Money and monetary policy

Money

- ***What is money?***
- ***Barter economy***
  - double coincidence of wants
- ***Functions of money***
  - medium of exchange (means of payment)
  - unit of account
  - store of value

- ***What money is not***
  - income
  - wealth
  - factor of production

- ***What does money consist of?***
  - notes and coins
  - deposits

- ***How is the total amount (stock) of money measured?***
  - M1 ⟶ (notes and coins and demand deposits)
  - M2 ⟶ (broader, more deposits)
  - M3 ⟶ (broadest measure, includes long-term deposits)

- Note small share of notes and coins

- ***By what is money backed up?***
  - gold?
  - confidence
  - role of the SARB

South African Reserve Bank

- South Africa's central bank and main monetary authority
- ***Functions***
  - formulation and implementation of monetary policy
  - service to government
  - provision of economic and statistical services
  - maintenance of financial stability
- ***Monetary policy***
  - discussed later

- ***Service to government***
  - acts as banker and advisor
  - custodian of gold and foreign exchange reserves
  - exchange control
- ***Economic and statistical services***
- ***Maintenance of financial stability***
  - supervises banks
  - National Payment System
  - acts as banker to other banks (lender of last resort)
  - banknotes and coins (sole issuer)

Demand for money

- Why do households, firms and government hold money?

- ***Cost of holding money***
  - opportunity cost
  - interest forgone
  - impact of inflation

- Why do people hold part of their income or wealth in the form of money, which earns little or no interest and loses some of its value during inflation?

- ***Motives for holding money***
  - transactions motive (money as means of payment/medium of exchange)
  - speculative motive (money as an asset; store of value)

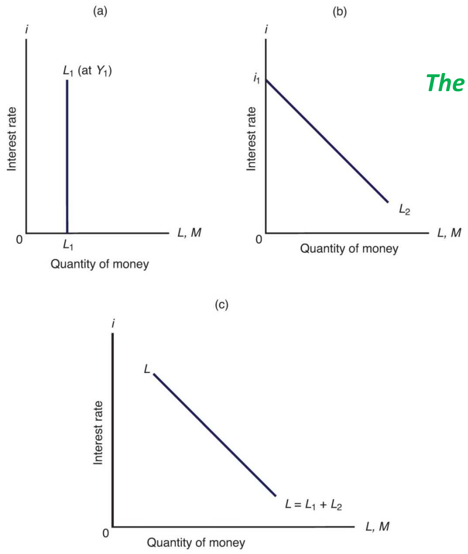
- ***Demand for money as a medium of exchange (L1)***

  = transactions demand (demand for active balances) (positively related to income *Y*)

- ***Demand for money as an asset (L2)***

  = speculative demand (demand for passive balances) (inversely related to interest rate *i*)

- ***Graphical presentation:***



The demand for money

- ***Thus:*** total demand for money (or liquidity preference) determined by income *Y* and interest rate *i*
- $L = L_1(Y) + L_2(i)$

- Summarised in table below

Function	*Motive*	*Active/passive*	*Main determinant*
Medium of exchange	Transactions	Active balances	Income
Store of value	Speculative	Passive balances	Interest rate

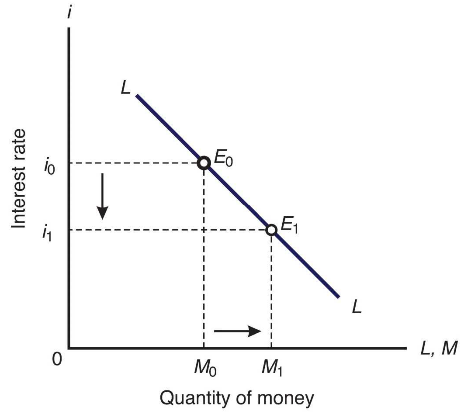
The demand for money (or liquidity preference): a summary

Money creation

- Many misconceptions
- Money created by banks, not by mint or printing press
- Banks create deposits (money) by granting loans
- Banks limited only by:
  - demand for loans
  - actions of central bank (SARB), by varying repo rate

- Stock of money determined by interaction between demand for money and the interest rate

The money market



- Stock (quantity) of money thus essentially dependent on the demand for money

Monetary policy

- Definition (interest rates, quantity of money)
- Responsibility of SARB
- Monetary Policy Committee (MPC)

- ***Monetary policy framework:***
  - ultimate objective (balanced and sustained economic growth)
  - intermediate objective (pre-announced inflation target)
  - operational variable (repo rate)
  - monetary control system (classical reserve system)
- ***Instruments***
  - accommodation policy/repo system/repo rate
  - open market policy
  - other instruments