

Chapter 29

The Monetary System

Introduction

- You eat in a restaurant, don't pay anything, and clean the plates- Think!
- Goods and services in the exchange of goods or services- **Barter trading system**
- Recent medium for transaction- **money, check, digital** (Gpay, Phonepe etc.)

The meaning of money

- What is money? - Bill Gates can buy anything! – Confusing with wealth
- Money is the medium of transaction for payment for regular use
- Example: Cash on your wallet

Functions of money

- Medium of exchange
- Units of account
- Store value
- Liquid asset

Kinds of money

- Commodity money
 - It has an intrinsic value
 - Example: Gold
- Fiat money
 - It doesn't have an intrinsic value
 - Example: Notes and currencies

Money

- M1
 - Currency
 - Demand deposits
 - Other checkable deposits
- M2
 - M1
 - Savings deposits
 - Small time deposits
 - Money market mutual funds
 - A few minor categories

Central Bank

- Fed is the central bank for the U.S.
- It monitors all the banks of U.S and regulates the banking system of the U.S.
- It controls fiat money only
- For India, the central bank is Reserve Bank of India (RBI)

Role of the central bank

- Central bank acts as a lender of last resort
- Open market operations is one of the major tools to control the money supply through purchase and sales of bonds and shares

Money multiplier

- You go to the bank with \$1000, and the reserve ratio is 10%. The rest of the amount is lent to another bank by the previous one. If it is continued it can serve the purpose of \$10000
- This is money multiplier helps in money supply

Policy instruments

- Open market operation
- Reserve ratio
- Discount rate