy</i>	101
<i>Supervision and Regulation of the Financial System</i>	102
<i>Facilitation of the Payments Mechanism</i>	104
<i>Operation as Fiscal Agent for the Government</i>	104
The Fed's Major Policy Tools	105
<i>Open Market Operations</i>	106
<i>The Discount Rate and Discount Rate Policy</i>	106
<i>Reserve Requirements</i>	108
Who Does What Within the Fed	108
The Federal Reserve System: An Independent Watchdog, Convenient Scapegoat, or Cunning Political Animal?	110
LOOKING OUT: Central Bank Independence and Macroeconomic Performance	111
LOOKING BACK: Early Attempts at Establishing a Central Bank	112
Summary of Major Points	115
Key Terms	116
Review Questions	116
Analytical Questions	117
Suggested Readings	117

PART TWO

<i>Financial Markets and Prices</i>	119
-------------------------------------	-----

6

Learning Objectives	121
Game Talk	122
Introducing Financial Markets	122
Major Financial Market Instruments	125
<i>Money Market Instruments</i>	125
<i>Capital Market Instruments</i>	129
The Role of Market Makers	133
LOOKING OUT: International Financial Markets	134
<i>Why Market Makers Make Markets</i>	136
<i>Market Making and Liquidity</i>	136
<i>Substitutability, Market Making, and Market Integration</i>	139
Summary of Major Points	142
Key Terms	142
Review Questions	143
Analytical Questions	144
Suggested Readings	144

7

Learning Objectives	147
The Present Versus the Future	148
The Time Value of Money	148
Compounding and Discounting	149
<i>Compounding: Future Values</i>	149
<i>Discounting: Present Values</i>	152
Interest Rates, Bond Prices, and Present Values	153
<i>Fluctuations in Interest Rates and Managing a Bond Portfolio</i>	156
The Determinants of Interest Rates	157
<i>Changes in the Demand for Loanable Funds</i>	158
<i>Changes in the Supply of Funds</i>	160
Inflation and Interest Rates	162
<i>The Cyclical Movement of Interest Rates</i>	165
Summary of Major Points	166
Key Terms	167
Review Questions	167
Analytical Questions	168
Suggested Readings	169
Appendix 7A Stock Prices and Interest Rates	171

Appendix 7B The Inverse Relationship Between Bond Prices and Interest Rates: The Case of Consols	174
--	-----

8

Learning Objectives	177
From One Interest Rate to Many	178
The Role of Term to Maturity in Interest Rate Differentials	178
<i>The Yield Curve</i>	179
The Expectations Theory	181
<i>Determining Interest Rate Expectations</i>	187
<i>Tying the Determinants of Expectations to the Changing Shape and Level of Yield Curves</i>	188
Some Necessary Modifications to the Expectations Theory	189
The Role of Credit Risk and Taxes in Interest Rate Differentials	192
<i>Credit Risk</i>	192
<i>Taxability</i>	194
Summary of Major Points	197
Key Terms	198
Review Questions	198
Analytical Questions	199
Suggested Readings	200
Appendix 8A Cracking the Code: The Treasury Securities Market	202

9

Learning Objectives	205
The Importance of Exchange Rates	206
Defining Exchange Rates	206
Determining Exchange Rates	208
Changes in Supply and Demand and How They Affect the Exchange Rate	215
Defining the Balance of Payments and Its Influence on the Exchange Rate, the Financial System, and the U.S. Economy	220
<i>The Current Account</i>	221
LOOKING OUT: A Common Currency for Europe?	222
<i>The Capital Account</i>	223
LOOKING BACK: The Gold Standard	224
<i>The Balance of Payments and the Exchange Rate</i>	224
Summary of Major Points	228

Key Terms	229
Review Questions	229
Analytical Questions	230
Suggested Readings	231
Appendix 9A Expansionary Monetary Policy and Restrictive Fiscal Policy: A Scenario	233

10

Learning Objectives	235
A Single Solution	236
Forward Transactions and Financial Futures	236
Determining the Futures Price	243
Options	247
<i>Put Options</i>	248
<i>Call Options</i>	250
<i>The Option Premium</i>	251
Swaps	253
Summary of Major Points	257
Key Terms	258
Review Questions	258
Analytical Questions	259
Suggested Readings	260
Appendix 10A The Foreign Exchange Futures Market	261
Appendix 10B Determining the Option Premium	263

PART THREE

<i>Financial Institutions</i>	265
-------------------------------	-----

11

Learning Objectives	267
Are All Financial Intermediaries More or Less Alike?	268
Common Characteristics	268
Types of Risks Faced By All FIs	272
<i>Credit or Default Risk</i>	272
<i>Interest Rate Risk</i>	273
<i>Liquidity Risk</i>	274
<i>Exchange Rate Risk</i>	274
A Guide to FIs and Their Balance Sheets	275
<i>Deposit-Type FIs</i>	275

<i>Contractual-Type FIs</i>	281
<i>Investment-Type FIs</i>	284
<i>Finance Company-Type FIs</i>	285
Pulling Things Together	286
Summary of Major Points	288
Key Terms	289
Review Questions	290
Analytical Questions	291
Suggested Readings	292

12

Learning Objectives	295
The Biggest Intermediary in Town	296
The Banking Regulatory Structure	297
The Structure of the Commercial Banking System	301
<i>Restrictions on Entry: Chartering and Branching</i>	302
The Definition of a Bank Holding Company	304
The Evolution of International Banking	308
LOOKING BACK: The Origins of the Dual Banking System	309
Bank Management: Managing Risk and Profits	309
<i>Managing Risk</i>	312
LOOKING OUT: The Contrast Between Banking Structures Here and Abroad	313
LOOKING OUT: The Japanese Banking Crisis	314
Bank Performance	314
Summary of Major Points	317
Key Terms	318
Review Questions	319
Analytical Questions	320
Suggested Readings	321
Appendix 12A A More In-Depth Look at the Major Assets of Commercial Banks	322

13

Learning Objectives	327
The Road from Here to There	328
Analytical Foundations and Major Causes of Financial Innovation	328
<i>The Beginning Regulatory Structure</i>	329

14

<i>The Analytical Foundations of Financial Innovation</i>	330
<i>Declining Costs of Innovation</i>	331
<i>Rising Benefits of Innovation</i>	331
<i>Increasing Competition</i>	333
<i>Greater Volatility</i>	333
Some Specifics About Financial Innovation	334
<i>Eurodollar Borrowings, Fed Funds, and Repurchase Agreements</i>	336
<i>Negotiable Certificates of Deposit</i>	337
The Regulation-Innovation Cycle and Its Influence on Deregulation	339
A Wave of Deregulation	342
LOOKING FORWARD: The Electronic Purse: An Innovation in the Making	346
The Financial Environment Following Deregulation	346
<i>The 1990s</i>	347
Summary of Major Points	351
Key Terms	352
Review Questions	352
Analytical Questions	353
Suggested Readings	353

Learning Objectives	355
Memory Is the Thing You Forget With	356
Financial Intermediation, Risk, and Financial Crises	357
The Savings and Loan Debacle	360
Crisis Within the Banking System	364
More Recent Strains on the Financial System	370
<i>Daylight Overdrafts</i>	370
<i>Program Trading</i>	371
LOOKING OUT: Japan Has an Ally at the Fed	372
<i>Derivatives</i>	373
<i>The Eurocurrency Market</i>	376
Summary of Major Points	377
Key Terms	378
Review Questions	378
Analytical Questions	379
Suggested Readings	379

15

Learning Objectives	383
----------------------------	------------

The Role of Regulation	384	Review Questions	430
The How and Why of Financial Services Regulation	385	Analytical Questions	431
Recent Major Legislation	386	Suggested Readings	433
<i>The Basel Accord</i>	386	Appendix 16A Other Factors That Affect the Monetary Base	434
<i>Financial Institutions Reform, Recovery, and Enforcement Act of 1989</i>	387	Appendix 16B The M2 Multiplier	440
<i>Federal Deposit Insurance Corporation Improvement Act of 1991</i>	392		
<i>Community Reinvestment Act</i>	393		
<i>Interstate Banking and Branching Efficiency Act of 1994</i>	394		
Other Concerns and Possible Reforms	395		
LOOKING BACK: A Time Line of Banking Legislation	400		
Summary of Major Points	401		
Key Terms	402		
Review Questions	402		
Analytical Questions	403		
Suggested Readings	404		

PART FOUR

Monetary Theory 405

Learning Objectives	407
Where Money Comes From	408
The Fed and Bank Reserves	408
<i>Open Market Operations</i>	408
<i>Discount Loans</i>	411
<i>Other Factors That Change Reserves</i>	411
Loan and Deposit Expansion by the Banking System	412
The Simple Multiplier Model of the Money Supply Process	416
<i>Policy Implications</i>	420
Some Complicating Realities in the Multiplier Model	422
<i>Modifying the Multiplier Model</i>	423
LOOKING BACK: The Money Multiplier During the Great Depression	424
LOOKING BACK: The Evolution of the Money Multiplier	427
<i>The Fed's Control over the Money Supply</i>	427
Summary of Major Points	429
Key Terms	430

Learning Objectives	443
Where Is All the Money?	444
The Demand for Real Money Balances	444
<i>Household Demand for Real Money Balances</i>	446
<i>A Firm's Demand for Real Money Balances</i>	448
The Interest Rate, Real Income, and Real Money Balances	450
Additional Factors Affecting the Demand for Real Money Balances	456
LOOKING FORWARD: Will Checks Go the Way of the Dinosaur?	457
Equilibrium in the Market for Real Money Balances	458
<i>A Final Note</i>	464
Summary of Major Points	465
Key Terms	466
Review Questions	466
Analytical Questions	467
Suggested Readings	468
Appendix 17A The Transactions Demand for Money by Households	469

Learning Objectives	475
To Spend or Not to Spend	476
Household Behavior from a Financial Perspective	477
<i>Asset Accumulation: Spending and Saving</i>	479
<i>Liability Accumulation: Borrowing</i>	481
<i>How Economic and Financial Conditions Influence Household Accumulation of Assets and Liabilities</i>	482
<i>The Sources and Uses of Funds for Households</i>	484