5.2 Money and money market

WHAT IS MONEY?

Money is anything that is generally accepted as a medium of exchange (with some other functions)

5.2 Money and money market

FUCTIONS OF MONEY

- **Medium of exchange, or means of payment :**
  What sellers generally accept and buyers generally use to pay for goods and services.

- **Store of value:**
  An asset that can be used to transport purchasing power from one time period to another.

- **Unit of account:**
  A standard unit that provides a consistent way of quoting prices.

5.2 Money and money market

TYPES OF MONEY

- **Commodity monies:**
  Items used as money that also have intrinsic value in some other use.
- **Paper money:**
  Claims on gold.
- **Fiat or token money:**
  Items designated as money that are intrinsically worthless.

5.3 Money supply

THREE WAYS OF MEASURING MONEY SUPPLY: M1, M2, M3

M1: Transactions money

Money that can be directly used for transactions.

M1 ≡ currency held outside banks
+ demand deposits
+ traveler's checks
+ other checkable deposits

Not include money held by central bank and ministry of finance

5.3 Money supply

THREE WAYS OF MEASURING MONEY SUPPLY

M2: Broad money

M2 ≡ M1
+ savings accounts
+ money market accounts
+ other near monies

Near monies: Close substitutes for transactions money, such as savings accounts and money market accounts.

5.3 Money supply

THREE WAYS OF MEASURING MONEY SUPPLY

M3: M2 + Promissory note (held by private sector)

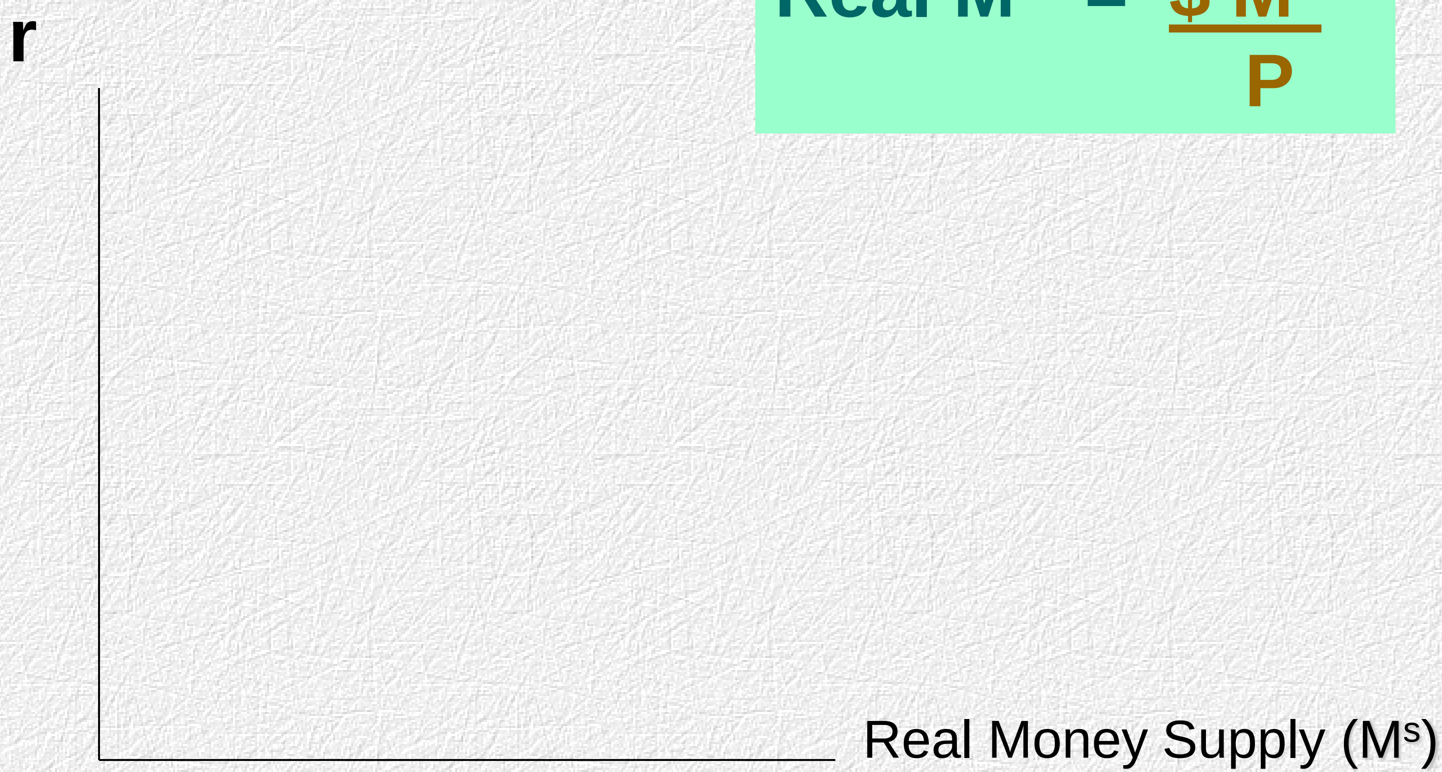
Should credit cards be counted as money?

Money supply

- Normally use M_2 definition
- $\$M^s$ normally determined by central bank
- $\$M^s$ not depend on nominal interest rate (i)
- Real Money Supply (M^s) = ($\$M^s/P$)

Money Supply

$$\text{Real } M^s = \frac{\$ M^s}{P}$$



5.4 Central Bank Roles

Central bank: the institution that regulate and supervise financial institutions in the country in order to achieve those macroeconomic goals

Central Bank

- The world's first central bank

- The most famous central bank:

- Federal Reserve System (1913)

Bank of Thailand (Dec 10th, 1942)

Bank of Thailand Governors

- ❑ H.H.Prince Vivadhanajaya (1)
- ❑ Puay Eungpakorn (10)
- ❑ M.R. Pridiyathorn devakula (20)
- ❑ Tarisa Watanagase (21)
- ❑ Dr. Prasarn Trairatvorakul (22)
- ❑ Dr. Veerathai Santiprabhob (23)
- ❑ Dr. Sethaput Suthiwartnarueput (24)

Functions of Bank of Thailand

1. Printing banknotes and coins

International reserves

- Gold
- Foreign currency
- International reserve at least 60% of amount of money issued

Functions of Bank of Thailand

2. Act as a bank for government

- Accept deposits from government and government’s organization
- Lending money for government
- Government’s representative to manage public debt

Functions of Bank of Thailand

3. Act as a bank for commercial bank

- Accept deposits (legal reserve and excess reserve)
- Lending money to commercial bank (at bank rate)
- Clearing interbank payments

Functions of Bank of Thailand

4. Regulate and Monitor commercial banks and other financial institutions

5. Monitor foreign currency exchange

6. Regulate and monitor flows of money into and out of the country

Monetary Policy

Policy of central bank to control money supply at the appropriate level according to current economic situation

Types of monetary policy

1. Contractionary Monetary Policy

→ Use during bubble economy

to reduce money supply in the economy

2. Expansionary Monetary Policy

→ Use during economic recession

to increase money supply in the economy

Monetary Policy tools

1. Open Market Operations: OMO

- **Bubble economy (Inflationary economy)**

- **Economic Recession (Deflationary economy)**

Monetary Policy tools

2. Bank Rate

- Inflationary economy →

→ Commercial bank borrows money from central bank → Lending from Commercial bank → Money supply

- Deflationary economy →

→ Commercial bank borrows money from central bank → Lending from Commercial bank → Money supply

Rediscount Rate

: the interest rate that central bank collect upfront when commercial bank buy promissory note from private sector (at discount rate) and then resale promissory note to central bank

: For example Bank A buy promissory note from Mr. Frank (discount rate = 10%). If value of promissory note is 1 million Baht, Mr. Frank will receive money from bank A ___________ Baht

If central bank buys this promissory note from Bank A (rediscount rate = 5%). Bank A will receive money from central bank _________ Baht.

Therefore, Bank A can make profits _____________ Bahts

Monetary Policy tools

3. Rediscount Rate

- Inflationary economy →

→ **Commercial bank sell bond to central bank (with rediscount rate)** → **Lending from Commercial bank** → **Money supply**

- Deflationary economy →

→ **Commercial bank sell bond to central bank (with rediscount rate)** → **Lending from Commercial bank** → **Money supply**

Monetary Policy tools

4. Legal reserve requirement ratio: rr

- Inflationary economy →

→ Commercial bank Excess Reserve → Lending from Commercial bank → Money supply

- Deflationary economy →

→ Commercial bank Excess Reserve → Lending from Commercial bank → Money supply

Financial Market

- **Definition:** a market that facilitates the transfer of money from the economic unit with saving to economic units needed money for investment

- **Types of Financial Market**

  Money market: short-term borrowing and lending (promissory note) with original maturities of one year or shorter time frames, such as money deposit in the bank, corporate bond, treasury bills (treasury notes) with maturities less than 1 year

  Capital Market: long-term borrowing and lending (promissory note) with original maturities of one year or longer time frames, such as money deposit in the bank, corporate bond, treasury bond with maturities more than 1 year

Capital market

Debt market

Security market

- **Primary Market**

deals with the issuance of new securities

- **Secondary Market**

the financial market where previously issued securities and financial instruments such as stock and bonds are bought and sold