📚 BUSINESS 📚

📚ECONOMICS📚

📚NOTES 📚

~HETVI ❤️

Money Market

__Unit :- 1__   The concept of money demand

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            ↓              ↓              ↓
   Store of value     unit of        medium of
                      Account        exchange

                      Provide
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→ Precautionary motive :-

(1) for future uncertain.

(2) uncertainity is Imp. element in keynesian Precautionary motive.

(3) Additional Amount money for contingencies like sudden expenditure, illness, accidents or to grab opportunities of Advantageous Purchase.

(4) Money Required at the time of temporary unemployment.

(5) Business People hold cash with them to meet any unforseen expenditure or to take Advantages of favourable market condition when Price declines.

(6) Demand for Precautionary motive like transaction motive also depends on level of Income. Richer will have more money for this motive Compared to Poorer.

(7) A firms Precautionary demand for money is influenced by political uncertainities.

(8) The demand for money for transaction or Precautionary motive is directly related to income. [income elastic]

x^1

Transa-
ctional /
Precautionary
Demand for
money

x

m_1 m_2
level of Income

$\longrightarrow$ These motives are Intrest Inelastic

6%

4%

2%

↳ The speculative (demand) motive :-

- The demand for money for speculative motiv is related to store of value function of money.
- Speculative demand is also called as "asset demand for money".
- People have the alternative of either holding cash or financial assets like government bonds or equities.
- speculative demand is also related to uncertain
- The cash hold under this motive is used to make speculative gains by dealing in bon whose price fluctuates.

Bonds	MIR → FD
1000 ₹	10 % ↑
5 % coupon	8 %
50 ₹	5 % ↑

→ If bond prices are expected to rise, business will buy bonds on the other bond if bond prices are expected to fall. business will sell Bonds to avoid capital loss.

- However if market Interest rate is expected to fall → businessmen will buy bond.

→ **IMP :**

Keynes assumed that at a very high rate of interest (low Bond price), all other asset holders will be bulls. And at a very low rate of intrest (high Bond price) all other asset holders will be bears.

- Speculative demand for money increase as market rate of intrest falls and vice a versa,

→ Concept of liquidity trap !

Demand of money for speculation

- liquidity trap is defined as set of points on the liquidity Reference schedule, when the Percentage increase in the demand for money in response to the Percentage change in rate of Interest is infinite.
- The inverse relationship between speculative demand for money and ROI transforms into different form of relationship at a very low rate of Interest.

→ keynes suggested few Points.

- Very low interest rate → Perfectly elastic

- Ex. USA / JAPAN

Unit : 2 Concept of money Supply.

→ measurement of money supply

   ↳ April 1977 → Second working Group on
                              money supply.

RBI
↓
money supply (control) ↑
↓
↓ Bank ↑
↓
↓ loan ↑
↓
↓ Income ↑
↓
↓ Demand ↑
↓
↓ Prices ↑

Inflation   Growth

liquid → M_1 = Currency notes and coins with the People + demand deposits of banks + other deposits with the RBI

M_2 = M_1 + Savings deposits with post office Savings bank

broad money → M_3 = M_1 + Net time deposits with the banking System.

M_4 = M_3 + Total deposits with the post office Savings Organization [excluding National Savings certificates]

Some IMP Point!

M_1 = most liquid monetary Aggregate
Demand deposits = CASA

Other deposit = CRR (cash reserve ratio)

| Total Post office deposit |
| Insurance | KVP | Fixed deposit | SA | RD | montly Income Plan |

M_1 = Narrow money

M_3 = Broad money

→ National Saving certificate excluded because it is issued by government for 5 years.

↳ money market is a short term concept.

⊢ RBI is least Intrested in M_2 and M_4
  ↳ as they Include (Post office)
          ↓
         Govt.

↳ Total money stock in india is M_3 Not M_4.

↳ New monetary Aggregates :- (1998)

NM_1 = Currency + Coins + Demand deposit + other deposits with RBI

NM_2 = NM_1 + Time liabilities Portion of Savings deposit + Certificate of deposit + Time deposit maturing within one year.

− FCNR (B) deposits.

→ Time liabilities Portion of savings deposit → ext kotak Bank
              ↓
          Savings A/c balance
              ↓
         ₹ 1,00,000
              ↓
       ₹ 50,000 Converted Automatically into . F.D.

→ Certificate of deposits [CDs] → Issued by Commercial banks to Institutions and Corporates (not individuals) at a Coupar rate

↓

Can take MF route to buy CDs.

- minimum Investment = ₹ 1 lakh
- Time period - 364 days → by 365th day. money shall be in your Account

→ FCRN (B) deposits : foreign currency Non residental Bank deposit.
      - Ignored because money is comming from NRI.

→ NRE A/c → Non Residental external A/c

↓

for NRI

↓

as india gives more Interest.

↓

This would make sure more FE is inflowing to India

↓

Popularised by "Raghuram Rajan."

→ Call borrowings → less than a day to 15 days

[Generally banks borrow from Banks
                        or RBI]
                        → last option

Inter bank call Borrowing.

⟹ Reserve money :

High Powered money :

Monetary Base :

RM = Currency in circulation
     + Bankers deposits with RBI ⟶ CRR + CAR
     + other deposits with RBI

         ↓   ↓
                                Capital Adequency
                                     Ratio
     Govt's money.
                                      ↓
                                As per BASE·L III
                                     Norms

                                      ↙
     Banks have to keep certain portion
              of deposits aside.

     ⎡ 8.- 10% → Public Sector banks ⎤
     ⎢   ⎥
     ⎣ 10- 14 % → Private sector banks ⎦
                                  ↓
                        [Kept with RBI]

→ Reserve money: Net RBI credit to Government
+ RBI credit to Commercial sector
[NABARD, EXIM]

+ RBI's claim on banks.
+ Net foreign Assets.
↳ [Includes foreign currency
+ (SDR) + Gold]
↳ special drawing rights
+ Govt's currency liability to Right
Public
↳ [Govt. Instructs RBI to
mint money]

minsr. — RBI's nonmonetary liability.

↳ In the form of bonds
↓
Govt. has issued bonds but RBI
is Acting as Agent.

→ Money Multiplier↳

(1) money supply is defined as.

$$M = m \times MB$$

(2) Where, M is the money supply, m is the money multiplier and MB is the Monetary base or high powered money.

(3) From the above equation, we can derive money multiplier as.

$$m = \frac{M}{MB}$$

4) Hence, money multiplier is the ratio that relates the changes in money supply to a given change in monetary base.

5) The money multiplier approach to money supply propounded by milton friedman and Anna Schwartz (1963) considers three factors as immediate determinants of money supply namely:

(A) The stock of High Powered money (H)

(B) the ratio of Reserves to deposits.

$$e = \frac{ER}{D}$$

(C) The ratio of currency to deposits

$$e = \frac{C}{D}$$

(6) Working of money multiplier :

Assume that the Reserve Ratio India → 10%
↓
Suppose you deposit Rs. 1000 in HDFC.
↓
Bank will hold 100 required reserves
and
lend the balance of Rs. 900 to Mr. A
↓
Mr. A deposits Rs.900. in his bank
                                    (Axis bank)
↓
Axis Bank will lend 900 × 90% = 810 to Mr.B
↓
Mr.B and this cycle will go on,

→ Hence by the end of this cycle initial
Amount of 1000 has help in the credit
creation of Rs.10,000. $\left[\dfrac{1000}{10\%}\right]$

(7) The whole working is Impacted by

a. The behaviour of central bank.

b. The behaviour of Commercial bank.