Money Supply

Money Supply is the total amount of money circulating in an economy at a particular point in time. Economics analyzes the Money Supply and develops policies around it.

- The Money Supply is expressed and measured with the use of different monetary aggregates like M1, M2, M3, M4, etc.
- Only highly-liquid forms of money like bank deposits and currency are considered.
- The analysis is performed by the Private and Public sectors because of the possible impact on Money Supply on the Price level, inflation, and the business cycle.

Types of Money

The types of money in an economy are:

- Full-bodied Money- the value of full-bodied money is equivalent to the value of a commodity.
- Paper/Credit/Token Money- the value is more than the value as a commodity.
- Representative Full-bodied money- is a type of token money and refers to money made of paper. The money value of this money is much higher than its commodity value.

Effects of Money Supply on the Economy

With the increase in Money Supply, the interest rate gets lowers, and it puts more money in the hands of the consumer while resulting in spending.

- Due to this scenario, business order more raw materials and increase production. With the increasing business activities, the labor demand also increases. The opposite of this can happen if the Money Supply declines.
- The measurement of Money Supply has shown that there is a relationship between price levels and inflation.
- The increase and decrease in the Money Supply influence many parameters of macroeconomics. However, a significant impact can be seen in the inflation and interest rates.

Monetary Aggregates- Money Supply

The measurement of the Money Supply is done with the help of Money aggregates. The supply of money is measured by the Reserve Bank of India on a weekly basis in India. There are three types of bank deposits - Current Account, Fixed Deposit, and Recurring Deposite Account.

M1= C + DD + OD (Narrow Money)

- Where C= Currency held by the public
- DD= Demand Deposits with Banks
- OD= Other Deposits

The Demand Deposits (DD) can be withdrawn only on the demand of banks, and Time Deposits (TD) can be withdrawn only after a specific period of time.

- Total Deposits= TD+DD

M1: Is the narrow money because it includes 100% liquid deposits. (Currency with the public + Deposit money of the public)
M2: includes M1 and the saving account deposits with the post offices. M2= M1+ Savings deposits with Post Office saving banks.
M3: Broad Money (M1+TD)
M4: M3+ All deposits with post office savings banks (excluding National Savings Certificates).

Money Supply Control

The Money Supply in a country can be affected by the central bank of that particular country. Purchasing the government securities such as government bonds and treasury bills can increase the Money Supply in an economy.

However, the reaction would be the opposite when the central bank tightens the Money Supply by selling the securities in an open market. The prices of such securities will fall when there is an increase in the supply, and as a result, the interest rates rise.