FACULTY OF JURIDICAL SCIENCES

Lecture-10

DEMAND FOR MONEY

- In economics, demand for money is commonly associated with cash or bank demand deposits. In general, the nominal demand for money increases with the level of nominal output and decreases with the nominal interest rate.
- The demand for money is influenced by a variety of factors, including income level, interest rates, inflation, and future uncertainty.
- The impact of these factors on money demand is typically explained in terms of the three motives for demanding money:
    - **Transaction motive –** It refers to the demand for money to meet the current needs of individuals and businesses.
    - **Precautionary motive –** It refers to people's desire to save money for various contingencies that may arise in the future.
    - **Speculative motive –** It refers to the motivation of individuals to hold cash in order to profit from market movements regarding future changes in the interest rate.
- Monetary policy can help to stabilize an economy when the demand for money is stable. When the demand for money is not stable, real and nominal interest rates change, and economic fluctuations occur.
- The demand for money explains people's desire for a specific amount of money.
- Money is required to manage transactions, and the value of the transactions determines how much money people wish to keep.
    - The greater the number of transactions, the greater the amount of money demanded.
- Since the quantity of transactions is determined by earnings, it should be obvious that an increase in earnings leads to an increase in the demand for money.
- When people save their money rather than putting it in a bank where it earns interest, the money they save is also subject to the rate of interest.
- People become less focused on stockpiling money when interest rates rise, because holding money leads to holding less interest-earning deposits. As a result, at high interest rates, the amount of money demanded decreases.

SUPPLY FOR MONEY

- Money supply is a stock variable, just like money demand. Money supply refers to the total stock of money in circulation among the general public at any given time.
- The RBI publishes figures for four different measures of money supply, namely M1, M2, M3, and M4. They are defined as below:
  - M1 = CU + DD
  - M2 = M1 + Savings deposits with Post Office savings banks
  - M3 = M1 + Net time deposits of commercial banks
  - M4 = M3 + Total deposits with Post Office savings organizations (excluding National Savings Certificates)
- Where, CU is public currency (notes and coins) and DD is net demand deposits held by commercial banks. The term 'net' implies that only public deposits held by banks are to be included in the money supply.
- Interbank deposits held by a commercial bank in other commercial banks are not considered part of the money supply.
- M1 and M2 are referred to as narrow money. M3 and M4 are referred to as broad money.
- The gradations are listed in decreasing order of liquidity. M1 is the most liquid and easiest to transact with, whereas M4 is the least liquid.
- M3 is the most commonly used money supply measure. It's also referred to as aggregate monetary resources.
- A credit control policy imposed by a country's banking system aid in determining the total supply of money.
- The money supply is solely determined by the central bank and is unaffected by interest rates. As a result, the money supply curve is vertical at the quantity of money supply, rather than upward or downward sloping.
- Since the central bank has control over the money supply, it can take actions to increase or decrease the money supply. Changes in the money supply cause interest rates to fluctuate.
- The monetary base and the money multiplier ultimately determine the money supply.

    - In most countries, the size of the monetary base is determined by the central bank.
    - The monetary base includes vault reserves as well as currency in circulation outside of banks.
    - Central banks may alter reserve requirements in order to alter the monetary base.
- Monetary policy has an effect on the money supply as well.
    - Expansionary policy raises the total supply of money in the economy faster than usual, while contractionary policy raises the total supply of money more slowly than usual.
    - Expansionary policies are used to combat unemployment, whereas contractionary policies are used to slow inflation.