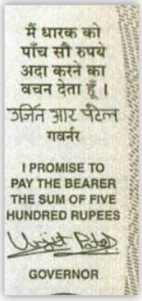
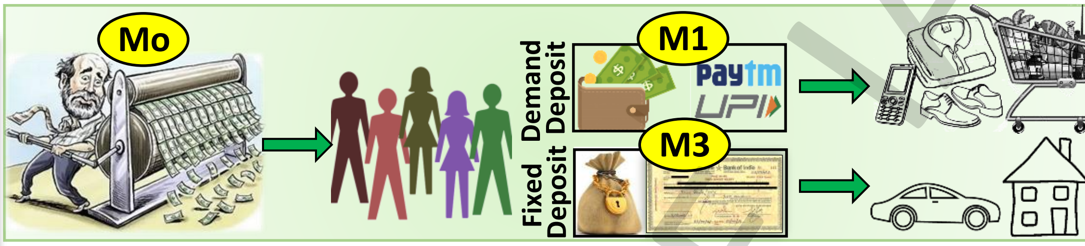
Measures of Money Supply

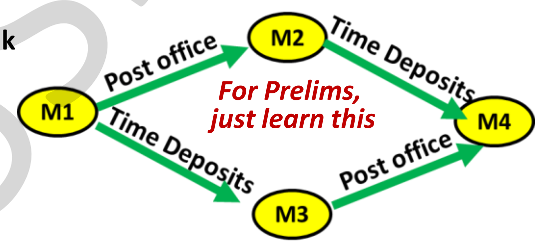




Mo
High powered money / Monetary base
Total liability of RBI (Money with RBI/Govt/Banks/Public)

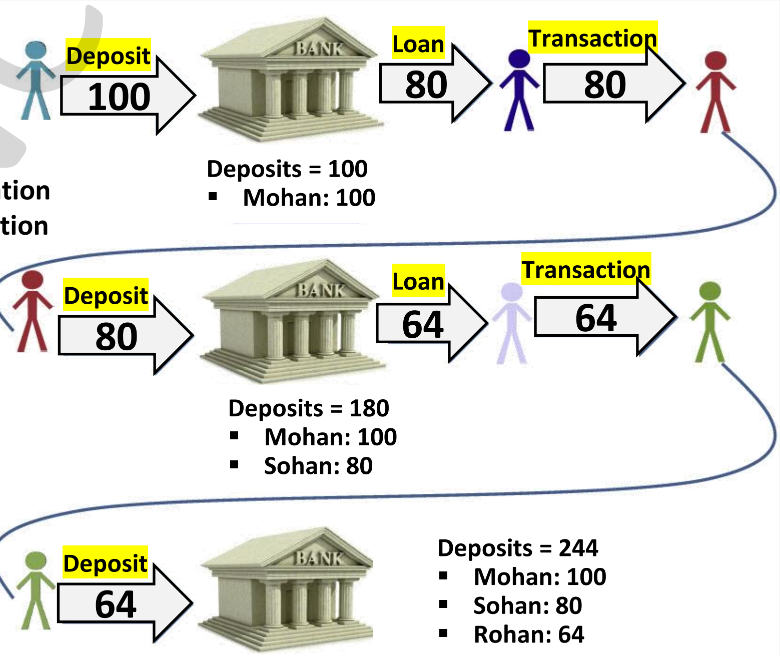
Seigniorage:
- (Face value) – (production cost)
- Govt profit by printing money

M1 = Currency with people + Demand deposit in bank
M2 = M1 + Post Office
M3 = M1 + Time deposits
M4 = M3 + Post Office
"1" is narrow money *(demand deposit)*
"3" is broad money *(fixed deposit also)*



Credit creation

- ✓ aka money creation/multiplier
- ✓ It means expansion of deposits.
- ✓ Low CRR or SLR → high credit creation
- ✓ High CRR or SLR → low credit creation
- ✓ Low credit creation leads to:
  - ✓ Low velocity of money
  - ✓ Low inflation risk



Velocity of money:
- It tells rate at which money is exchanged in an economy.
- Approx. formula:

$$Velocity = \frac{GDP}{Money\ supply}$$

Prelims 2002

Consider the following:

1. Currency with public
2. Demand deposit with banks
3. Time deposits with banks

Which of these are included in Broad Money (M3) in India?

(a) 1 and 2 (b) 1 and 3

(c) 2 and 3 (d) 1, 2 and 3

Prelims 2020

If you withdraw Rs 1,00,000 in cash from your Demand Deposit Account at your bank, the immediate effect on aggregate money supply in the economy will be

(a) to reduce it by Rs 1,00,000

(b) to increase it by Rs 1,00,000

(c) to increase it by more than Rs 1,00,000

(d) to leave it unchanged

Prelims 2012

Which of the following would result in increase in money supply in economy?

1. Purchase of government securities from the public by the central bank
2. Deposit of currency in commercial banks by the public
3. Borrowing by the government from the central bank
4. Sale of government securities to the public by the central bank

Select the correct answer using the codes given below:

(a) 1only (b) 2 and 4 only (c) 1 and 3 (d) 2, 3 and 4

Prelims 2021

The money multiplier in an economy increases with which one of the following?

(a) Increase in Cash Reserve Ratio in banks (b) Increase in Statutory Liquidity Ratio in banks

(c) Increase in banking habit of people (d) Increase in population of country

Near Money: (aka quasi-money)
Non-cash assets that are highly liquid and easily converted to cash

Dear money: (aka tight money)
Money that is hard to obtain because of high interest rates

Remember:
When supply of money increases
→ interest rates fall
When demand for money increases
→ interest rates increase

Import Substitution

Continued from class-12

Import substitution: (inward looking trade strategy)

- Meaning: replacing imports with domestic production
  - By either creating barriers (quota/tariff) or increase competitiveness
- Post-independence India till 1991: created barriers
- Atmanirbhar India: creating barriers, but saying we are increasing competitiveness
  - Example: Embargo on 101+108 defence imports
- Problem with barriers: Protectionism makes domestic industry uncompetitive

mint

Atmanirbhar Bharat is not a return to import substitution of pre-1991 period: Principal Economic Adviser

NEW DELHI : Principal Economic Adviser to the government, Sanjeev Sanyal on Wednesday said that Atmanirbhar Bharat is not a vision of a return to the import substitution of the pre-1991 period.

Business Standard

Towards indigenisation: MoD puts 108 defence items on import ban list

This list supplements an earlier import embargo on 101 defence items announced last August

The Ministry of Defence (MoD) announced on Monday a "Positive Indigenisation List" of 108 items of defence equipment that must be compulsorily procured from indigenous sources

LAF and MSF

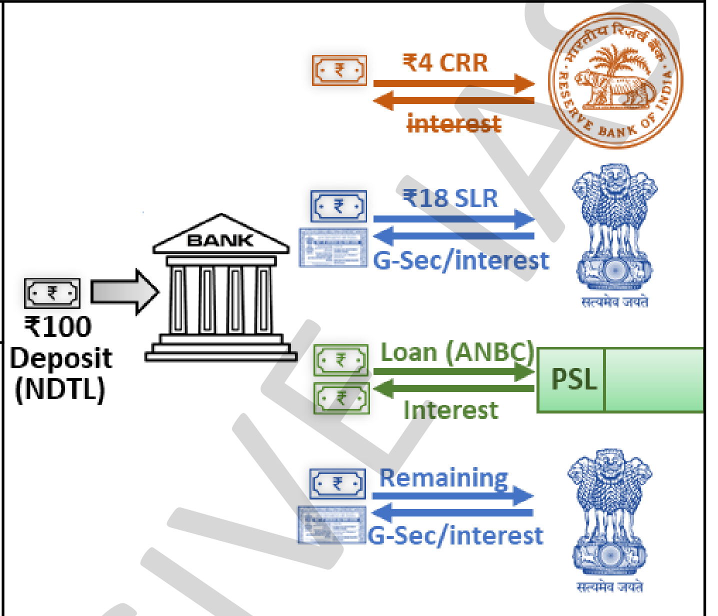
- ✓ Commercial Banks
- ✓ Cooperative Banks
- ✓ Regional Rural Banks

Prelims 2014

The terms 'Marginal Standing Facility Rate' and 'Net Demand and Time Liabilities', sometimes appearing in news, are used in relation to
(a) banking operations
(b) communication networking
(c) military strategies
(d) supply & demand of agricultural products

Prelims 2010

Which of the following terms indicates a mechanism used by commercial banks for providing credit to the government?
(a) Cash Credit Ratio
(b) Debt Service Obligation
(c) Liquidity Adjustment Facility
(d) Statutory Liquidity Ratio

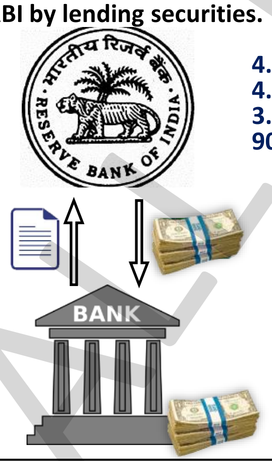


	Loan	Duration	Collateral
Repo	RBI → Bank	1 day	G-sec outside SLR
Reverse-Repo	Bank → RBI	1 day	
Long-term Repo	RBI → Bank	1-3 years	
MSF	RBI → Bank	1 day	G-sec of SLR
Call Money	Bank → Bank	1 day	None
Notice Money		2-14 days	
Term Money		> 14 days	

- ❑ CRR is held with RBI, but SLR is held at the bank itself
- ❑ SLR: Cash, Gold, T-bill, G-sec, SDL, etc
- ❑ LAF means Repo and Reverse-Repo
- ❑ MSF (since 2011) is penal rate, reduces volatility in inter-bank market

CRR: Cash Reserve Ratio
SLR: Statutory Liquidity Ratio
NDTL: Net Demand & Time Liabilities
ANBC: Adjusted Net Bank Credit
LAF: Liquidity Adjustment Facility
MSF: Marginal Deposit Facility
LIBOR: London Interbank Offered Rate
MIBOR: Mumbai Interbank Offered Rate

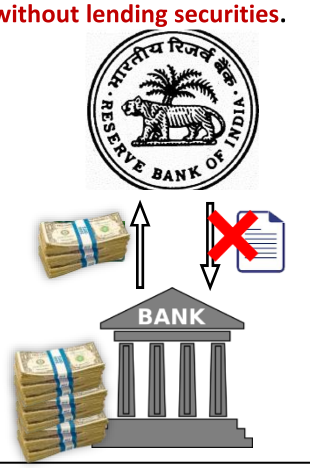
Repo: *(and MSF)*
Banks borrow money from RBI by lending securities.



4.25% MSF
4.00% Repo
3.35% Reverse-Repo
90 bps Policy Corridor

Reverse repo:
RBI borrows money from banks by lending securities.

Standing Deposit Facility:
RBI borrows money from banks without lending securities.



Prelims 2010

When the Reserve Bank of India announces an increase of the Cash Reserve Ratio, what does it mean?

(a) Commercial banks will have less money to lend
(b) RBI will have less money to lend
(c) Union Government will have less money to lend
(d) Commercial banks will have more money to lend

Prelims 2020

If RBI decides to adopt an expansionist monetary policy, which of the following would it not do?

1. Cut and optimize the Statutory Liquidity Ratio **Do**
2. Increase the Marginal Standing Facility Rate **Not do**
3. Cut the Bank Rate and Repo Rate **Do**

Select the correct answer using the code:

(a) 1 and 2 only (b) 2 only
(c) 1 and 3 only (d) 1, 2 and 3

Prelims 2014

In context of Indian economy, which of the following is purpose of 'Statutory Reserve Requirements'?

1. To enable the Central Bank to control the amount of advances the banks can create
2. To make people's deposits with banks safe & liquid
3. To prevent commercial banks from making excessive profits
4. To force banks to have sufficient vault cash to meet their day-to-day requirements

Select the correct answer using the code:

(a) 1 only (b) 1 and 2 only
(c) 2 and 3 only (d) 1, 2, 3 and 4

Prelims 2015

When the Reserve Bank of India reduces the Statutory Liquidity Ratio by 50 basis points, which of the following is likely to happen?

(a) India's GDP growth rate increases drastically
(b) Foreign Institutional Investors may bring more capital into our country
(c) Scheduled Commercial Banks may cut their lending rates
(d) It may drastically reduce the liquidity to the banking system

Liquidity trap A situation of very low rate of interest in the economy where every economic agent expects the interest rate to rise in future and consequently bond prices to fall, causing capital loss. Everybody holds her wealth in money and speculative demand for money is infinite. *– NCERT*

Liquidity Trap:

- **Low interest rate:** Monetary policy becomes ineffective
- **High savings rate:** People don't spend money despite low interest rates
- **Bond prices fall:** People avoid Bonds (People keep money in bank)

Liability: money that Bank will give

Asset: money that Bank will get

Interest rate spread = 9% - 4% = 5%

Legal tender:
Money recognized by law of and **cannot be refused** by any citizen of the country

Legal tender / fiat money

Fiat money:
(Dollar, Euro, Rupee, etc.)
- Money with **no intrinsic value**.
- **Not backed by gold** (physical commodity)
- **Backed by govt** authority
- Problem: print as much as one wants

- **Coins** are issued by Central **Govt**.
- **Notes** are issued by **RBI**.
- But **One Rupee note** is issued by Central **Govt**. It has sign of **Finance Secretary**

Prelims 2018
Which one of the following statements correctly describes the meaning of **legal tender** money?
(a) The money which is tendered in courts of law to defray the fee of legal cases
(b) The money which a creditor is under **compulsion to accept** in settlement of his claims
(c) The bank money in the form of cheques, drafts, bills of exchange, etc.
(d) The metallic money in circulation in a country



Functions of money


MEDIUM OF EXCHANGE


STORE OF VALUE


UNIT OF ACCOUNT

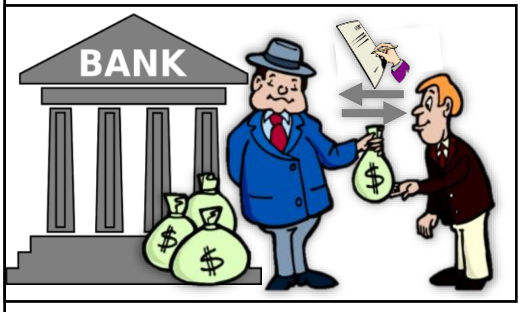

STANDARD FOR DEFERRED PAYMENTS

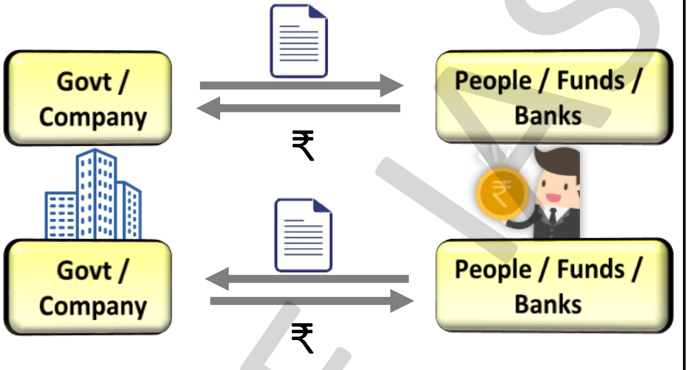
Functions of money:
- **Medium of exchange**: Money is used to make payments (think of Barter!)
- **Measure of value**: Value of goods and services is expressed in terms of money
- **Store of value**: Money is used to store wealth for future use
- Transfer of value; Standard of deferred payment, etc

Demand for Money:
- **Transaction demand:**
  - money needed to buy goods
  - Generally more TD → more inflation and GDP
- **Precautionary demand:**
  - money needed for financial emergencies
- **Speculative demand:**
  - money people hold instead of investing
  - Generally more SD → less rate of interest

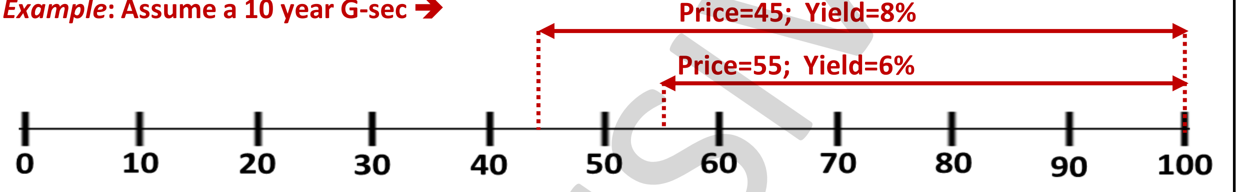
Bond ; G-Sec ; T-bill

India's corporate bond market is shallow:
- ❑ Most bonds are privately placed
- ❑ Most bonds are held to maturity





Bond: A financial instrument of indebtedness, just like a loan agreement
Bond price and yield are inversely related
***Example*: Assume a 10 year G-sec ➔**



Types of Bond ?
- ➢ **Zero-coupon bond**: Give ₹600 now, get ₹1000 later
- ➢ **Coupon Bond**: Give ₹800 now, get ₹1000 later, in b/w you also get ₹20 every 6 months
- ➢ **Floating Rate Bond**: Give ₹800 now, get ₹1000 later, in b/w you also get something every 6 months.

FRBs issued by RBI in July 2020 have NSC rate as base and 0.35% over it. (6.80 + 0.35% = 7.15%).
Here coupon rate will be reset every 1 January and 1 July, i.e. after every 6 months.

Government securities (G-sec) ?
- ➢ **Bonds** issued by Government.
- ➢ They are considered as **risk-free**.
- ➢ Tenure less than 90 days : **Cash Management Bills**
- ➢ Tenure less than 1 year : **T-bills** (issued by only centre)
- ➢ Tenure more than 1 year : **dated securities** (issued by both centre and states (State Development Loans))

Treasury Bills:
- ➢ Zero-coupon; issued at discount
- ➢ T-bills tenure : 14, 91, 182, 364 days.
- ➢ **14 day T-bills are non-marketable.**

Can NRIs invest in G-sec?
- ➢ Yes, but with some **restrictions**.

Prelims 2018

Consider the following statements:
1. RBI manages and services Govt. of India **Securities** but not any State Government Securities.
2. **Treasury bills** are issued by Govt. of India and there are no treasury bills issued by State Govts.
3. **Treasury bills** offer are issued at a discount from the par value.

Which of the statements given above is/are correct?

(a) 1 and 2 only (b) 3 only $\boxed{\text{(c) 2 and 3 only}}$ (d) 1, 2 and 3