Money & Banking

B.COM HONS. Part II

Topic:- Supply of Money & High Powered Money

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Supply of Money & High Powered Money

Supply of Money:- It means the total amount of Money available in the economy on a particular time, but it include only that stock of money which is with the public of a country not with the suppliers that is the govt and the financial institutions of the country.

Definitions of Supply of Money:-

There are three opinious regarding this.

(a) Under traditional or Narrow approach
(b) Under broad approach.
(c) Gurley & Shaw approach.

(a) Under traditional or Narrow approach:-

Supply of Money (M_1) = Currency held by public + Demand Deposit in commercial banks.

Teacher's Signature

Above implies that cash with the public and the cash deposited in bank which can be with drawn by cheque is the supply Money.

(b) Under Broad Approach —

$M_3 = M_1 +$ Time desosits (in Britain)

$M_2 = M_1 +$ Time desosits (in America)

Prof. fried man had given the above theroy according to him. "The supply of money in a specific is that money which is with the public or in the form of time deposits with commercial banks"

According to this definition medium of exchange and store of money both are important In america it is called M_2 and in britain it is called M_2.

(F) Gurley and Shaw Approach —

$M_3 = M_1 +$ Time deposits + other deposits

It is the broadest approach given by gurley and Shaw According to them, in the Supply of Money the above stated M_3 or M_2 the deposit of the Saving banks and other deposits are considered.

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Measures and Components of Money Supply in India

In India traditional approach was in use till April 1977 after that RBI adopted new method to measure the supply of money. They are four methods defined as.

(a) M_1.
(b) M_2
(c) M_3.
(d) M_4.

(a) M_1 measurement.

M_1 = Currency with public (C) + Demand deposit (DD) + other deposit with RBI (OD)

Here:—

(C) = Currency with public (Paper Money + coins)

(DD) = Demand deposit, deposited with the commerical bank, which can be withdrawn by cheque.

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(OD) = other deposit which includes

(i) Time deposit of public sectors financial institutions such as IDBI with RBI

(ii) Demand deposits of foreign central Banks and foreign govt with RBI

(iii) Demand deposits of international financial institutions Such as IMF and world bank but It doesnot include the deposits of R.B.I and the deposits of the banking system of the country under R.BI.

(b) M_2 measurement :—

$M_2 = M_1$ + Savings deposits with post office Saving banks.

It is broader approach than M_1 measurement In this measurement Savings with post office is also included.

(c) M_3 Measurement :—

$M_3 = M_1$ + Term deposits with commercial banks.

It is also broader measurement than M_1 In this approach term deposits are included with the component of M_1.

(d) M_4 Measurement

$M_4 = M_3$ + Total deposits with post office (excluding N.S.C)

$M_4 = M_3$ + All deposits with post office - NSC

It is the broadest approach where all the components of M_3 are added with all the deposits of post office excluding NSC.

In India chakrabarti committee had recommended M_3 Measurement and RBI also publishes the data according to M_3 measurement because it includes currency with the public and deposits ~~it~~ with bank, which helps to prepare the credit budget for credit policy.

Money stock & flow of Money

At any specific time the amount of Money in cirulation is called stock of Money. Secondly the amount of Supply money on a particular date is ~~kno~~ known as stock of Money.

Flow of Money is stock of Money multiplied by the average velocity of Money. For ex. if ~~average velocity~~ ~~of~~ stock of Money is Rs 10000 crore and the average velocity of Money is 20 then the supply of money will be 200000 crore Rs.

Velocity of money is controlled by the public of a country as it reffers to the usage of currency in multiple times. The stock of money is controlled by the central Bank of the country.