Money Supply and

And

Money Multiplier & **Credit Multiplier**

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Money Supply

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- The money supply is the total value of money available in an economy at a point of time.
- Reserve Bank of India (RBI) →measures the money supply and publishes it on a weekly or fortnight basis.

The 3 main sources of Money supply in India are:

- These are:
- The government who produces all the coins and the one rupee notes
- The Reserve Bank of India (RBI) which issues all the paper currency
- And commercial banks as they create the credit as per the demand deposits

- The Reserve Bank of India has a long tradition
- of compilation and dissemination of monetary
- statistics, since July 1935.

Three working groups were set up so far >>

The First Working Group on Money Supply (FWG) (1961)

The Second Working Group (SWG) (1977) and The “Working Group on Money Supply: Analytics and Methodology of Compilation” (WGMS) (Chairman: Dr. Y.V. Reddy) (1998)

Monetary aggregates are published on a regular basis

- in RBI publications like the »
- Bank's Annual Report,
- Report on Currency and Finance,
- Handbook of Statistics, RBI Bulletin,
- Weekly Statistical Supplement, etc.

There is no unique definition of ‘money’,>>

- either as a concept in economic theory or as measured in practice.
- Money is a means of payment and thus a lubricant that facilitates exchange.
- Money also acts as a store of value and a unit of account.

Defined>>

- Money can, therefore, be defined for policy purposes as the set of liquid financial assets, the variation in the stock of which could impact on aggregate economic activity.

Thus,like other countries, a range of monetary and liquidity measures are compiled in India.

- DEFINITIONS OF RBI MONETARY AGGREGATES:
- **Researve Money or Monetary Base (M0)**
- **M1**
- **M2**
- **M3**
- **M4**
- **NM1**
- **NM2**
- **NM3**
- **L1**
- **L2**
- **L3**

Note:

- Recommendations of the Second Working Group on Money Supply **(SWG) in 1977**>> RBI publishes four monetary aggregates – **M1, M2, M3 and M4** - besides the reserve money.
- >> M1 and M3 are extensively used both for policy purposes and in academic exercises.
- While M1 includes currency with the public, non-interest bearing deposits with the banking sector including that of RBI.
- M3 captures the complete balance sheet of the banking sector.
- The reserve money and M3 aggregates are presented both for the components (liabilities) and sources (assets).

M2 and M4 that include post office savings banks deposits are not very widely used.

- The weekly balance sheet data of RBI are used for the compilation of reserve money.
- The balance sheet data for the entire banking sector which include apart from RBI, commercial and co-operative banks are used for compilation of M3.

The RBI calls H(High Powered Money)
Reserve Money or Monetary Base (M0)

- Reserve Money = Currency in circulation + Bankers' deposits with the RBI + 'Other' deposits with the RBI
- = Net RBI credit to the Government + RBI credit to the commercial sector + RBI's claims on banks + RBI's net foreign assets + Government's currency liabilities to the public – RBI's net non-monetary liabilities

The 4 CONCEPT OF MONEY SUPPLY :

- **M1 = Currency notes and coins with the people+demand deposits of banks (Current and Saving deposit accounts) + other deposits with the RBI.**
- M1 (Narrow Money)
- **M1 includes all the currency notes being held by the public on any given day.**
- **It also includes all the demand deposits with all the banks in the country, both savings as well as current account deposits. It also includes all the other deposits of the banks kept with the RBI.**
- **So M1 = CC + DD + Other Deposits**

M2, also narrow money

- M2, also narrow money, includes all the inclusions of M1 and additionally also includes the saving deposits of the post office banks.
- So M2 = M1 + Savings Deposits of Post Office Savings

M3 (Broad Money)

- M3 = M1+net time deposits with the banking system
- M3 consists of all currency notes held by the public, all demand deposits with the bank, deposits of all the banks with the RBI and the net Time Deposits of all the banks in the country.

M4=M3+total deposits with the Post-Office SavingsOrganization (excluding National Savings Certificates)

M4 is the widest measure of money supply that the RBI uses.

It includes all the aspects of M3 and also includes the savings of the post office banks of the country.

It is the least liquid measure of all of them.

New Monetary Aggregates>> NM1,NM2,NM3

- NM1 = Currency with the public + Demand deposits with the banking system + 'Other' deposits with the RBI.
- NM2 = NM1 + Short-term time deposits of residents (including and up to the contractual maturity of one year).
- NM3 = NM2 + Long-term time deposits of residents + Call/Term funding from financial institutions.

New Monetary Aggregates>> NM1,NM2,NM3

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- In addition to the monetary aggregates, the Working Group had recommended compilation of three liquidity aggregates namely, L1, L2 and L3.
- These which include select items of financial liabilities of non-depository financial corporations such as development financial institutions and non-banking financial companies accepting deposits from the public, apart from post office savings banks.

L1 = NM3 + All deposits with the post office savings banks (excluding National Savings Certificates).

- L2 = L1 +Term deposits with term lending institutions and refinancing institutions (FIs) +Term borrowing by FIs + Certificates of deposit issued by FIs.

L3 = L2 + Public deposits of non-banking financial companies.

What are these?

- **Net bank credit =** Net RBI credit to the to the Government (i.e., Net RBI Government Credit to the Centre + Net RBI Credit to State Governments) + Other banks' credit to the Government
- **Bank credit to the commercial sector =** RBI credit to the commercial sector + Other banks' credit to sector the commercial sector

Know what they represent>>

- The 'Reserve Bank's credit to the commercial sector' represents investments in bonds/shares of financial institutions, loans to them and holdings of internal bills purchased and discounted.
- 'Government's currency liabilities to the public' comprise rupee coins and small coins.

- Net non- monetary liabilities of the banking sector= RBI’s net non-monetary monetary liabilities + Net non-monetary liabilities of the liabilities of other banks.

Know what they represent>>

- 'Currency in circulation' includes notes in circulation, rupee coins and small coins.
- Currency with the public is arrived at after deducting cash with banks from total currency in circulation, as reported by RBI.

Contd.

- Bankers' deposits with the Reserve Bank' represent balances maintained by banks in the current account with the Reserve Bank mainly for
- i. maintaining **Cash Reserve Ratio (CRR)** and
- as working funds for clearing adjustments.

Contd.

- Other’ Deposits with the Reserve Bank, for the

purpose of monetary compilation, include

deposits from foreign central banks, ultilateral institutions, financial institutions and sundry

deposits net of IMF Account No.1.

Time deposits’

- ‘Time deposits’ are those which are payable
- otherwise than on demand and they include fixed deposits, cash certificates, cumulative and recurring deposits, time liabilities portion of savings bank deposits, staff security deposits, margin money held against letters of credit if not payable on demand, India Millennium Deposits and Gold Deposits

CASA or LIQUID Money: This is defined as currency with the public and demand deposits with commercial banks.

- **Demand deposits(DD)= savings account(SA) + current accounts(CA) ,of depositors in a commercial bank.**
- **This CASA →** liquid form of money because depositors can draw cheques for any amount lying in their accounts and the bank has to make immediate payment on demand.

Narrow and Broad Definition of Money

- Monetary aggregates are the measures of the money supply in a country
- M_1 (the money supply)→ Demand deposits with commercial banks plus currency with the public are together →regarded **as a narrow definition of the money supply.**
- M3 (money supply) → **called ‘broad money’,**

Class Activity 2: Answer these questions>>

- Q1. Differentiate Between the following:
- i. M1 and NM1
- ii. M2 and NM2
- iii. M3 and NM3
- iv. M4 and NM3
- v.Narrow Money and Broad Money
- vi. Net bank credit to the government and to the business sector

THANK YOU

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