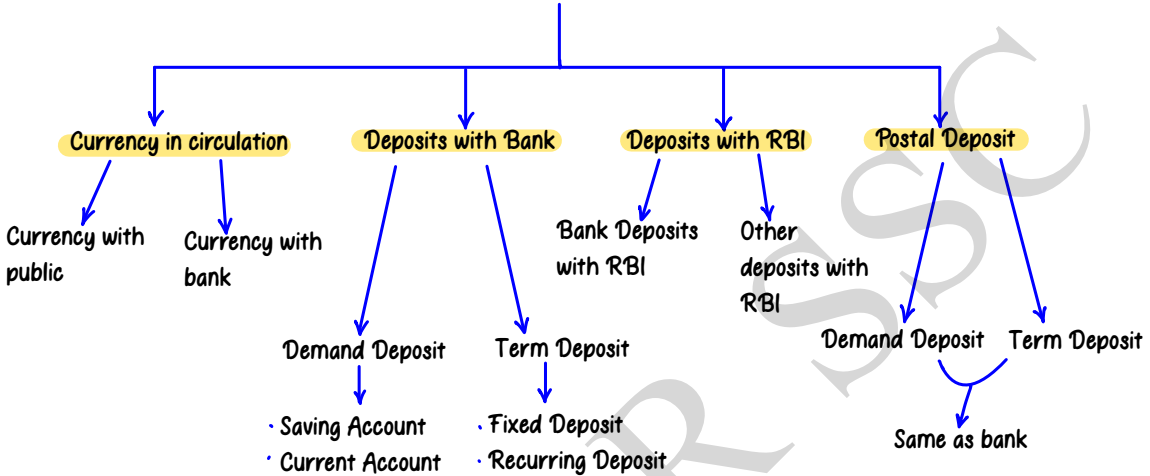


# MONEY AND BANKING



## Types of Money in our Economy



## Liquidity in Economics

• **Liquidity:** the ease with which an asset or security can be converted into ready cash without affecting its market price

→ Demand Deposit is more liquid than Term Deposit

• Liquidity: Cash > Cheque > Bonds

Fiat currency

Fiduciary Money

## Monetary Aggregates

RBI → to check **liquidity**  
 ↓  
 Usable

· Fiduciary money (Mutual agreement)  
 Eg: checks, bitcoins

•  $M_0$ : Monetary Base/High Powered Money/Reserve Money

3 components:

1. Currency in circulation
2. Bankers deposit with RBI
3. Other deposits with RBI (eg: deposits of Governmental/Quasi-Judicial authority)

•  $M_1$

3 components

1. Currency with public
2. Demand Deposits
3. Other deposits with RBI

Narrow Money

•  $M_2$ :  $M_1$  + Saving deposits with Post Office

Actual Money Supply

•  $M_3$ :  $M_1$  + Time deposits with Bank

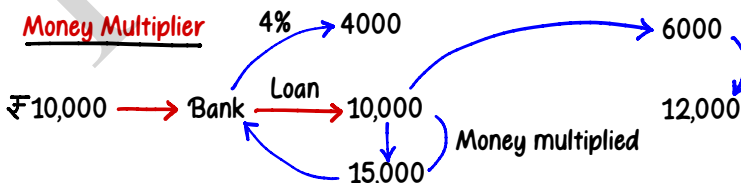
Broad Money ( $M_3$  → priority)

•  $M_4$ :  $M_3$  + All deposits with Post Office

• **Liquidity Order**

$$M_1 > M_2 > M_3 > M_4$$

Money Multiplier

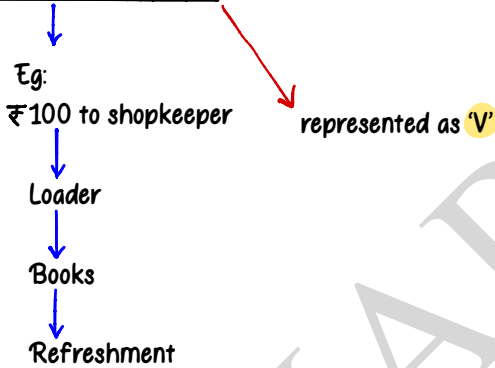


$$MM = \frac{1}{CRR} = \frac{\text{Money in Circulation}}{\text{Reserve Money}}$$



CRR ↓ Money multiply ↑  
 CRR ↑ Money multiply ↓

Value of Circulation of Money: No. of hands exchanged



## QUANTITY THEORY OF MONEY

Theory by  
 Irving Fisher

### Quantity Theory of Money

**Velocity of Circulation**  
 How many times a dollar, euro, etc. is spent purchasing finished goods and services

**All Transactions**  
 All the goods and services sold within an economy

$$M \times V = P \times T$$

**Money Supply**  
 All the money in the economy

**Price Level**  
 The price level of all goods and services in an economy

purchasing power of money decreases

When Money Supply ↑ keeping other factors constant (Velocity of circulation/transactions) → Price level of goods ↑

eg:



Currency printing → Banks

# Money Illusion

Given by Fisher

**Money illusion**

The tendency to think of money in nominal terms rather than real terms

<p><b>Wages - 1%</b></p>  <p><b>Inflation -2%</b></p> <p><b>Real wages = +1%</b></p>	<p><b>Wages + 5%</b></p>  <p><b>Inflation +7%</b></p> <p><b>Real wages = - 2%</b></p>
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**Money Illusion**



**Inflation 5%**      **Inflation 0%**

## Basel Norms

Basel is a place in Switzerland  
Headquarter of Bank of International Settlements (BIS): Basel, Switzerland

130 countries were there when estd.

1930

Basel Committee, 1974 by G10

**3 norms**

India adopted BASEL I in the year 1999

**BASEL I: 1988**

- Focused on Credit Risk
- Min. capital requirement at 8% of Risk Weighted Assets (RWA)

**Capital Adequacy Ratio**

Eg:

	<u>Risk</u>
Salaried employee: 100%	0
Ratan Tata: 90%	10%
Ashneer Grover: 50%	50%
Vijay Mallya: 10%	90%

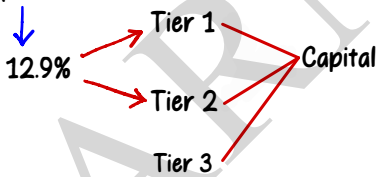
Microlending

**Non-banking Financial Companies-MFI (NBFC-MFI)**

Capital Adequacy Ratio: 15% of RWA

- NBFC cannot accept Demand Deposits
- CRR/SLR maintenance: No

- BASEL II: 2004
- BASEL III: 2008



LAF: Liquidity Adjustment Facility

Repo Rate

Reverse Repo Rate

Liquidity Trap: A situation in economy where people love to hold their money despite of any changes in interest rates which renders any Monetary Policy ineffective

No spending

happens when rates will increase

Speculative Demand: perfectly elastic

Money Market

- Short-term loans
  1. Call Money: to be paid within a day
  2. Notice Money: to be paid within 2-14 days

Capital Market

- Long-term loans

Treasury Bills: issued by RBI

- Maturity Bills: less than 1 year
  - 3 types of maturity bills:
    1. 91 days
    2. 182 days
    3. 364 days
- They are always listed on discount rate
- No rate of interest

- Speculative Demand is generally relatively inelastic

- Rate: Interbank Money Transfer to fulfil their CRR

Also called Offer Rate

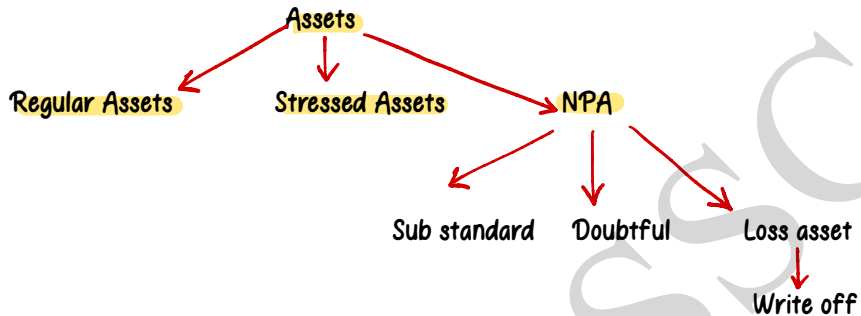
LIBOR: London Interbank Offer Rate base

In India: MIBOR (Mumbai Interbank Offer Rate)

Removed: 31st Dec 2021

Now, it's SOFIR: Secured Overnight Financial Rate

Non Performing Assets (NPA): Delay is more than 90 days



Bad Banks: Financial entity setup to buy NPAs

Recovery of NPAs

2021 budget:

2 bad banks to be established

1. National Asset Reconstruction Company Ltd. (NARCL)
2. India Debt Resolution Company Ltd. (IDRCL)

SARFAESI Act 2002

Full form: Securitisation and Reconstruction of Financial Assets and enforcement of Security Interest Act

- Provides power to the bank/any financial institution to seize the property of a defaulting borrower
- Wilful Defaulter: a person who would not pay to banks even if he has the ability to do so

Insolvency and Bankruptcy code, 2016

- Consolidates the existing laws on bankruptcy