CH-8

Money Market

Unit : 1

- Money can be anything that has
  - i. store of value
  - ii. Unit of account
  - iii. Medium of exchange

Functions of Money :

1. Generally acceptable
2. Durable
3. Recognisable
4. Difficult to counterfeit.
5. Relatively Scarce
6. Portable
7. Possess uniformity
8. Divisible

- National Currencies
- Transferable Deposits

} Narrow Money

- Other deposits → F.D, Saving deposits

} Broad Money

- Demand for Money :

  - Derived Demand.
  - Liquidity & Store value

1. ↑ Income => ↑ Demand

2. ↑ Prices => ↑ Demand

3. ↑ Interest Rates => ↑ Opportunity cost => ↓ Demand

4. Innovations (ATM, Net banking, UPI) => ↓ Demand

Theories of Demand for Money

Classical Approach | Cambridge Approach | Keynesian Theory (imp)

1. Classical Approach. (Quantity Theory of Money - QTM)

Irving Fischer → Book → Purchasing Power of Money 1911

↓

Demand for money is for Transaction Purpose.

Fischer $\Rightarrow$ Eqⁿ of Exchange

$$\boxed{MV = PT}$$

nb. of transaction

money in circulation

Avg. Price level

Transact. velocity of circulation

2. Cambridge Approach (cash balance)

→ Alfred Marshall — D.H Robertson

A.C. Pigou — J.M Keynes

Transaction motive & Precautionary Motive

- $M_d = kPY$

M_d = Demand

Y = Real Nation income / Real output

P = Avg. price level of currently produced goods & ser.

PY : nominal income

K : Proportion of nominal income ~~that~~ to hold as cash balance.

3. Keynesian Theory of Demand for Money

(Liquidity Preference theory)

JM Keynes → 1936 → General Theory of Employ., int, & Money

3 motive
- Transaction Motive
- Precautionary Motive
- Speculative Motive

1. Transaction motive

$L_T = KY$

L_T — Transact^n Demand for money

K — Ratio of earning kept for trans. purposes.

Y — earnings

· Speculative Motive :

1. Interest payments
2. expected rate of Capital Gain

Invest in Bonds

· Current rate is high :- Low spec. demand

· Current rate is low :- High spec. demand

Inverse.

Liquidity Trap. (Ineffective Monetary Policy)

RBI follows expansionary Mon. Policy

↓

Open market operations

↓

Buy Govt. securities

↓

To increase money supply

To increase income

To —||— AD

Unit 2: Money Supply

1. M_1 is Narrow Money (currency with public)

(+) Demand Deposits with banking system

2. M_2 is M_1 + Saving deposit of post office savings bank

3. M_3 is Broad Money :- M_1 (+) Time deposits with Bank

↳ F.D

M_3 as at 31^{st} Mar 22 : ₹ 2,04,93,729 crore

Measurement of Money Supply:

M_1 = Currency Notes & coins with public
(+) Demand deposits with bank
(+) other deposits with RBI

M_2 = M_1 + Saving deposit with Post off. sav. banks

M_3 = M_1 (+) Time deposits

M_4 = M_3 (+) Total deposits with Post office Savings organisation (excluding National sav. cert)

☆ Money Multiplier:

RBI → High powered money (H) [Monetary Base)

$M = C + D$

M → Supply
C → Currency with public
D → Demand deposits

$M = m \times MB$

m → money multiplier
MB → Monetary Base

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

$$m = \frac{1}{R} \quad \text{(Reserve ratio)}$$

Monetary base

$H = C + TR$

$= C + ER + RR$ Total Reserve

Ratio of Reserves to Depos.
(Reserve Ratio)

$$r = \frac{R}{D}$$

Currency Deposit Ratio - CDR

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

☆ Money Supply M is affected by:

H, m } Direct.

r, c, e } Inverse

$$M = \left(\frac{C+1}{C+r}\right) H$$

↓

m

$$M = \left(\frac{C+1}{c+r+e}\right) H$$

i * Reserve money / Central Bank Money / Base money / High Powered money

= Currency in circulation
(+) Bankers deposit with RBI
(+) Other deposit with RBI

ii * Currency with Public = Notes in Circul"
(+) All coins in Cir.
(-) Cash with banks

iii * Deposit money with public
= Demand Deposit with bank
(+) other depos. RBI

IV * $M_1 = \underbrace{C}_{ii} + \underbrace{DD + OD}_{(iii)}$

Unit 3: Monetary Policy

The transmission can be as:

Change to monetary policy

↓ Affects

Interest rates

↓ Affects

Economic activity & inflation

Stage ①: Change to monetary policy → Interest rates

②: Interest rates → Economic activity & inflation

i. Saving investment Channel

ii. Cash flow channel

iii. Asset Prices & wealth channel

iv. Exchange Rate Channel

Operating Procedures & Instruments.

Quantitative

↓

Impact supply in entire eco.

↓

Reserve Ratio
- CRR
- SLR

Open market operations

Qualitative

↓

specific sector.

↓

· Moral Suasion

Margin requirement.

* Market Sabilisation Scheme (MSS)

$$\text{RBI} \xrightarrow{\text{Long term loan}} \boxed{\text{Bank}}$$

int.

(Bank Rate)

Liquidity Adjustment Facility (LAF)

Repo Rate

Reverse RR

↓

$$\text{RBI} \xleftarrow{\text{Deposit}} \text{Bank}$$

interest

↓

Repo Rate (-) 1%

MSF

Marginal standing facility

$$\text{RBI} \xrightarrow{\text{1 day loan}} \text{Bank}$$

int

MSF rate

+

Repo Rate

+

1%

RBI Act, 1934 → amended — June 27, 2016

for giving a statutory backing the Monetary Policy Framework Agreement. (MPFA)

& for setting up Monetary Policy Committee (MPC).

MPFA ⇒ GOI + RBI
on max tolerable inflation rate

↳ GG. 4% Cons. Price Index (CPI)
Inflation as target.

RBI publish Mon. Policy Report every 6 months

Ch-9

International Trade

Imp Theories:

i. Mercantilist's View of international trade

Exports > Imports

(Favourable Bal. of Payment)

ii Theory of Absolute Advantage [Adam Smith]

assumed :
1. Two commodity & trade betn two countries
2. No transportation cost.
3. Labour mobile within & immobile ~~and~~ betn countries

Country A	Country B
Ko X product बनाना सस्ता पड़ रहा है Country B से	Ko Y product बनाना सस्ता पड़ रहा है A से

Both will trade for their product
to obtain ~~max~~ minimum cost advantage

iii. Theory of Comparative Advantage [David Ricordo]

Trade was driven by comparative rather than absolute cost.

Country A	Country B
1 hr. labour → 3 Kg steel	1 hr. labour - 1kg steel
1 hr. labour → 2 shirts	1 hr. labour - 2 shirts
2hr - 6 kg steel	2hr - 2 shirts
2 shirts	

A exchanges 2kg of steel for 2 shirts from B

B will take 2 hrs for 2 shirts

& A will use the 1 hr to produce steel & produce 3kg steel

Still A will have 1kg extra steel advantage.

iv. Heckgsher - Ohlin Theory [Factor endowment Th. / Moder Th. of Trade]

Country tends to specialise

Export - Abundant resources of productⁿ

Import - Scarce resources

Theory of comparative cost
Ricardo

Modern Theory
दो देशों

- Based on labour theory of value
- Money cost (more realistic)
- labour as sole factor
- Labour as well as capital
- Only comparative cost.
- Relative prices (labour & capital)
- ~~F~~ Normative
- Positive

v. Globalisation & New International Trade theories

Americal economist & ~~g~~ journalist Paul Krugman
2008 Nobel Price

Krugman promoted free Trade

{ In Praise of Cheap labour published in slate } in 1997

Cheap labour ko outsource karo

Paul A. Samuelson : Factor Price equalization theoram :

NTT (New Trade Theory) gave 2 advantages to the countries that import goods to compete with domestic goods.

1. Economies of Scale

Scale of Prodⁿ (↑) cost (↓)

2. Network Effect (Bandwagon effect)

(e.g. whatsapp or windows

———— x ————

Unit : 2

Instruments of Trade Policy

- Tariff → 16 Types
- Non-Tariff measures (NTM)
  - Technical → 2 Types
  - Non-Tech. → 13 types
- Export Related Measures → 4 Types

I TARIFF (Custom Duties)
↳ Both import & export
* Import duties

1. Specific Tariff - Fixed amount

e.g. ₹1000 / cycle.

* 2. Ad Valorem Tariff - Fixed %

e.g. 20 % on value of cycle

3 Mixed Tariff - Either of 1 or 2 . whichever is HIGHER

e.g. 5% ad Valorem or ₹ 1000 on cycle.

Compound Tariff - Both 1 & 2

e.g. 5 % ad Valorem (+) ₹ 1000 on cycle.

4. Technical /other Tariff - On specific content

e.g. ₹ 3000 on Solar panel &
₹50 per kg on the battery installed.

* 5. Tariff Rate Quota - Under Quota (Limit) lower tariff
above Quota higher tariff

e.g. Limit → 3 cycle
7 cycles — [3 cycle → 0.5 %
extra 4 cycles → 5 %]

6. Most Favoured Nations (MFN) -

Promise to impose on imports from other members of WTO

7. Variable Tariff -

To level the price of imported good up to domestic level.

= 2000+2000=4000

e.g. imported cycle ₹2000 → ₹2000 variable tariff.

domestic price ₹4000

8. Preferential Tariff -

Less than MFN rate to some members

e.g. others (10%) > Special (8%) for one

9. Bound Tariff -

WTO member binds itself to not to raise tariff.

10. Applied Tariff - Actually charged for bound.

20% - bound

17% - actually charge.

11. Escalated Tariff -

Rawmaterial - less tax

Finished goods - more tax

e.g. RM - 5%

F.G - 12%

12. Prohibitive Tariff - so high => zero imports.

e.g. 1000 % tax.

13. Import subsidy - per unit or % of imported goods

14. Response Tariff to Trade Distortion -

on confirmation of distortion (सस्ते में product बेचना)
importing country responds with tariff.

(Trigger - Price Mechanism)

15. Anti Dumping Duty

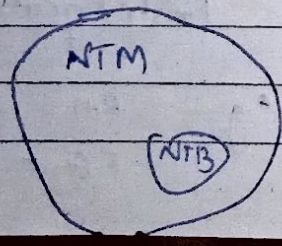
Country dumping products at cheap prices
in another country. below fair price.

16. Countervailing Duties - off set the artificially low prices
charged by exporters who enjoys export subsidy

II NON TARIFF MEASURES (NTM)

* Mandatory, rules, requirements or regulations on export & import.

NTMs are not same as non tariff barriers
NTM ≠ NTB



NTB is subset of NTM

2 Types :

1. Technical Measures

a. Sanitory & Phytosanitary (SPS)

To Protect biodiversity
e.g. Prohibition of Poultry from flu effected countries

b. Technical Barriers to Trade (TBT)

Mandatory standards & Technical Regulations
e.g. Food laws, labelling

2. Non-Technical Measures - Custom formalities, trade rules Policies.

Hard Measures (Price & Quality control)
Threat Measures (Anti dumping)
Other measures.

i Import Quotas

ii. Price control measures
e.g. MSP

iii Non automatic licensing & Prohibitions

iv. Financial Measures

v. Measures affecting competition
↳ special preference
↳ limited groups.

vi. Govt. Procurement Policies
↳ Pref. to local traders

vii. Trade related invest. measures
↳ restricting level of imported components
↳ limiting purchase / use of imported products
↳ mandatory level of local product usage.

viii. Distribution Restrictions
↳ e.g. medicine sold by chemist with fridge.

ix. Restriction on Post Sale services.
↳ reserved to local services.

x. Administrative Procedures

xi. Rules of origin → certificate of origin

xii. Safeguard Measures.
↳ Restrict imports temporarily

xiii. Embargoes - Total ban. (∞ time)

III EXPORT RELATED MEASURES

i. Ban on Exports

ii Export Taxes

iii. Export Subsidies & Incentives

iv. Voluntary Export Restraints

* Free Trade Agreement with Mauritius on 1 April 21

→ Economic Cooperation & Trade Agreement (ECTA) with Australia on 2nd April 22

18 Feb 22: Comprehensive Eco. Partnership Agree. with UAE (CEPA)

339 RTA

Unit - 3 Trade Negotiations

↓ RTA ↓ GATT ↓ WTO

1. Regional Trade Agree. (RTA)
↳ Group of countries reducing barriers to trade

Types of RTA

i. Unilateral TA
One way Trade

ii. Bilateral TA → 2 countries
→ 2 blocs
or 1 bloc & 1 country
(ASEAN - Indian Free T Area)
Bloc ⇄ Country

iii Regional Preferential TA
↳ Group [आपस में Tariff नहीं लगाएंगे]

iv. Trading BlOC
↳ Group [-11- पर बाहर वालों से Trade पर लगाएंगे]
e.g. Arab League (AL), European Free Trade Assoc. (EFTA)

v. Free Trade Area
e.g. ASEAN - Indian Free Trade Area

vi. Economic & Monetary Union
↳ Free transit of goods & ser. through borders
Single currency → Euro

2. General Agreements on Tariff & Trade (GIATT)

- Covers international trade in goods only.
- working responsibility - Council for Trade in Goods. (Goods Council)
- Goods Council → 10 committees.
- GIATT lost its relevance by ~~the~~ 1980s because
  i. Intellectual property rights & service trade not covered.
  ii. Ambiguities in multilateral system.
  iii. ~~World~~ Merchandise Trade increased (beyond scope of GIATT)
  iv. Inadequacies in Dispute settlement system.
  v. Not a treaty.

URUGUAY Round (8th)

- Started in Punto del Este in uruguay Sept. 1986
- Completed in Dec. 1993, longest round with 123 countries
- Agreement signed on 15 April 1994 & effect from 1 July 1995 marked the birth of WTO

3. WORLD TRADE ORGANISATION (WTO)

Objectives

- To set & enforce rules
- To provide forum for negotiations.
- To resolve disputes
- To increase transparency.
- To help developing nations.
- To involve in global eco. management

* Structure of WTO

- Secretariat located in GENEVA, by Director General.
- Three tier system. [Top - Middle - lower]
- Accounts 95% World Trade & 164 member countries (117 developing)

DOHA Round (9th)

- QATAR in Nov. 2001
- Most controversial Topic was agriculture Trade.

G20

- India Presidency from 1 Dec 2022 to 30 Nov. 2023
- Founded in 1999 after Asian Financial Crisis.
- Since COVID-19, 61% measure were Trade Facilitating, 39% were Trade Restrictive
- By Oct 22, 77% of export restrictions has been repealed.

Argentina
Australia
Brazil
Canada
China
France
Germany
India
Indonesia
Italy
Japan
Mexico
Repub. of Korea
Russia
Saudi Arabia
South Africa
Turkey
UK
USA
European Union

Unit: 4

Foreign Exchane Rate

Direct Quote => Amt. of local currency to exchange for 1 Foreign Currency.
₹80/$

Indirect Quote => Amt of foreign currency to exch. for 1 local currency.
$0.0125/₹

Exchange Rate Regime (3 Regimes)

1. Free Floating exchange Rate system. [Demand & Supply determining Rate]

- No Govt. intervention.
- Self Regulating
- Speculation can be there
- No need to maintain foreign reserves.
- Less stability
- Internation trade - riskier.

II. Managed Floating System

Govt. & central Bank often seek to increase or dec. their exch. rate by buying or selling their own Currencies.

III Fixed Exchange Rate System.

- Set by Govt.
- less speculation
- Huge foreign currency reserves.
- Stable
- Avoids currency fluctuation.
- Enhances Inter. trade

Nominal & Real Exchange Rates

↓

$\frac{\text{units of One currency}}{\text{unit of other currency}}$

$$\text{Real E.R} = \frac{\text{Nominal ER} \times \text{Domestic Price}}{\text{Foreign Price}}$$

$$\text{Real effective ER (REER)} = \frac{\text{Nominal ER}}{\text{Price Deflator}}$$

Forign Exchange Market → Commercial Banks & Brokerage Houses.

Spot market → immediate delivery

Future market → Delivery in future

Dollar ⇒ Vehicle Currency

1. Increase in demand or Decrease in Supply of Dollar

⇓

Home Currency Depreciation
(रुपया weak)

2. Decrease in Demand or Increase in Supply

⇓

Home currency Appreciation (Rupaya strong)

Depreciation
↓
Export rises, import falls

~~ER~~ Appreciation
↓
Exports falls, imports rises.

Ch: 9 Unit: 5

International Capital Movements

1. Foreign Capital.

1. Foreign aid or assistance
   - Bilateral or direct inter govt. grants
   - Multilateral aid from many govt.
   - Tied aid with stipulation.

2. Borrowings (Loan)
   - Trade credit facilities
   - soft loans

3. Deposits from NRIs.

4. Investments
   - Foreign Portfolio Investments (FPI)
   - Foreign Direct Investment (FDI)

2. FDI — Real investment.

Acc- to IMF & OECD, aquisition of atleast 10% of shares or voting power in public or pvt. enterprise by NRS investors makes FDI

FDI → 1. Equity Capital 2. Reinvested earnings 3. Other direct Capital

(Factory, Assets Land, inventories.)

FDI

- Horizontal → Same Type
  - e.g. Wallmart
- Vertical → Different but Supportive
  - e.g. Volkswagen acquired plastic molding co. in India
- Conglomerate → Unrelated
  - e.g. Volkswagen & Amul ice Cream.

3. FPI · Unreal invest.

- short term
- less than 10%
- Financial assets
- No physical Assets.
- Easy to withdraw

4. Reasons for FDI

i. Profits
ii. Higher Returns
iii. Risk diversification
iv. Emerging markets
v. Cost effective
vi. Tax benefits.

* FDI takes place through:

i. Open subsidiary or associate co.
ii. Equity injection - lumpsum.
iii. Acquiring control.
iv. Mergers & Acquisitions
v. Joint Venture.
vi. Green Field investment
vii. Brown Field Invst.

5. Problems of FDI

- Use of capital intensive method in labour abundant country.
- Regional Disparity ↑.
- Crowding out of domestic invest.
- Diversion of Capital ⇒ Distortion of production.
- Instability in BOP & exch. Rate.
- Repatriation of Profits
- Over exploitation of resources.
- Jeopardizing national security.

6. Benefits of FDI

- New innovations
- Higher Efficiency
- Higher employment.
- Better products
- Lower prices
- welfare of consumers
- Better acces to foreign markets.
- Improvment in BOP.

* Mauritius - leading country in rest of inflow of FDI in India.

* A foreign investor may enter India :
  - Through automatic Route
  - Through Govt. route
  - Through Equity.

* FDI prohibited in Chit Funds & Nidhi Company.

* Acc to RBI overseas Direct Invest.
  ↳ $ 1,922.51 million In Sep 22

* World Invst. Report 22, India was 8th in major FDI recepients
  ($ 81,973 million 20-21)