The origin of money – Part II: book money

1. Gap-fill

Watch the film "The origin of money – Part II: book money" then fill in the gaps.

The credit balance in a bank account is known as _____

_____ .

The banks book their customers' payments to their bank accounts.

When a bank customer withdraws money from their account, the book money is turned into _____. When the customer makes a cash payment into the account, the cash becomes book money again. No new money is created by withdrawing from or paying into an account. The money merely changes its _____ . In the euro area, there is much more book money than cash.

The banks _____ new book money when they grant _____ . The loan amount is credited to the customer's account. Book money can also be created when a bank purchases _____ from its customers, for example shares, gold or property. The purchase amount is credited to the customer's account.

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Book money is _____ whenever a customer _____ an instalment of their loan or if the bank _____ assets to a customer, as the bank withdraws the purchase amount from the customer's credit balance as payment.

In short, banks can create book money. The most important factors determining the creation of money are the economy's _____ for loans, the cost of _____ for borrowers and banks, the _____, banking supervision regulations and the central bank's _____.

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2. Statements on price stability – what do you think?

Here are some statements on the topic of book money. What's your take on them?
Use what you have learnt to write a response to each.

a) **When somebody makes a withdrawal from their bank account, new money is created.**

b) **Book money only gets created when customers pay money into their bank accounts.**

c) **Book money is destroyed when customers withdraw money from their account.**

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d) The creation of book money through lending primarily benefits the banks, as the interest payments on loans make them richer.

e) Interest payments on loans are a risk-free source of income for banks.

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3. The limits governing the creation of book money

Banks cannot simply create however much book money they like. Explain how the following points each influence lending and, therefore, the creation of book money.

a) The economy's demand for loans

b) The cost of interest for borrowers

c) The cost of interest for banks' refinancing measures

d) Banking supervision regulations

e) The monetary policy of the central bank

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4. How the policy rate influences the creation of book money

Use the terms below to complete the two flowcharts. Following the downward arrows, fill in the blanks so that left and right each show a logical sequence of events.

- go down
- raises the policy rate
- less
- grows
- go up
- deflation
- fewer loans
- diminishes
- more loans
- more
- lowers the policy rate

Risk of inflation

↓

Central bank _____

↓

Interest rates on loans _____

↓

Demand for loans _____

↓

Banks issue _____

↓

_____ book money is created

Risk of _____

↓

Central bank _____

↓

Interest rates on loans _____

↓

Demand for loans _____

↓

Banks issue _____

↓

_____ book money is created

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