Money

BCA Sixth Semester

What is Money?

- Money is a commodity which is used to denote anything, widely accepted in payment of goods or in discharge of other business obligations. Robertson
- Money is what money does. Hartley Withers

Characteristics of Money

General Acceptability

Purchasing Power

Legal tender

Store Capacity

Value Measurement Capacity

Types of money

1. **Metallic Money**
2. **Paper Money**

Functions of Money

1. Medium of exchange (better than the barter exchange)

2. Measure of value (difficulties of the comparison of the value of different goods in barter exchange)

3. Store of value (saving for the future)

4. Standard of deferred payment (easy for future payments)

Money Supply

- Money supply is the amount of money in an economy at a given period of time. It is the sum of currency held by public and demand deposit of public in the bank.
- It is a stock as well as flow variable.
- At a point of time, money supply is stock variable and it becomes flow variable when it is viewed over a period of time.
- Basically, central bank of a country (in case of Nepal, NRB established in 2013, Baishakh 14) controls the money supply.
- If money supply exceeds money demand, there will be inflationary situation in the economy.

Components of Money Supply

Narrow Money

Narrow money supply refers to the sum of currency held by public and demand deposits held at commercial banks including other deposits held at central bank. Symbolically

$$M_1 = C + DD$$

Where, M_1 = Narrow money

C = Currency (notes and coins) held by public

DD = Demand deposits held at commercial banks (including other deposits of central bank)

Broad Money (M2)

The broad money supply is the sum of narrow money and time deposit. The time deposits consists of saving deposits and fixed deposits. Symbolically,

$M_2 = M_1 + TD$

Where, M_2 = Broad Money

M_1 = Narrow Money

TD = Time Deposits (including saving and fixed deposits)

Money Market

The classical economists believed in quantity theory of money. According to quantity theory of money, the supply of money determines price level in the economy. Irving Fisher's equation states that total expenditure on final goods and services (MV) is equal to the total value of output (PT).

MV=PT

Where, M = Quantity of money

V = Velocity of money

P = Price Level

T = Total physical volume of transaction

So, MV = Supply of money

PT = Demand for money

Contd…

- Total volume of transaction or aggregate output (T) remains constant at full employment level. V = velocity of money depends upon people's behavior on consumption, saving, ability to invest and institutional arrangements. Velocity of money is also assumed to be constant.
- Percentage increase or decrease in quantity supply of money will lead to the same percentage of increase or decrease in general price level. In other words, value of money falls and the price level rises proportionately along with increase in the quantity of money supply. So, there is the positive relation between general price level to the stock of money- later always determines the former.

Quantity theory of money

Figure