ECONOMICS SS2

THE SUPPLY OF MONEY

The supply of money is the total stock of money available for use in the economy; it consists of bank notes, coins and bank deposits in the current account of commercial banks which are withdrawable on demand by cheque.

FACTORS DETERMINING THE SUPPLY OF MONEY.

1. The amount of currency put into circulation by the central bank.

2. The credit policy of commercial bank. A restrictive monetary policy will reduce the supply of money while expansionary monetary policy will increase it.

THE VALUE OF MONEY

The value of money refers to the purchasing power of money; that is the quantity of goods and services which a given sum of money can buy. If such a sum of money can purchase fewer goods and services, this will mean that the value of money has fallen and vice versa.

FACTORS DETERMINING THE VALUE OF MONEY

1. The price level: The value of money varies inversely with the price level. If the price level increases, the

value of money will fall. On the other hand, a fall in the prices leads to an increase in the value of money.

2. The supply of money and its speed or velocity of circulation: if the quantity of money in circulation increases without a corresponding increase in the available quantity of goods and services, the value of money will fall. On the other hand a contraction in the supply of money will increase the value of money.

The velocity of circulation of money refers to the speed at which money circulate within the economy by changing from one hand to another. The higher the velocity of circulation of money the lower the value of money and vice versa.

3. The volume of goods and services available within the economy. If more goods and services are available while the supply of money remains constant, the value of money will increase and vice versa.

Assignment

Differentiate between inflation and deflation.