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What Is Money?

Misplaced Focus on Bank Reserves & the Fed

(Eurodollar University)

‘Base Money’ Isn’t Base Money

“ *Mr. Mitchell said he could think of no time when* ***the monetary aggregates were less useful for policy purposes than they were now****…Another uncertainty in the interpretation of the monetary statistics arose in connection with Euro-dollars;* ***he suspected that at least some part of the Euro-dollar-based money supply should be included in the U.S. money supply****. More generally, he thought* ***M1 was becoming increasingly obsolete as a monetary indicator****. The Committee should be focusing more on M2 and it should be moving toward some new version of M3…*

MEMORANDUM OF DISCUSSION

A meeting of the Federal Open Market Committee was held in the offices of the Board of Governors of the Federal Reserve System in Washington, D.C., on Monday and Tuesday, December 16-17, 1974, beginning at 4:00 p.m. on Monday.

PRESENT: Mr. Burns, Chairman
Mr. Hayes, Vice Chairman
Mr. Black
Mr. Bucher
Mr. Clay
Mr. Coldwell
Mr. Holland
Mr. Kimbrel
Mr. Mitchell
Mr. Sheehan
Mr. Wallich
Mr. Winn

Messrs. Baughman, MacLaury, Mayo, and Morris, Alternate Members of the Federal Open Market Committee

Messrs. Eastburn, Francis, and Balles, Presidents of the Federal Reserve Banks of Philadelphia, St. Louis, and San Francisco, respectively

Mr. Broida, Secretary
Mr. Altmann, Deputy Secretary
Mr. O'Connell, General Counsel
Mr. Partee, Senior Economist
Mr. Axilrod, Economist (Domestic Finance)
Mr. Solomon, Economist (International Finance)
Messrs. Brandt, Bryant, Davis, Doll, Gramley,

FOMC Memorandum of Discussion
Committee Policy Meeting
December 16/17, 1974

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"The results of this paper are difficult to characterize. Insofar as the objective was an improved specification of the demand function for M1, capable of explaining the current shortfall in money demand, the paper is rather a failure. Specifications that seem most reasonable on the basis of earlier data are not the ones that make a substantial dent in explaining the recent data.

STEPHEN M. GOLDFELD
Princeton University

The Case of the Missing Money

THE RELATION between the demand for money balances and its determinants is a fundamental building block in most theories of macroeconomic behavior. Since it is also a critical component in the formulation of monetary policy, it is not surprising that the money-demand function has been subjected to extensive empirical scrutiny. The evidence that emerged, at least prior to 1974, suggested that only a few factors (essentially income and interest rates, with due allowance for lags) were needed to explain adequately the quarterly movements in money demand. There were episodes that, during their course, gave the impression that the money-demand function was shifting. On the whole, however, in the time allowed for final data revisions by a "wait and see" attitude, the apparent puzzles tended to clear up.[1]

As has been widely documented,[2] the U.S. economy is once again experiencing an apparent shift in the money-demand function. In particular, when money-demand functions that have been successfully fitted to pre-1974 data are extrapolated into the post-sample period, they consistently and significantly overpredict actual money demand. Furthermore, as the economy has moved into the upturn phase of the business cycle, the forecasting errors have mushroomed. While one might hope that subsequent data revisions could "solve" the present puzzle, this sanguine attitude

Stephen Goldfeld, David I. Fand and William C. Brainard

Brookings Papers on Economic Activity

Vol. 1976, No. 3 (1976), pp. 683-739

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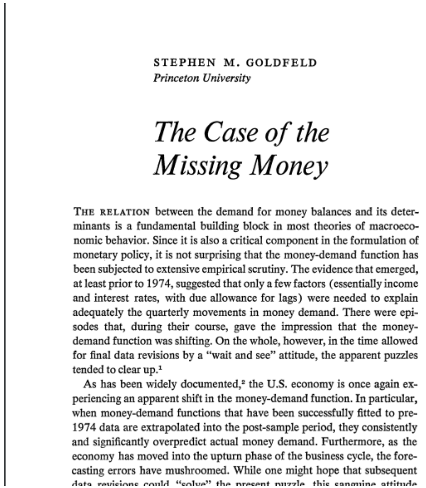
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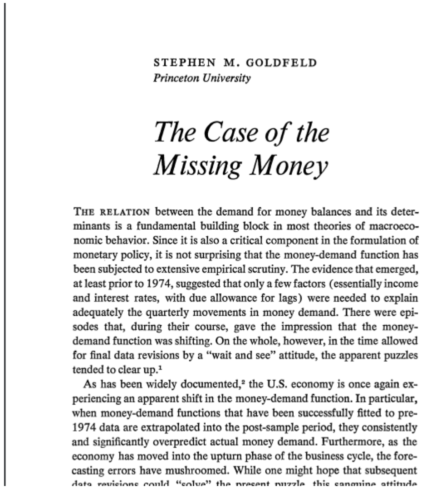

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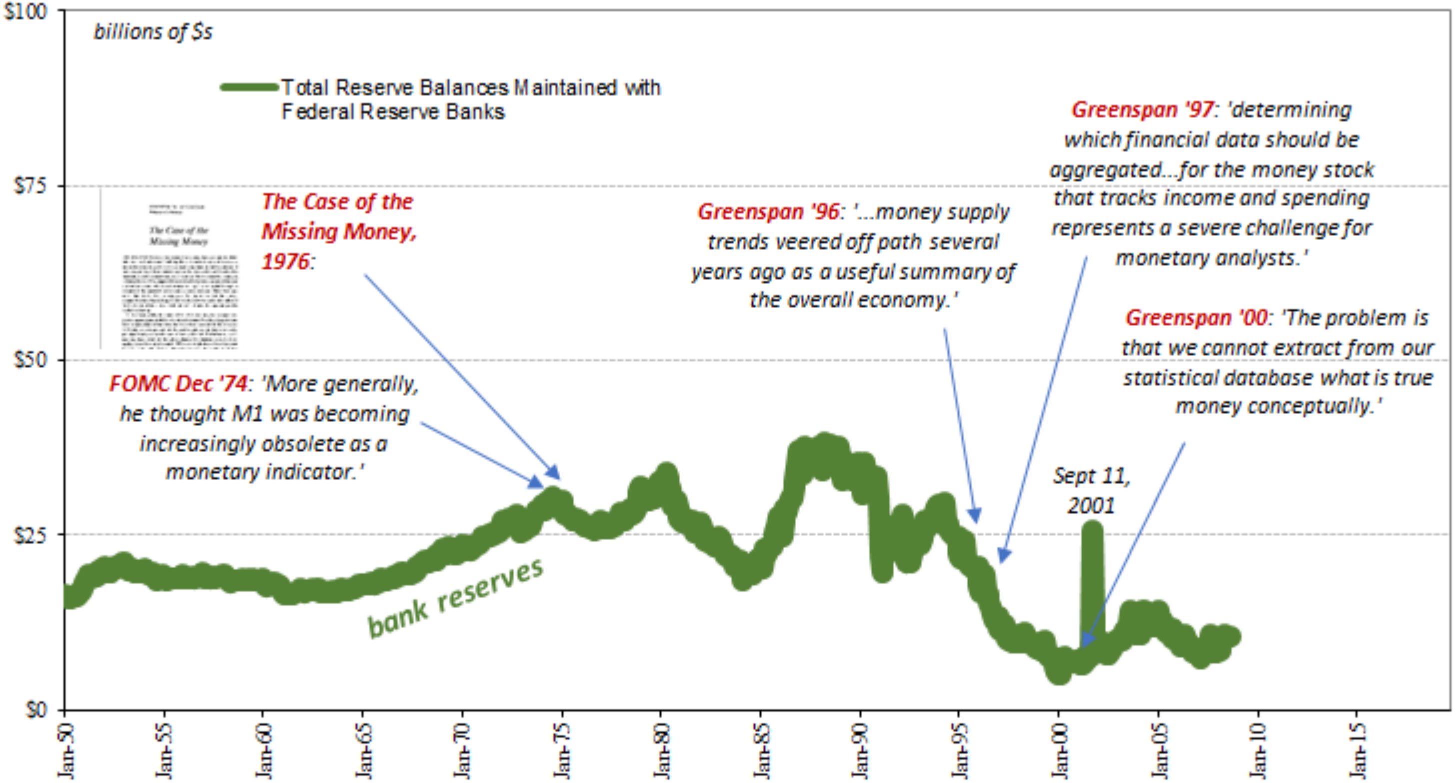
*Unfortunately, **money supply trends veered off path several years ago as a useful summary of the overall economy**. Thus, to keep the Congress informed on what we are doing, we have been required to explain the full complexity of the substance of our deliberations, and how we see economic relationships and evolving trends…But **how do we know when irrational exuberance** has unduly escalated asset values, which then become subject to unexpected and prolonged contractions as they have in Japan over the past decade? And how do we factor that assessment into monetary policy?*

Federal Reserve Chairman Alan Greenspan

At the Annual Dinner and Francis Boyer Lecture of The American Enterprise Institute for Public Policy Research, Washington, D.C.

December 5, 1996

Federal Reserve Balance Sheet (H.4.1)



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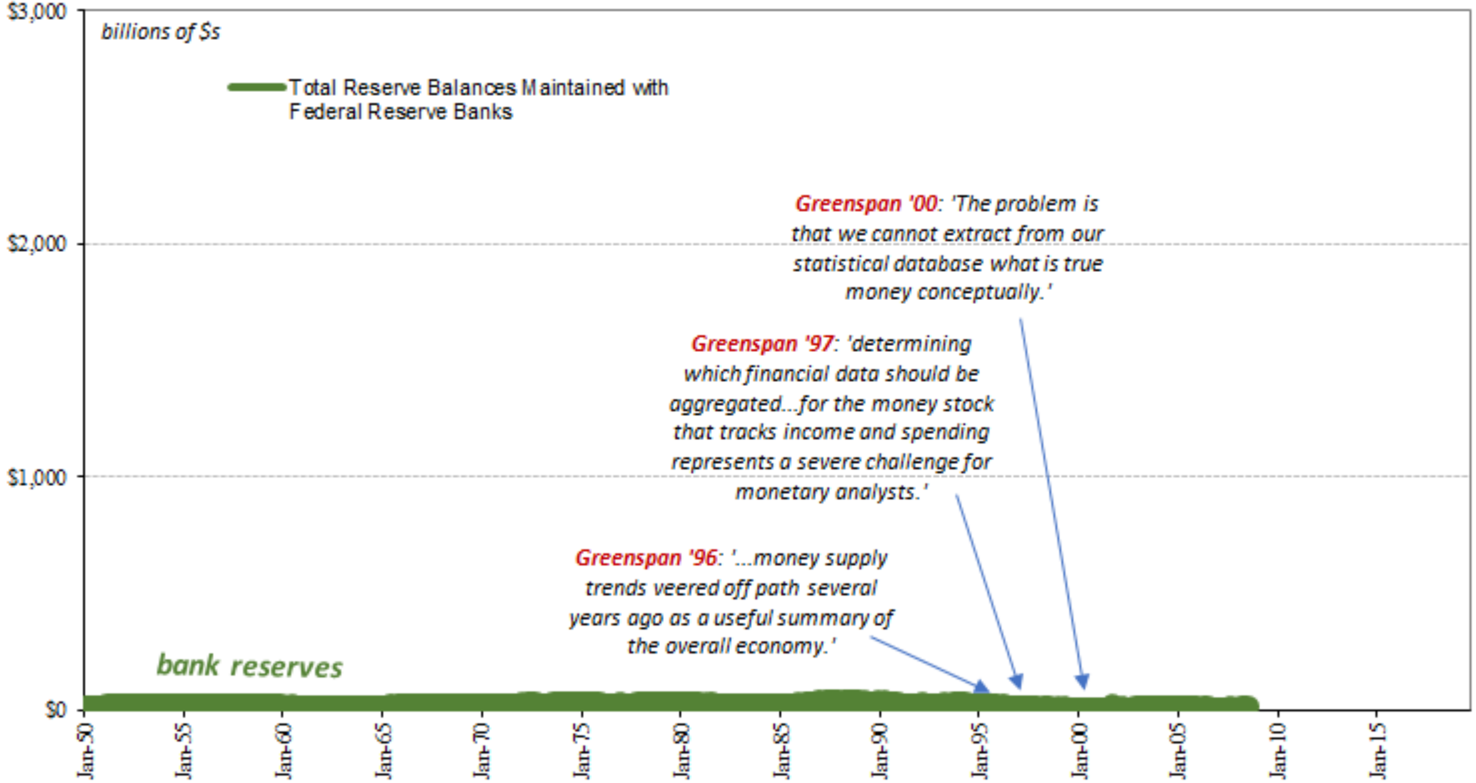

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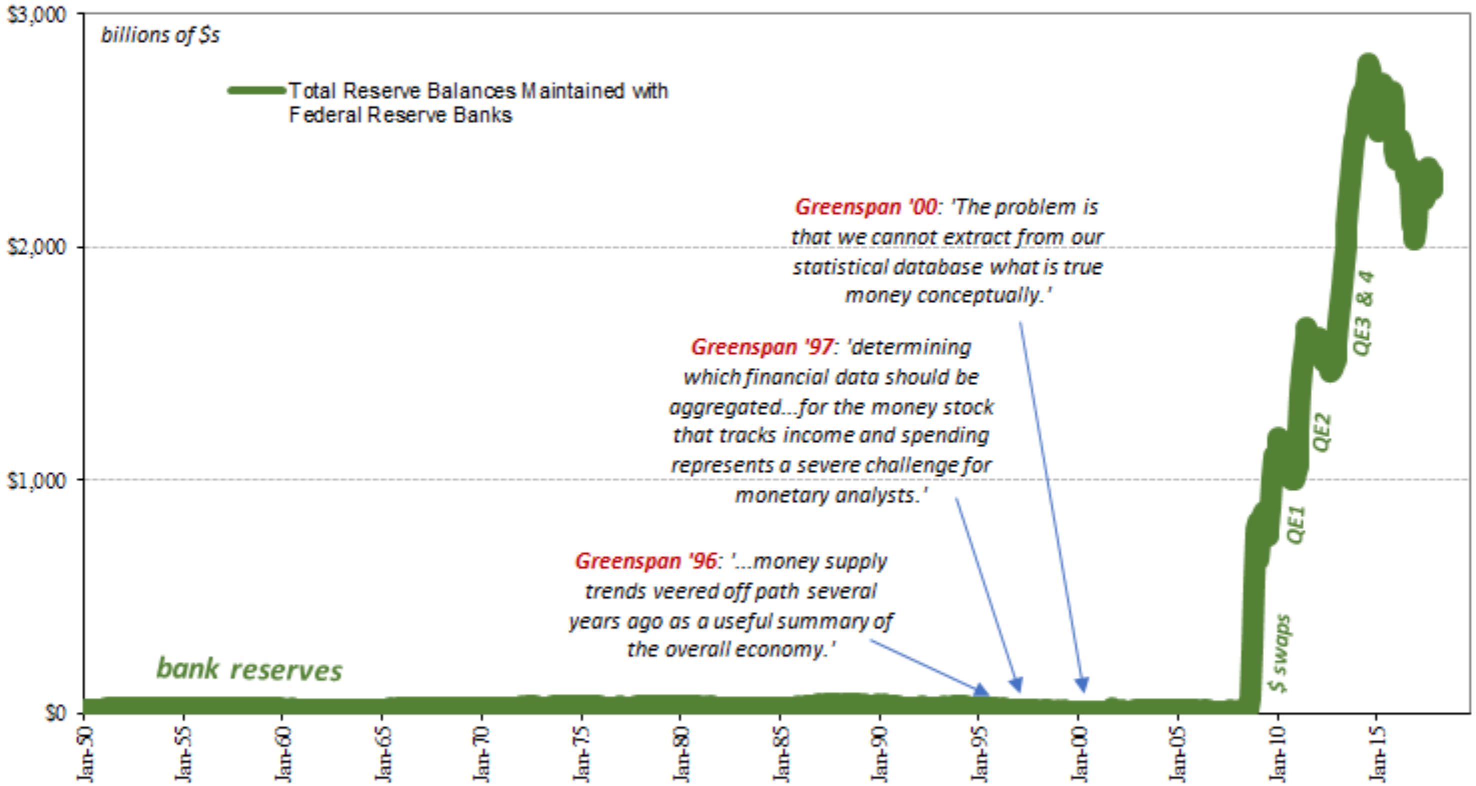

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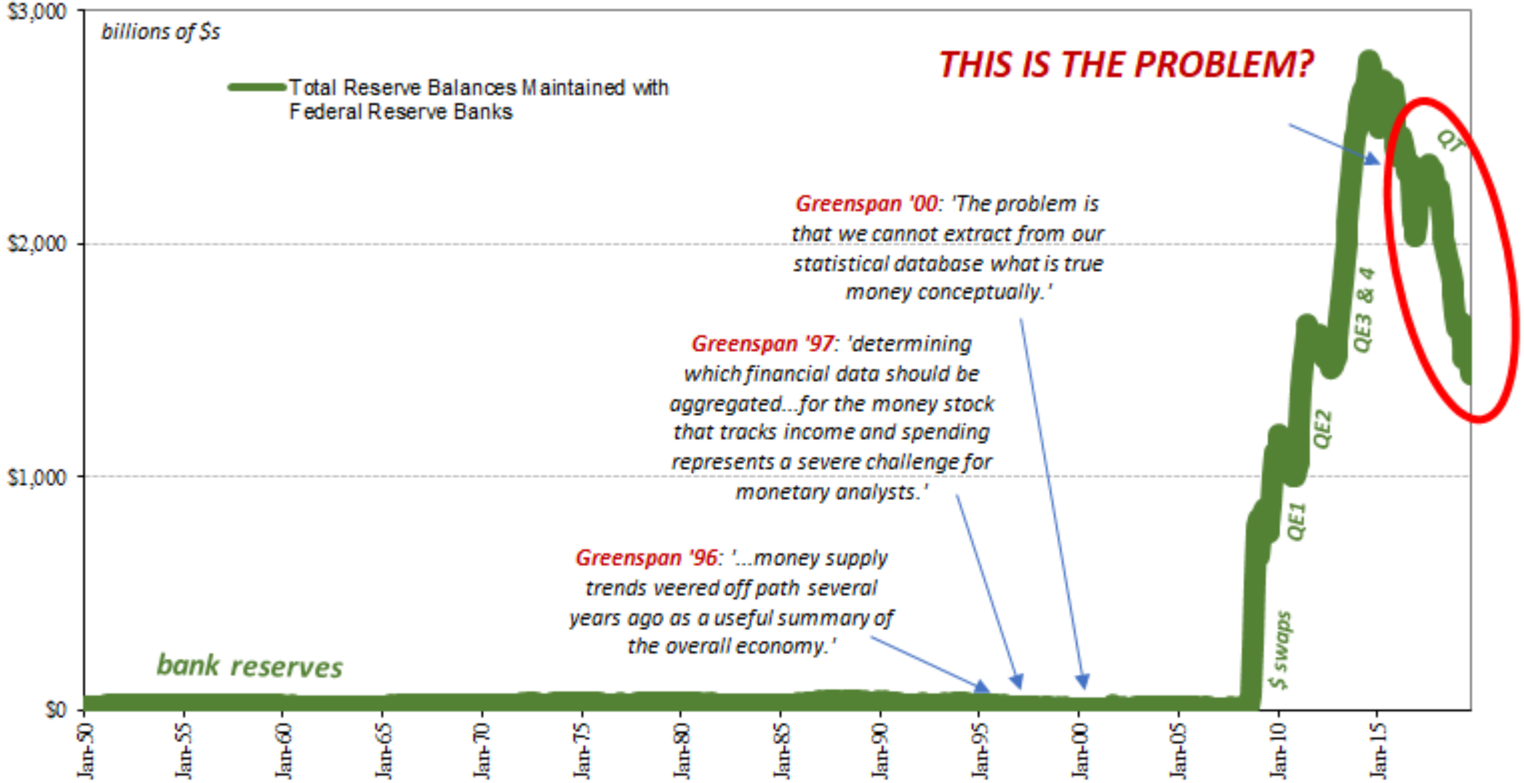

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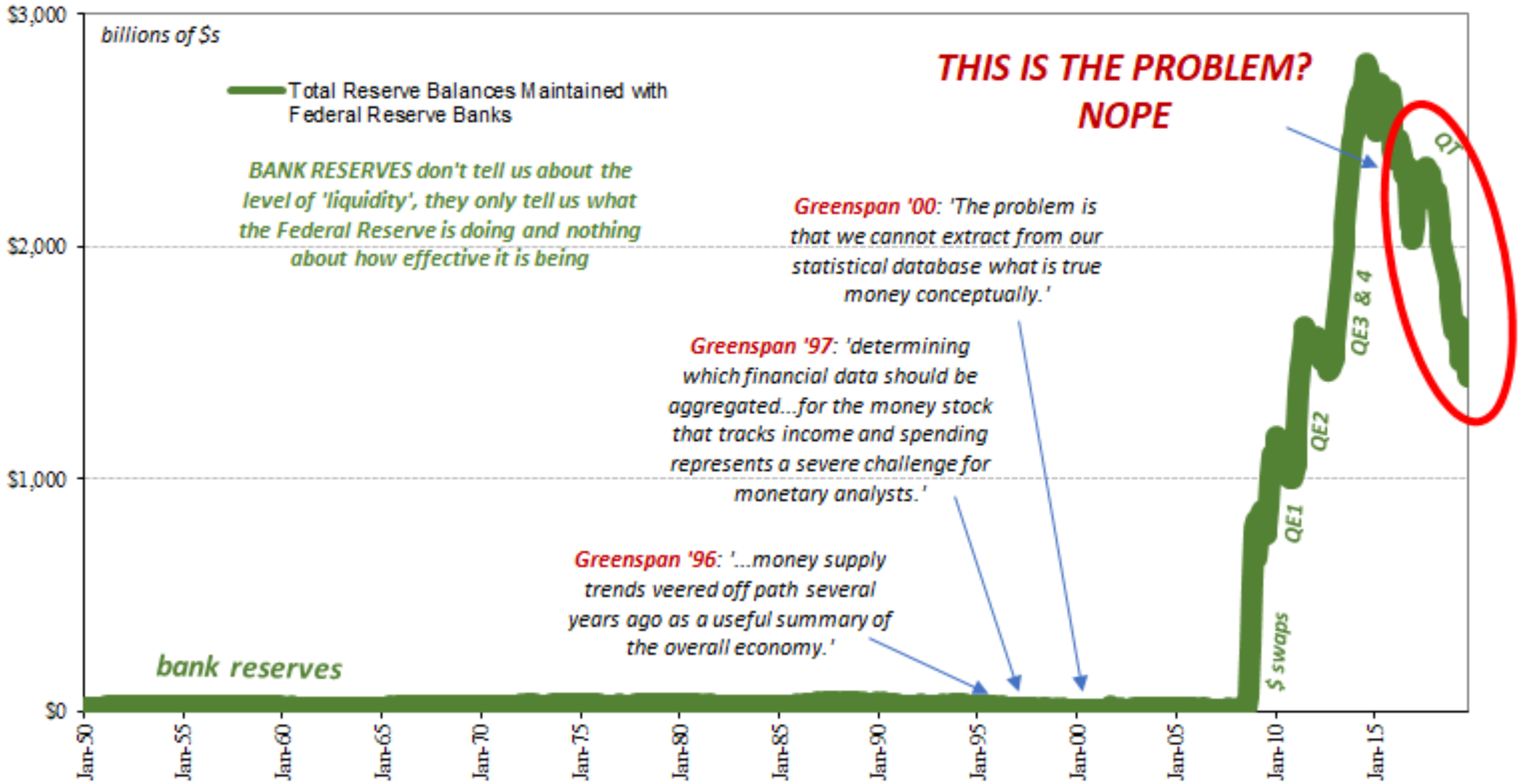

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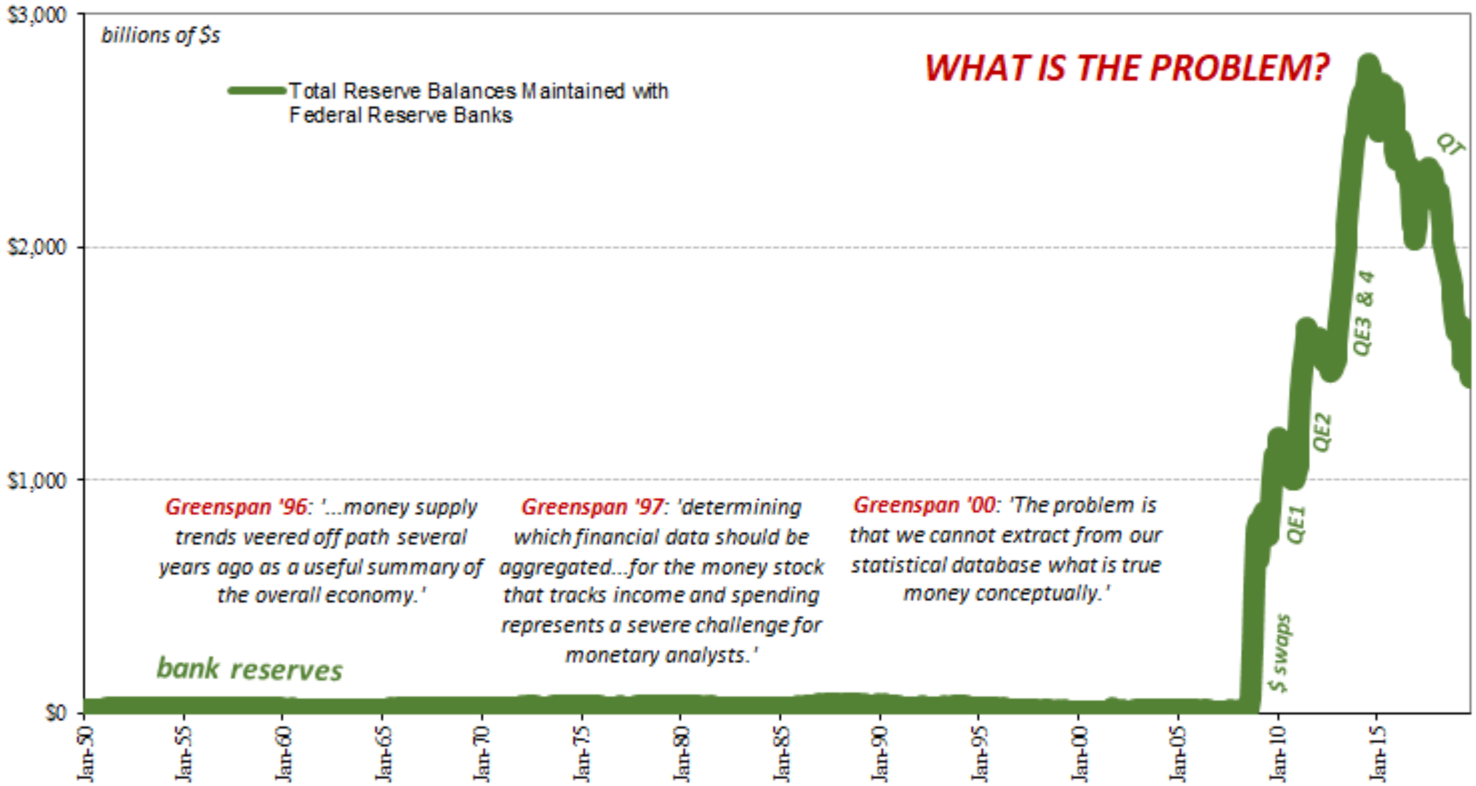

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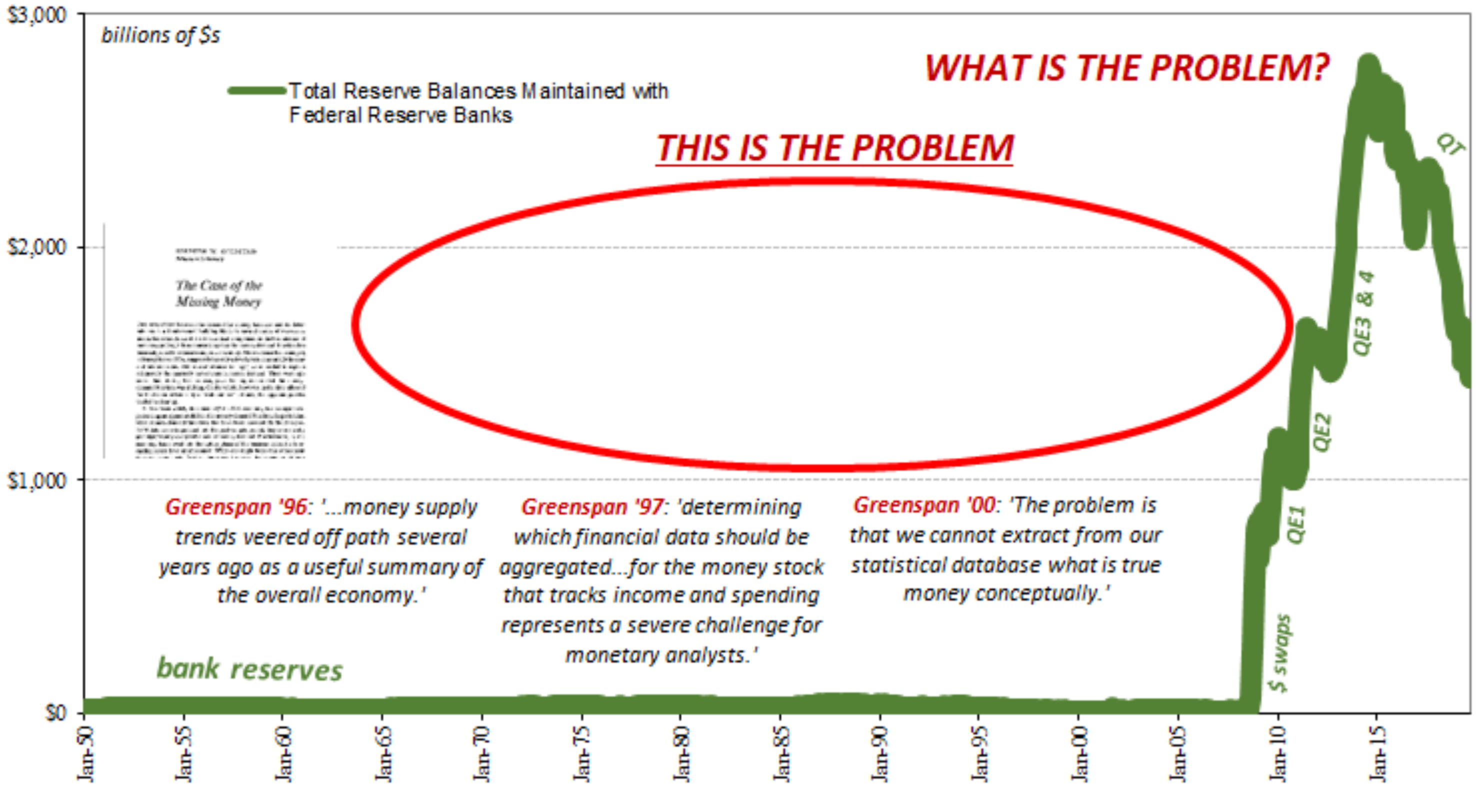

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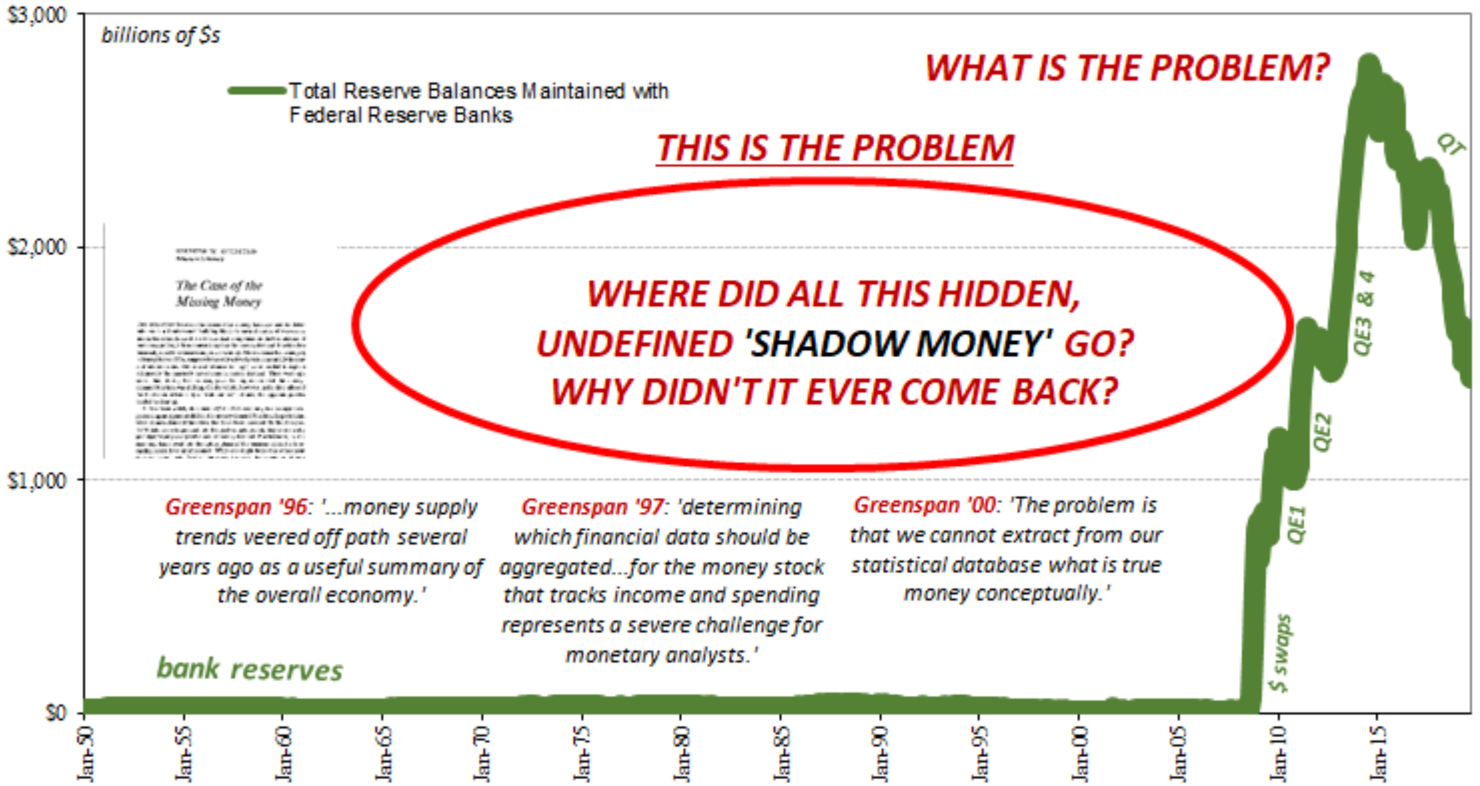

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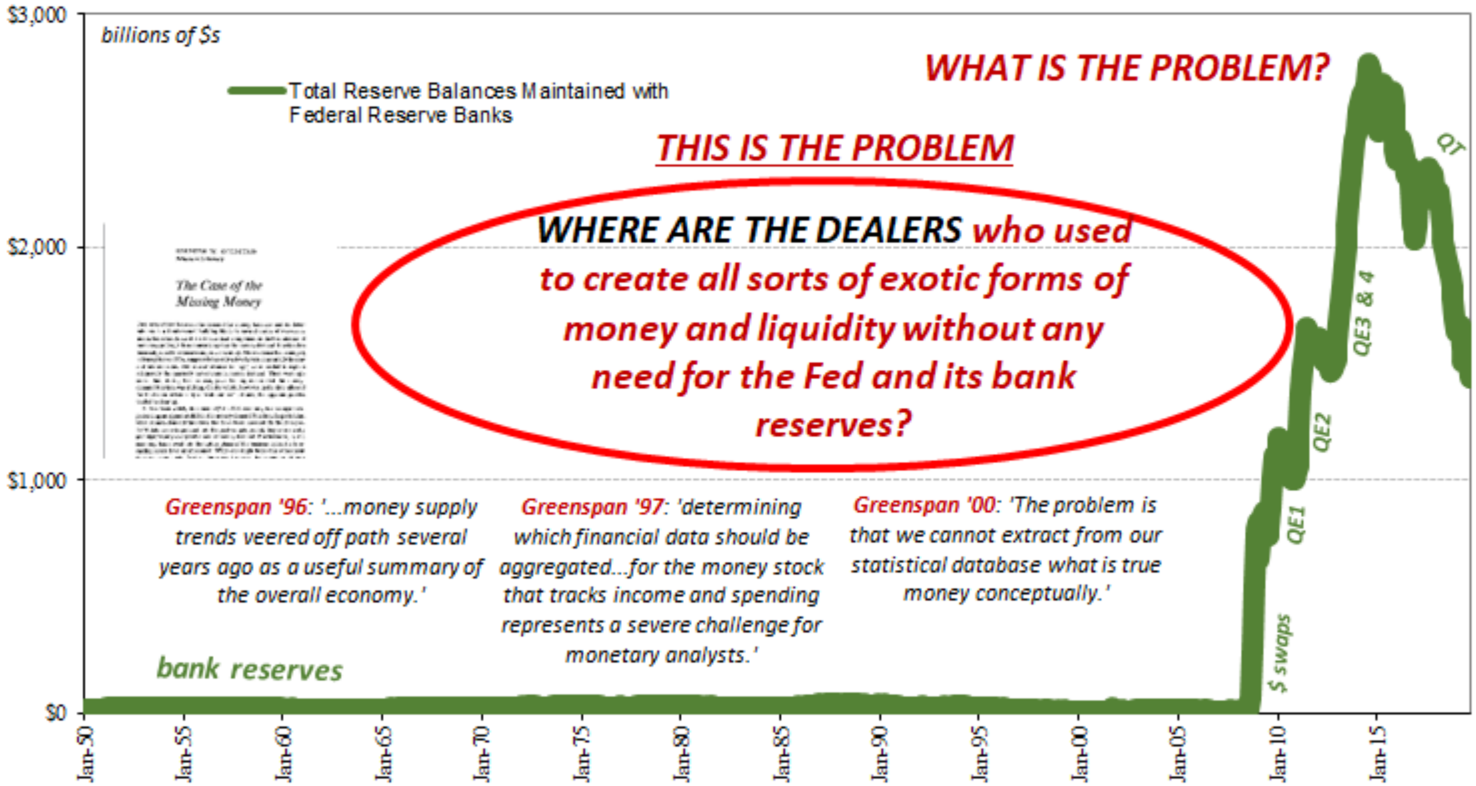

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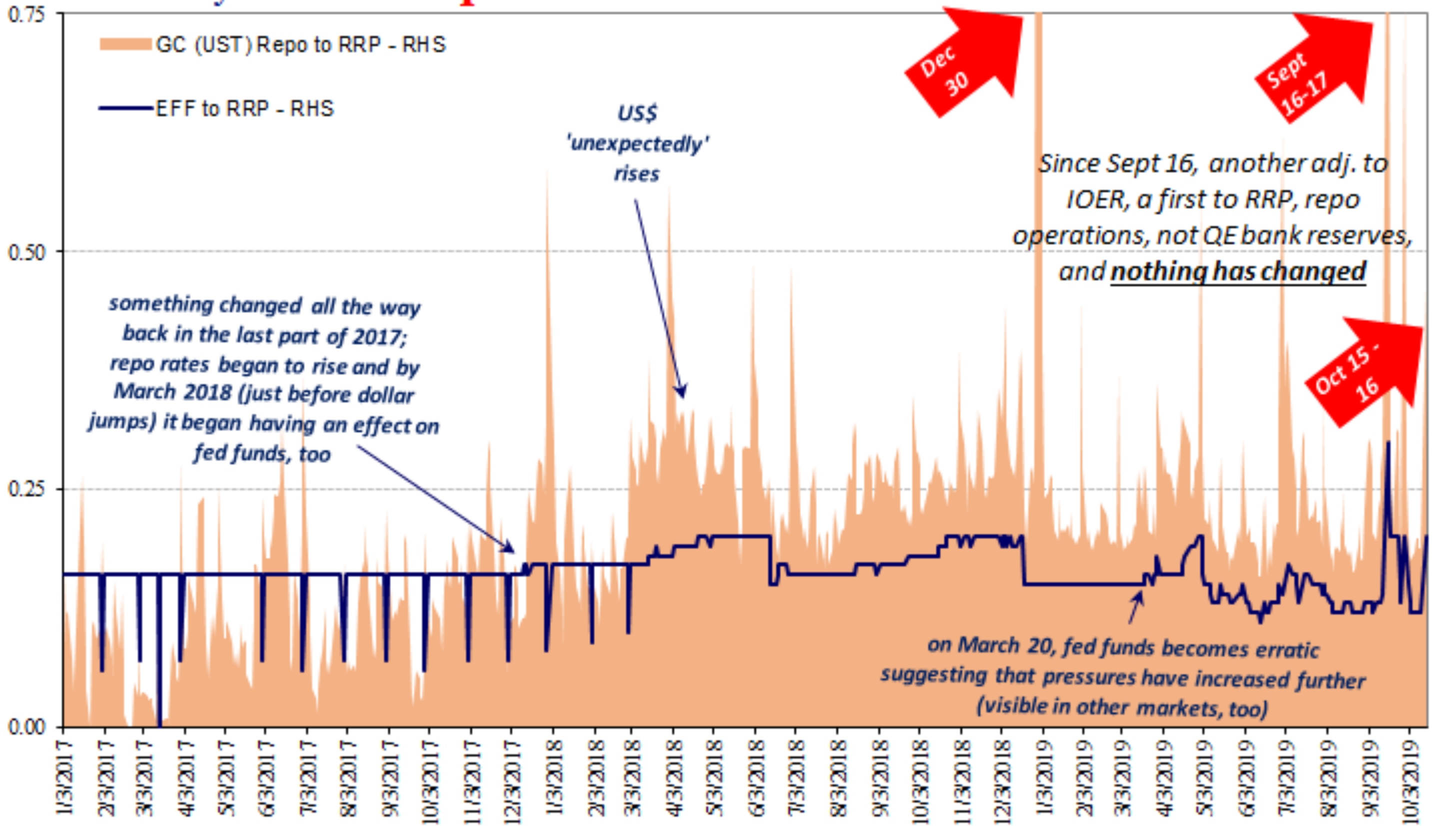
Money Markets Equivalents

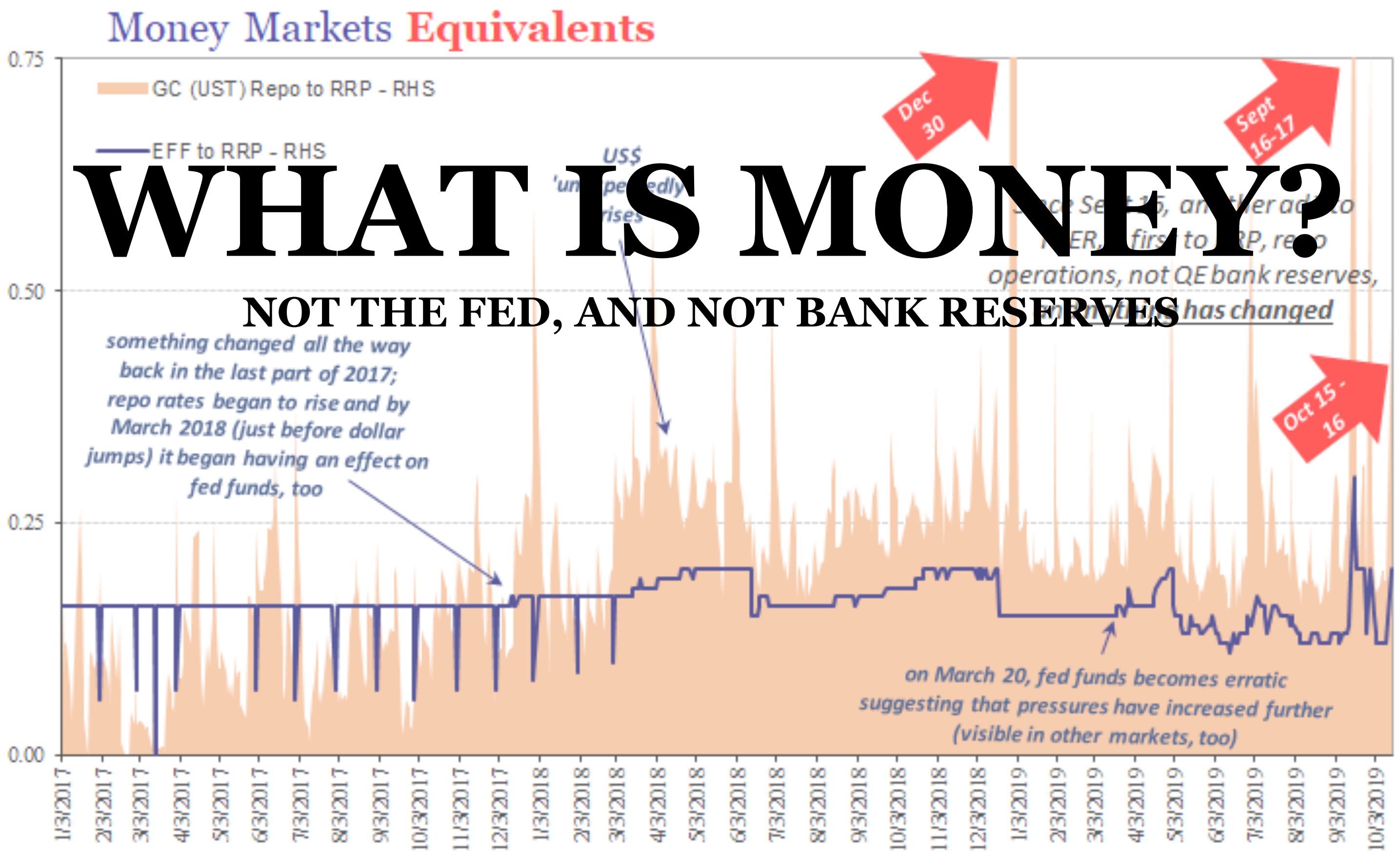


WHERE ARE THE DEALERS???

THE REAL MONEY IS STILL MISSING

WHAT IS MONEY?

NOT THE FED, AND NOT BANK RESERVES



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