TIP: It is important to understand the definition and the distinction between the monetary base, the money supply, and reserves.

The money supply is the value of financial assets in the economy that are considered money: this would include cash in the hands of the public, checkable bank deposits, and traveler's checks, using the narrow definition of the money supply given by the monetary aggregate M1. Bank reserves are composed of the currency banks hold in their vaults plus their deposits at the Federal Reserve. The monetary base is the sum of currency in circulation and bank reserves. The monetary base is not equal to the money supply: the money supply is larger than the monetary base.

TIP: It is important to understand the distinction between assets and liabilities.

Make sure you clearly understand what an asset and a liability are and then recognize that any financial instrument represents both an asset and a liability. For example, a mortgage represents a liability for the borrower and an asset for the lender; a checking account deposit represents a liability for the bank providing the check service and an asset to the individual depositing the funds.

TIP: For any T-account, clearly identify whose perspective is represented in the T-account.

T-accounts represent the assets and liabilities of an institution or an individual. When making a T-account, consider whose T-account it represents: this will help you more clearly identify whether the financial instruments you include are assets or liabilities. For example, bank reserves are a liability in the Fed's T-account and an asset in a bank's T-account.

TIP: Each T-account must always balance: that is, total assets must equal total liabilities where total liabilities include capital.

If your T-account does not balance, check your entries to find your error.

TIP: Remember that when the Fed purchases Treasury bills it injects reserves into the banking system and this increases the money supply. When the Fed sells Treasury bills, it removes reserves from the banking system and this decreases the money supply.