Increase in Money Supply

According to recent **Reserve Bank of India (RBI)** data, the uncertainty caused by the **Covid-19 pandemic** has led to a surge in money supply.

Key Points

- **RBI Data:**
  - Since the end of March, 2020 **currency held by the public** increased by 8.2%.
  - **M3 money supply (refer explanation below)** increased by 6.7% in the first five months of 2020 compared with the same period last year. This is the highest growth in seven years.
  - **Currency in circulation,** which measures money with the public and in banks, has also surged.
  - However, the **savings and current account deposits decreased** by 8%. Gross capital formation also fell by 7% in the March, 2020 quarter.
- **Reason:**

  The recent increase reflects **higher cash withdrawals** by depositors to meet needs during the lockdown period and also to safeguard themselves against salary cuts or job losses.
- **Impact:**
  - A rise in money supply usually is seen as a leading indicator of growth in consumption and business investments, but due to Covid-19 pandemic, the rise this time is unlikely to bolster either.
  - People have curtailed their discretionary spending as they're not sure of their permanent income.
  - Lenders too are unwilling to take risks as slowing discretionary spending slows demand for manufactured and industrial goods.

- **Money Supply:**
  - The **total stock of money in circulation among the public** at a particular point of time is called **money supply.**
    - It needs to be noted that total stock of money is different from total supply of money.
    - Supply of money is only that part of total stock of money which is held by the public at a particular point of time.
  - The circulating money involves the **currency, printed notes, money in the deposit accounts** and in the **form of other liquid assets.**
  - RBI publishes figures for four alternative measures of money supply, viz. M1, M2, M3 and M4.
    - **M1** = CU + DD
    - **M2** = M1 + Savings deposits with Post Office savings banks
    - **M3** = M1 + Net time deposits of commercial banks
    - **M4** = M3 + Total deposits with Post Office savings organisations (excluding National Savings Certificates)
  - CU is **currency (notes plus coins)** held by the public and **DD is net demand deposits held by commercial banks.**
  - The word 'net' implies that only deposits of the public held by the banks are to be included in money supply.

    The interbank deposits, which a commercial bank holds in other commercial banks, are not to be regarded as part of money supply.
  - M1 and M2 are known as **narrow money.** M3 and M4 are known as **broad money.**
  - These gradations are in **decreasing order of liquidity.**
    - M1 is **most liquid and easiest for transactions** whereas M4 is least liquid of all.
    - M3 is the most commonly used measure of money supply. It is also known as **aggregate monetary resources.**

Key Terms

- **Gross capital formation** refers to the 'aggregate of gross additions to fixed assets (that is fixed capital formation) plus change in stocks during the counting period.'

  Fixed asset refers to the construction, machinery and equipment.
- **Currency in circulation** includes notes in circulation, rupee coins and small coins.
- **Currency with the public** is arrived at after deducting cash with banks from total currency in circulation.

<u>Source: TH</u>