

Money Supply

function of money

- ① Store of value
- ② Unit of Account
- ③ Medium of exchange
- ④ Standard of deferred payment.

Measures / Components of Money Supply :

M_1 → most liquid form of money (narrow money)

M_2

M_3 → Broad Money

M_4 → least liquid form of money

$$D = DD + OD$$

$$M_1 = C + \overset{\swarrow}{D.D} + \overset{\nwarrow}{O.D}$$

$$M_2 = M_1 + \text{post office savings.}$$

$$M_3 = M_1 + \text{Net time deposits of Banks.}$$

$$M_4 = M_3 + \text{Total deposits of PO savings Organisation} \\ \text{(excluding National Saving Certificate or NSC)}$$

M_0 ⇒ High powered money or monetary base

$M_0 \Rightarrow$ High powered money or monetary base
 or reserve money.

$(H) > (B)$

$M_0 (H \text{ or } B) =$ Currency in circulation + Banker's deposit with the RBI + other deposit with the RBI.

$$M_1 = C + D$$

$$M_0 \text{ or } B = C + R$$

(1) $C/D \Rightarrow$ ^{Currency} Cash-Deposit ratio (C/D)

\rightarrow it is the amount of currency (C) people hold as a fraction of their holding of deposits (D)

It reflects the preference of public about the form of money they wish

Factors: to hold.

- (1) C/D will vary inversely with the rate of interest on savings because economic agents like to hold more deposits and less cash at higher rate of interest.
- (2) Cost and convenience of obtaining cash.

② Cost and convenience of obtaining cash.

Reserve Deposit / Required Reserve Ratio

is the amount of money (deposit a bank is required to keep with themselves as Reserve.

$$RR = \frac{R}{D}$$

B/H/M₀

$$KB = C + R \quad \text{--- (1)}$$

$$M = C + D \quad \text{--- (2)}$$

Dividing (2) by (1)

$$\frac{M}{B} = \frac{C+D}{C+R}$$

$$\frac{M}{B} = \frac{\frac{C+D}{D}}{\frac{C+R}{D}}$$

$$\frac{M}{B} = \frac{\frac{C}{D} + 1}{\frac{C}{D} + \frac{R}{D}}$$

$$\frac{M}{B} = \frac{CR + 1}{CR + RR}$$

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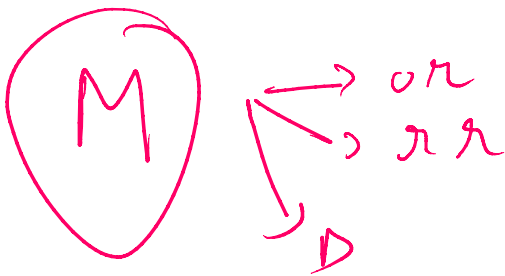
B

$$m = B \left(\frac{c r + r d}{c r + r d} \right)$$

Let $\frac{c r + r d}{c r + r d} = m = \text{money multiplier}$

$c r$ and $r d$ $\therefore \uparrow m \propto B \uparrow$

$$M = B \cdot m$$



$$c r \downarrow = \frac{c}{D} \downarrow$$

$$c < D$$

more deposits with bank
 \downarrow
 more money available to lend out.
 \downarrow
 money supply will rise

$c r$ and M_s inversely related

$r d \uparrow = \frac{R}{D} \uparrow \Rightarrow R > D \Rightarrow$ less money available for lending
 \Rightarrow money supply will decrease.

$r d$ and M_s is inversely related

$B \propto m \Rightarrow$ directly related.

$B \propto M \Rightarrow$ directly related.

Instruments of Anti-Inflationary policies
(~~How to~~ ^{measure} reduce or control money
by RBI: Supply)

- ① CR ↑
- ② RR ↑
- ③ Discount Rate / Bank rate ↑ ses.
- ④ Repo-rate
- ⑤ Reverse Repo-rate
- ⑥ open-market operations
- ⑦ SLR \Rightarrow Statutory Liquidity Ratio.