

B.Com. Part III

Sub: Money and Financial System

Alternate Measures of Money Supply in India and its different components

Money Supply Measures and its components

Supply of money refers to the currency with the public and demand deposits in the banks.

Different economist have different views on supply of money.

Components of supply of money

1. Currency(Coins, currency notes)
2. Demand Deposits(Term Deposit, Demand Deposit)

Money Supply Measures/ Supply of Money in India

M_1 = Currency with the public + Demand deposits with the banks + other deposits with the reserve bank

M_2 = M_1 + Deposits with post office savings bank account

M_3 = M_1 + Time deposit with the commercial bank

M_4 = M_3 + Total deposit with post offices (excluding National Saving certificate)

M_1 Narrow concept

M_3 Broader concept

Factors Influencing the supply of money

1. Size of money base

Gold Stock

Reserve asset of Reserve Bank

High Powered Money/ Monetary Base/ Reserve Money = Currency with the public (Notes + Coins) + Bank Reserves

On the basis of assets (Govt. securities, debentures etc.) central bank of the country and the government create money, this money is known as High Powered Money (to produce DD banks have to maintain R, which is part of H)

Money = currency + Demand Deposits

High Powered Money = Currency + Total Deposit with banks

2. Proportion of cash and Demand Deposit

3. Velocity of Circulation

Velocity of money is the number of times a unit of money changes hands in the course of a year.

Factors Influencing Velocity of Money

1. Quantity of Money
2. Cash Transactions
3. Propensity to consume
4. Credit Facilities
5. Liquidity Preference
6. Velocity of Credit Money
7. Payment of Wages
8. Extent of the Market
9. Expansion of Trade
10. Level of Economic Development

DETERMINATION OF MONEY SUPPLY

It is determined by the currency and money multiplier

$$M = mH$$

M = Supply of Money, m = Money Multiplier, H = High Powered Money

1. Monetary Base or H

$$H = R + C$$

R = Total reserve of banks

C = currency in circulation

2. Money Multiplier

Supply of Money (M) is equal to currency (C) and demand deposits of banks (D)

$$M = C + D \quad \dots(i)$$

High Powered Money includes Currency (C) Required reserve of banks or cash reserves (RR) and other deposits of the banks or Excess reserve (ER)

$$H = C + RR + ER \quad \dots(ii)$$

$$m = M/H = C+D / C+RR+ER \quad \dots(iii)$$

Divide the right portion of equation (iii) by D(demand deposits)

$$m = C/D + D/D / C/D + RR/D + ER/D \quad \dots(iv)$$

if we right **C_n** in place of C/D, **R_n** in place of RR/D and **E_n** in Place of ER/D

$$m = M/H = 1 + C_n / C_n + R_n + E_n$$

$$M = 1 + C_n / C_n + R_n + E_n * H$$

Supply of money is determined by **C_n**, **R_n**, **E_n** and H

Thank you