

Why do we need money?

Why do we need money? to exchange for those Gs & Ss we wach need and want but are unable to produce for ourselves we are **not self-suffiecient and we specialize** which makes us dependent for some Gs & Ss on others

Specia- lization community that practised specialization was able to produce more than enough food, clothes, pots, etc.

increased production achieved by specialization is the result of the division of labour, where each worker specializes on doing a particular task

Barter was not a first form of money, because the value couldn't be measured fairly

it was an exchange of Gs & Ss without using money

Problems with barter **fixing a rate of exchange** - the value of each good had to be expressed in the value of another one

finding someone to swap with - not having the same intrests

trying to save for later usage - you can't store Gs for later usage as many of them can go bad

Functions and characteristics of money

Functions **medium of exchange** - is generally accepted for all Gs & Ss and we don't have to search for someone who is willing to trade with us

unit of account/measure of value - we can reliably price Gs & Ss to express their true value

Functions and characteristics of money (cont)

store of value - it can't go bad (only inflation can make it lose value)

means of deferred payment - borrowers, hire purchase, loans (therefore payments can be spread overtime)

What makes good money?

Money is generally acceptable medium of exchange

Develo pment **commodity money** - shells, beads or bones were commonly accepted in exchange for Gs & Ss; later abandoned because it didn't possess the qualities of good money

precious metals - gold or silver which were scarce enough but harder to divide

coinage - precious metals in predetermined weights and easier to walk around with; they could be easily worn out

paper money - people with money saved them at goldsmith's and in return they were given the paper receipt stating their value, later goldsmiths realized that they could issue papers with much more money than they have since nobody is depositing them

token money - nowadays money is no longer convertible into gold

What makes good money? (cont)

Why is money important? it encourages specialization by making trade easier which results in increased national output and income and standard of living

Creation of deposit money

Creation of deposit money deposits in banks can be converted back into cash so the bankers must ensure they have enough cash to do so

credit creation for this purpose bankers create reserves - banks receive deposits from which they deduct the deposit ratio to create reserves

the remaining money can be used to lend to other clients and so does the list go on and on since when someone buys something the seller does the same with his profit

this process is called credit creation - bankers create moeny by relending any cash that returns to the bank as a bank deposit

deposit ration a certain percentage of money from deposits

the multiplier effect if reserve requirement is 20% and the deposit is 100€ then 80€ can be loaned out to other bank customers, 16€ (20% from 80€) is then kept as reserve and 64€ is loaned againg until 100€ creates a total of 500€ deposits

Creation of deposit money (cont)

the higher the reserve requirement the tighter the money supply - which leads to lower multiplier effect

Money multiplier equation

$$\text{Total money created} = \text{Initial deposit} \times \frac{1}{\text{Reserve ratio}}$$

Forms of money

Types of money notes, coins and deposits with banks and other financial institutions create the money supply in an economy

financial assets can be a good store of value if they are **liquid assets** meaning how quickly we can turn them into money

financial assets can be thought of as **near money**

near money - a form of money, these are non-cash asset which are highly liquid and can be quickly converted into cash (bills of exchange, treasury bills, bonds, shares, fixed and saving deposits, saving certificates, etc.)

to sum up some assets are nearer money than other because **some assets fulfill the functions of money better than other, some assets can be converted into cash quicker than other and some retain their value on conversion to cash better than other**

Forms of money (cont)

Velocity of circulation NI of an economy is not equal to SoM because money can be used more than once - they circulate

VoC is the number of times notes and coins are exchanged or circulate in an economy each year, the higher the VoC the lower the SoM needs to be

Equation of exchange $MV = PY$

$M = \text{SoM}$, $V = \text{VoC}$, $P = \text{price level}$, $Y = \text{real GDP}$ ($P*Y = \text{the nominal GDP}$)

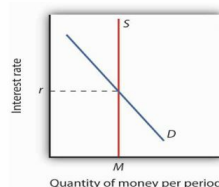
Liquidity the ability to exchange an asset for cash without losing its value

Money aggregates are definitions of what money is, there are two groups of money aggregated in GB

M0 (base money) contains money as a medium of exchange, cash held by general public

M4 is a wider definition of what money is, it contains money as a medium of exchange as well as store of value - cash, savings in banks and savings in other financial institutions such as building societies

The equilibrium interest rate



Price of money

Interest is the price of money

The equilibrium interest rate is determined on the money market when SoM equals demand for money, when there is an excess demand for money IR rises and vice versa

Changing of IR missing out the opportunity to use the money risk of not returning

loss of value

Financial system money needs to flow where it can be used the best and financial system allows this to happen

is made up of different parts (banks, other financial institutions - insurance companies, etc.) and it provides crucial services which keep the economy moving (payments, borrowing, saving, risk management)

Financial stability a way of describing the financial system when it's fulfillin its basic roles

Market for money

financial institutions business organizations that specialize in providing financial services (borrowing money, making investments, exchanging the money, etc.)

Money market is made up of all those people and organizations that want money, and all the people and organizations willing and able to supply money

Market for money (cont)

Commercial banks a banks is a financial intermediary because they bring clients who want to save money and clients who want to borrow money

How banks earn revenue charge IR on loans

charge fees for the provision of other financial services (withdrawls from ATMs, exchanging and transferring foreign currency, etc.)

they make investments, etc.

Commercial banks provide these services accepting deposits of moeny and savings

helping customers make and receive payments

making personal and commercial loans

arranging insurance

buying and selling shares for customers

privision of other services - exchange services, operating pension funds, deposits in banks safes, leasing, etc.

The central bank is the centre of the banking system in most economies
its main fucion is to maintain the stability of the national curreny and the SoM

Market for money (cont)

The role of CB to issue notes and coins for the nation's currency

it manages payments to and from the government

it manages the national debt

it supervises the banking system, regulates the conduct of banks, hols their deposits and transfers funds between them

it is the lender of the last resort to the banking system

it manages the nation's gold and foreign currency reserves

it operates the government's monetary policy

Open-market operations refer to CB purchases or sales of government securities in order to expand or contract money in the banking system and influence IR

Market for money (cont)

when people or organizations buy gov. securities they will take money from their bank account and so reduce deposits available to lend by the banks to private sector - so selling gov. sec. to private sector reduces the SoM, when the CB purchases the gov. sec. it increases the SoM

Special deposits the CB can order commercial banks to deposit money with it for a certain period of time

this reduces the amount of money banks have available to lend to its clients

Quantitative easing a tool the CB can use to inject money directly into the economy

this invloves using newly created money to buy up financial assets held by banks (gov. or corporate bonds)

by buying these assets back from banks a CB can increase the quantity of money banks have available to lend to people and firms in order to stimulate the economy and increase liquidity

