Tutorial 2

1)Three main functions of money

-Medium of exchange - An instrument or item widely accepted in exchange of goods and services or an item that facilitates the sale and purchase of goods and services.

-Unit of account - An agreed measure for stating the prices of goods and services.

-Store of value - For saving or financial investment. By saving money, the saved proceeds can be used for purchasing goods and services in the future.

2)Three motives for demanding money and what drives the level of money demanded

-Transactional motive – Money is held in liquid form so individuals can make transactions and cover short term obligations.

-Precautionary motive – holding money for financial emergencies or having access to some liquid money in case there is income loss. For example, carrying cash in your wallet when doing long distance drives in the event your car breaks down and a mechanic may only accept payment in cash, or you can only pay for petrol in cash.

-Speculative motive - This includes the holding of money to avoid capital losses in the bond market. It is a financial asset motive

3)Why the South African Rand is a legal tender in South Africa and why a stronger and international currency such as the U.S. dollar may not be accepted for purchasing goods and services at your local Pick n Pay Store.

- The South African Rand is legal tender in South Africa because it is recognized by law as a means to settle a public or private debt or meet a financial obligation, including tax payments, contracts, exchange of goods and services and legal fines or damages. We can use the South African Rand to purchase goods and services in South Africa as it is recognized by the law. A stronger and more internationally recognized currency like the U.S. dollar might have a higher value and be more stable but it is not a legal tender in South Africa as it is not recognized by law, therefore, it will not be accepted for purchasing of goods and services at a local store because it is not a recognized currency in the South African law. On the other hand, using foreign currency for purchasing goods and services would result in the need for currency conversions thereby complicating pricing for both consumers and businesses.

4) For a market-based economy to function efficiently and to allow the exchange process to run smoothly, money is important.

- In a market-based economy, money serves as a medium of exchange and eliminates the double coincidence of wants. Money also allows for a transfer of purchasing power from the purchaser of a good or service towards the seller of a good or service. (market participants). Money also of delays expenditure for the recipient of money in exchange for their goods and services. For a market-based system to work, a common unit is also needed because this allows us to determine how to best spend any income and to compare the pricing or expense associated with one good relative to another. Money also functions as a store of value, enabling people to save and defer consumption until later. All this allows for the exchange process to run smoothly. Without money it would be difficult to match the needs and wants of buyers and sellers.

5) Concept of base money/high-powered money or the monetary base and how the monetary base (as a monetary aggregate) differs from money supply and explicitly characterize the different forms of money supply from M0 to M3.

- The monetary base of an economy includes all of the physical paper cash currency and coin currency in circulation, plus bank reserves held by the central bank. It is the total of banknotes and coin in issue and in circulation outside of the SARB, net of issuance and removal from circulation, plus both banks’ required reserve deposits as well as excess cash reserves and other deposits at the SARB in rand. The monetary base is considered "high-powered" because it forms the foundation of the money supply in an economy therefore, a small change in the monetary base can lead to a larger change in the total money supply, which is why it is termed "high-powered.”

The monetary base differs from money supply as the monetary base forms the most liquid forms of money that can be used to create more money through lending and money supply is the total money in the economy measured in different aggregates(M0,M1,M2,M3)

Different forms of money supply from MO to M3:

M0 – M0 is the monetary base currency (cash and coins) in circulation plus commercial banks’ excess cash reserves and required reserve balances at the central bank.

M1 – M1 is a measure of the money supply that also includes physical currency (cash and coins). It also counts demand deposits traveler’s checks, and other checkable deposits.

M2 – M2 consists of less liquid assets in comparison to M1 and are not suitable as exchange mediums but can be converted to cash or checking deposits.

M3 – M3 consists of even less liquid assets.M3 consists of M2 as well as large time deposits, institutional money market funds, short-term repurchase agreements (repo), and larger liquid assets.

6)Credit card is not money as it does not change the level of M0,M1,M2, AND M3. It however, facilitates transactions and affects how people access and use money. If my bank offers me an extension of my credit card limit, they have not increased my money supply in the economy.As credit itself is not included in the definition of money supply(M1, M2).

7) Chandre’s Current Consumption:

Current earnings + Discounted Expected Future Earnings

=R120 000 + (1/1.10) \* R160 000

=R265454.55

Future consumption:

Expected Future Earnings + Current Earnings Adjusted for Interest Earnings for

Saving Per Period

= R160 000 + (1.1)\* R120 000

=R292 000

8)Central bank currencies are electrical currencies rather than physical currencies and can be used for transactions.

b) Market participants may hold central bank digital currencies and thus conduct transactions with central bank digital currencies as the money can be loaded in digital wallets based on phone apps thereby allowing to do transactions.

c)Benefits associated with financial inclusion and financial technology:

- allows people without banks to facilitate transactions

- there is a lower risk of handling cash and losing it

- lower costs are made (instead of taking a taxi to go buy bread, one could just buy the bread online)

- increases financial inclusion to individuals that do not have bank accounts, but have access to smart phones