The origin of money – Part III: central bank money

1. Terms

Watch the film "The origin of money – Part III: central bank money".

a) Whilst you watch, make notes on the following terms:

Central bank money	
Minimum reserve	
Price stability	
Policy rate	

b) Compare your notes with your partner's and add to them if necessary.

c) In small groups or in front of the class, take turns explaining one of the terms listed above without saying which one it is. The person who guesses it correctly goes next.

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2. Gap-fill

"Central bank money" is the term used to refer to deposits held at the central bank and cash brought into circulation by the central bank, as only the _____ can create this money. New central bank balances arise when the central bank extends a loan to a commercial bank. If the commercial bank pays back the _____ using its account balance, the central bank money that was previously created _____.

Central bank balances also arise if the central bank purchases assets such as _____, _____ or _____ from a commercial bank. By contrast, if the central bank sells an asset to the commercial bank, the central bank money that was previously created once again _____.

Commercial banks need to hold central bank money in their _____ at the central bank:

(1) because the central bank may call for commercial banks to maintain a certain minimum balance on their central bank accounts – otherwise referred to as the _____ _____.

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(2) because their customers are withdrawing more and more _____.

The commercial banks have to obtain this additional cash from the _____. To do so, they need _____ _____ that they can draw upon.

(3) for cashless _____.

Commercial banks obtain central bank balances by taking out loans from the central bank. The commercial banks are required to pay _____ on these loans at the ECB's _____. This, in turn, serves as the lever for the Eurosystem's _____ _____: the Eurosystem has the option of using the policy rate to influence interest rate levels in the _____. If there is a risk of deflation, the ECB Governing Council will _____ interest rates. If there is a risk of inflation, the Eurosystem will _____ interest rates.

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3. A definition for central bank money

Use the words in the cloud to complete the equation.

Account balance
at the central bank

Central bank money

Cash

_____ + _____

= _____

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4. Central bank money: how it's created and why it's needed

Sort the following phrases into the correct columns. Watch out though: there are five incorrect phrases that don't belong in either column.

- Central bank purchases property from commercial banks
- Commercial banks print their own banknotes
- Commercial banks buy bitcoin from the central bank
- Holding of a minimum reserve
- Central bank purchases government bonds from commercial banks
- Customer cash withdrawals
- Central bank grants loans to commercial banks
- Borrowing from the government
- Cashless payments between banks
- Central bank purchases gold from commercial banks
- Commercial banks grant loans
- Commercial banks purchase assets from their customers

Ways in which central bank money can be created

1. _____
2. _____
3. _____
4. _____

Incorrect answers

1. _____
2. _____
3. _____
4. _____
5. _____

Reasons why commercial banks need central bank money

1. _____
2. _____
3. _____

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5. Transmission mechanism

The Eurosystem can use the policy rate (the rate at which commercial banks pay interest on central bank money) to influence interest rate levels – and thus, ultimately, the rate of inflation – in the euro area. Assuming a rising policy rate, study the right and left options in each box and choose the correct one to describe what happens next. Write the letter on the side that you have chosen in the corresponding numbered box to reveal the solution word.

P	**1. The policy rate increases**	Banks increase interest rates on loans.	Banks reduce interest rates on loans.	F
A	**2. Borrowing**	Bank customers take out more loans.	Bank customers take out fewer loans.	R
I	**3. Book money creation**	Less book money is created.	More book money is created.	L
C	**4. Consumption**	Fewer goods are purchased.	More goods are purchased.	S
F	**5. Companies**	Companies put up their prices.	Companies lower their prices.	E
H	**6. Prices**	The inflation rate rises.	The inflation rate falls.	S

Solution word:

1	2	3	4	5	6

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