MAHATMA GANDHI CENTRAL UNIVERSITY

ECON4010 : Monetary Economics

Course Code : ECON4010

Unit II : Supply of Money

Supply of Money

Money supply mean the total volume of monetary media of exchange available to the community for use in connections with the economic activity of the country.

Constituents of Money Supply

Traditional Approach (Narrow Concept)

- Coin
- Currency Notes
- Demand Deposit

Modern Approach (Wider Concept)

Money + Near Money

- Coins
- Currency Notes +
- Demand Deposit
- Time Deposit +
- Deposits with Non-Banking Financial Intermediaries such as :
  - ✓ Deposits with Post Office Savings Banks
  - ✓ Units of the Unit Trust
  - ✓ Deposits with Building Societies etc. +
  - ✓ Bills
  - ✓ Treasury Bills
  - ✓ Bills of Exchange +
  - ✓ Government Securities
  - ✓ Bonds
  - ✓ National Savings Certificates etc +
  - ✓ Equity Shares

Constituents of Money Supply

Money Supply M1 or Narrow Money:

This is the narrow measure of money supply and is composed of the following items:

Ml = C + DD + OD

Where, C = Currency with the public

DD = Demand deposits with the public in the commercial and cooperative banks.

OD = Other deposits held by the public with Reserve Bank of India.

The money supply is the most liquid measure of money supply as the money included in it can be easily used as a medium of exchange, that is, as a means of making payments for transactions.

Constituents of Money Supply

Money Supply M2:

M2 is a broader concept of money supply in India than M1. In addition to the three items of M1, the concept of money supply M_2 includes savings deposits with the post office savings banks. Thus,

M2 = M1 + Savings deposits with the post office savings banks.

The reason why money supply M2 has been distinguished from M1 is that saving deposits with post office savings banks are not as liquid as demand deposits with commercial and cooperative banks as they are not chequable accounts. However, saving deposits with post offices are more liquid than time deposits with the banks.

Constituents of Money Supply

Money Supply M3 or Broad Money:

M3 is a broad concept of money supply. In addition to the items of money supply included in measure M1, in money supply M3 time deposits with the banks are also included. Thus M3= M1+ Time Deposits with the banks.

It is generally thought that time deposits serve as store of value and represent savings of the people and are not liquid as they cannot be withdrawn through drawing cheque on them. However, since loans from the banks can be easily obtained against these time deposits, they can be used if found necessary for transaction purposes in this way. Further, they can be withdrawn at any time by forgoing some interest earned on them.

It may be noted that recently M3 has become a popular measure of money supply. The working group on monetary reforms under the chairmanship of late Prof. Sukhamoy Chakravarty recommended its use for monetary planning of the economy and setting target of the growth of money supply in terms of M3.

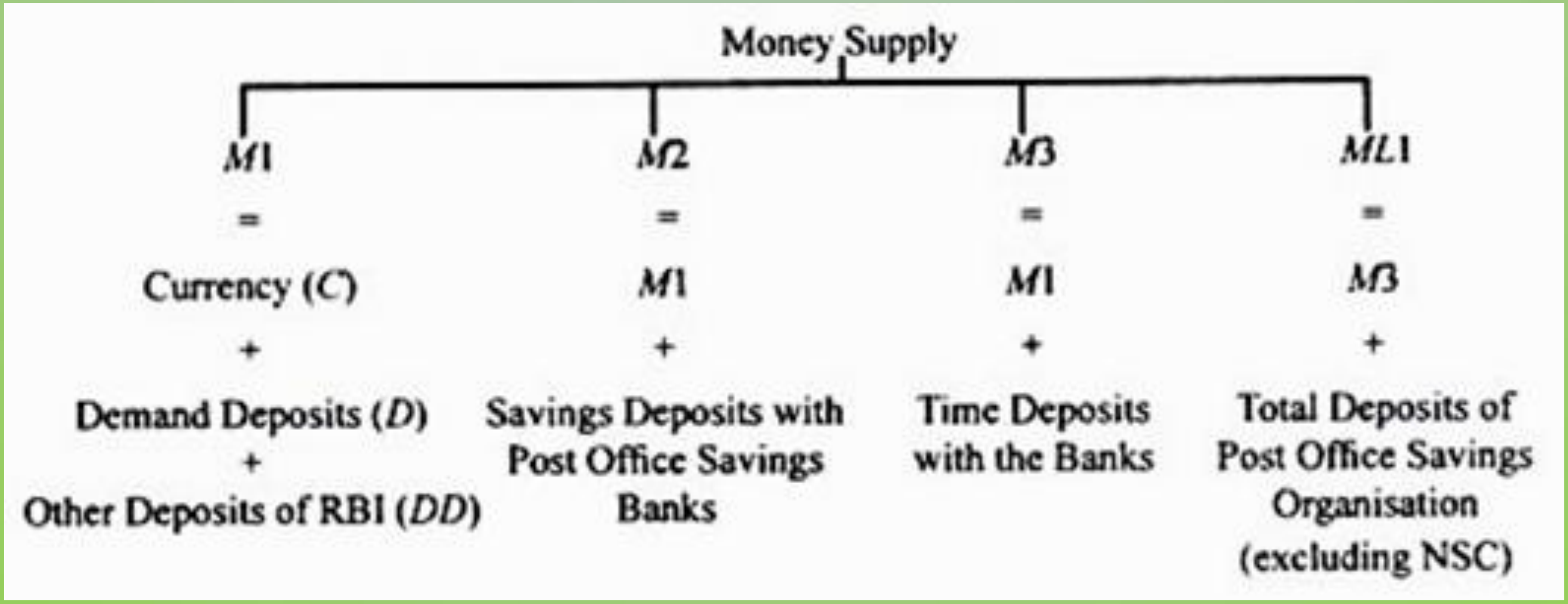
Therefore, recently RBI in its analysis of growth of money supply and its effects on the economy has shifted to the use of M3 measure of money supply. In the terminology of money supply employed by the Reserve Bank of India till April 1977, this M3 was called Aggregate Monetary Resources (AMR).

Constituents of Money Supply

Money Supply M4:

The measure M4 of money supply includes not only all the items of M3 described above but also the total deposits with the post office savings organisation. However, this excludes contributions made by the public to the national saving certificates. Thus,
M4 = M3 + Total Deposits with Post Office Savings Organisation.

Let us summaries the four concepts of money supply as used by Reserve Bank of India in the following tabular form:



THANK YOU