Mohamed Khaider University, Biskra

Faculty of Economics, Commerce and Management Sciences

Commerce Department

Module: English
Branch: Commercial Sciences
Level: Second year Bachelor

Lecture 04: The Money Supply; Definition and Counterparts

This lecture examines the more frequently used measures of money supply

Objectives

After reading this unit, you should be able to:

- Understand the meaning of Money Supply
- List the components of Money Supply
- Identify how to measure money.
- Discuss the Counterparts of Money Supply

1- Definition

Money supply is the total stock of assets that are generally acceptable as media of exchange within an economy at a particular time. A number of items may qualify as media of exchange. The decision as to what items are to be included in the money supply remains an issue in economic debates. There is no universally applicable empirical definition of money supply and the choice may vary dependent on what issue is being examined. There are varying degrees of ***liquidity*** or 'moneyness', depending on how easily an asset can be converted into other assets. With the most ***liquid assets*** being notes and coins established as medium of exchange by legal fiat, "moneyness" of other assets depends on how easily they may be converted to notes and coins. Furthermore, as the degree of liquidity falls, the distinction between monetary assets and other ***financial assets*** becomes increasingly blurred. Therefore, in this context, the International Monetary Fund (IMF) has sought to outline standards for the measurement of the amount of money in an economy.

2- Components of the money supply: It consists of two parts: a section related to cash ready funds and a section represented by semi-cash ready funds.

A- Ready cash money (cash available): It includes three types, which are:

- Banknotes in circulation issued by the issuing institution (central bank).

- Helping money in circulation

- Scriptural money (demand deposits), distributed according to the institutions that receive them as follows:

• Demand deposits with banks and other lending institutions, which represent a high percentage of the total demand deposits, in addition to check accounts that are included among the demand deposits with banks.

• Deposits with the treasury (at postal check centers in some countries such as Algeria, France) and current accounts of individuals and institutions.

• Accounts of individuals and institutions with the Central Bank.

• Other deposits in checking accounts at savings funds.

B- Ready-to-use quasi-cash funds:

It represents quasi-cash funds and the sum of bank and treasury deposits that cannot be integrated into circulation directly and immediately through all forms of dealing, such as checks or transfers. They include the following deposits:

- Demand deposits on the ledger, which are:

Accounts on ledgers in banks that generate interest for deposit holders and are intended for savings.

Savings and reserve accounts or housing savings accounts that benefit from the interest generated, and later allow obtaining housing loans with preferential interest. These deposits are like demand deposits, and their owner may withdraw them at any time and for any amount, but unlike current account deposits, he cannot cash out of them. With checks, he must present himself to the bank with a savings book.

- Term deposits:

It constitutes another type of ready-made, semi-cash money, which is either in banks or in the treasury for a specific period, and this term ranges from a month to a year or more. The maturity date for these deposits is agreed upon between the bank and the customer, and their owner receives interest from the bank. Therefore, the monetary mass consists of ready cash and semi-cash available.

3-Monetary Aggregates

A- Concept

Monetary Aggregates are statistical indicators of the amount of money in circulation, reflecting the ability of resident financial agents to spend.

B-Importance

The importance of Monetary Aggregates is that they:

- Monitored to measure the amount of money circulating in the economy

- It takes into account the links that occur between prices and inflation

- A tool in the hands of the central bank for managing monetary policy (setting and controlling monetary policy objectives)

- It allows the analysis of the financial behaviors of economic agents

- It helps in calculating the velocity of money circulation (V), which represents the number of transactions financed by a stock of money during a certain period.

C- The Structure of Monetary Aggregates

The following table presents an outline of the standard definitions of money supply. It is presented in accordance with the IMF's Manual on Monetary and Financial Statistics. Each monetary aggregate is ranked according to the degree of liquidity it provides.

Table 1; *Standard measures of the money supply*

Measure	Definition	Comments
M0	Currency in the hands of the public plus reserves held on behalf of commercial banks.	Often referred to as the monetary base or reserve money. Controlled by the monetary authority/central bank.
M1	Notes and coins outside of the banking system plus current account balances, held for transactions.	Most commonly used definition. Readily accepted for payment of goods and services. Some of these assets may attract a minimal interest payment. May include foreign currency deposits that are directly used for domestic transactions.
M2	M1 plus short-term time and savings deposits, foreign currency transferable deposits, certificates of deposit and repurchase agreements.	Minimal cost of conversion to cash. Close substitutes for current accounts.
M3	M2 plus travellers' cheques, short term bank notes, long term foreign currency time deposits and money market mutual funds.	The components of M3 vary between countries. Emphasis is placed on degree of liquidity or ease of conversion to cash.
M4 or L	M3 plus treasury bills, negotiable bonds and pension funds.	Very broad money, which is usually, considered a measure of fairly liquid assets. Generally includes most of the instruments traded in money markets

4- The Counterparts of Money Supply

A- Definition

Sources of money creation embodied by the monetary system, the existing financial system, or the overall financial system. It means equivalents or parts of the financial system's resources that constitute a large part of the monetary aggregates. This means that money has corresponding parts that explain the reason for its issuance. To clarify this, we resort to analyzing the balance sheet of both the central bank and the banking sector as follows:

Balance sheet of central Bank

Liabilities	Assets
Banknotes B Required reserves RS	Gold and Foreign Currency GC Credits for Public treasury CPT Refunding of Economy Ref

Balance sheet of Banking sector

Liabilities	Assets
Deposits D Refunding Ref	Required reserves RS Credits C

After merging these two balance sheets

Liabilities	Assets
Monetary Mass; Banknotes B Deposits D	Parts as Counterparts of Monetary Mass; Gold and Foreign Currency GC Credits for Public treasury CPT Credits C

B- The Parts as Counterparts of Monetary Mass;

- Gold and Foreign Currency; Every purchase of hard currency by the central bank leads to the issuance of central money, which means an increase in the money supply, while sales of hard currency have a contractionary effect because they lead to a reduction in the money supply.

- Credits for Public treasury; The Treasury requests loans from the Central Bank and other banks to meet its expenditures in exchange for bonds it issues on its own. These bonds represent one of the parts as counterparts of the monetary mass because their increase leads to an increase in the amount of money in circulation, and vice versa.

- Credits; These loans are used to finance commercial and investment operations, and they are also one of the forms of corresponding elements of the monetary mass because granting these loans leads to an increase in the amount of money in circulation. Since these loans are used in many operations, they in turn feed bank deposits. Hence, if the level of loans increases, the available cash means increase, and vice versa