MONEY, FINANCIAL SYSTEM AND MONETARY POLICY

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EE212

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fiscal policy The government's spending and taxing policies.

monetary policy The behavior of the central bank concerning the nation's money supply.

MONETARY POLICY

- Monetary policy is about the actions set by **"Central bank"** so as to
  - Control *money supply*
  - Intervene *financial system*
  - Adjustment the *interest rate*

- **Ultimate objective:** fix the economic problems; *moving the macroeconomy to the right/appropriate direction*

QUESTIONS TO BE DISCUSSED ABOUT

- We build our agenda around the key important questions.
  - What is money and what is financial system?
  - What role does money play in the financial system?
  - How can a central bank control money supply?
  - How can a central bank adjust interest rate?

AGENDA

- Money and financial system
- Deposit creation process
- Interest rate determination
- A primer on monetary policy

MONEY AND FINANCIAL SYSTEM: WHAT IS MONEY?

- What is money?
  - Object that is commonly accepted and used to facilitate the transaction – i.e. *transaction technology*
- Function of money
  - Medium of exchange
  - Store of value
  - Unit of account
  - Legal tender

MONEY AND FINANCIAL SYSTEM: WHY DO WE USE MONEY?

- Why do we use money?
  - *Exchange market* and *Barter system* -- The lack of double of coincidences of wants

- Forms of money?

MONEY AND FINANCIAL SYSTEM: FORMS OF MONEY

- Forms of money
  - Commodity money (Bimetallic money)
  - Paper money
  - Bank money
  - Electronic money
- Intrinsic valued money v.s. Intrinsically valueless money
  - The value is backed up *social trust!*

MONEY AND FINANCIAL SYSTEM: MEASURING THE TOTALS OF MONEY

- The total amount of money is important!
  - This is called "*money supply*" or "*monetary aggregate*"
- Central bank *monitors* the development of money supply.
  - Money supply relates with overall economic activities
- How many *measurement concepts* of money supply are there?
  - The principle used to classify types of money supply

MONEY AND FINANCIAL SYSTEM: MEASURING MONEY

- Two important concepts of money supply
  - M1 = narrowly defined money
    - Currency in circulation + *Checking account*
    - Why checking account → *Resemble to cash; can be easily converted into cash (high liquidity)*
  - M2 / M3 = broadly defined money
    - M1 + *Saving accounts* + *Time-deposit accounts* + *Short-term assets*

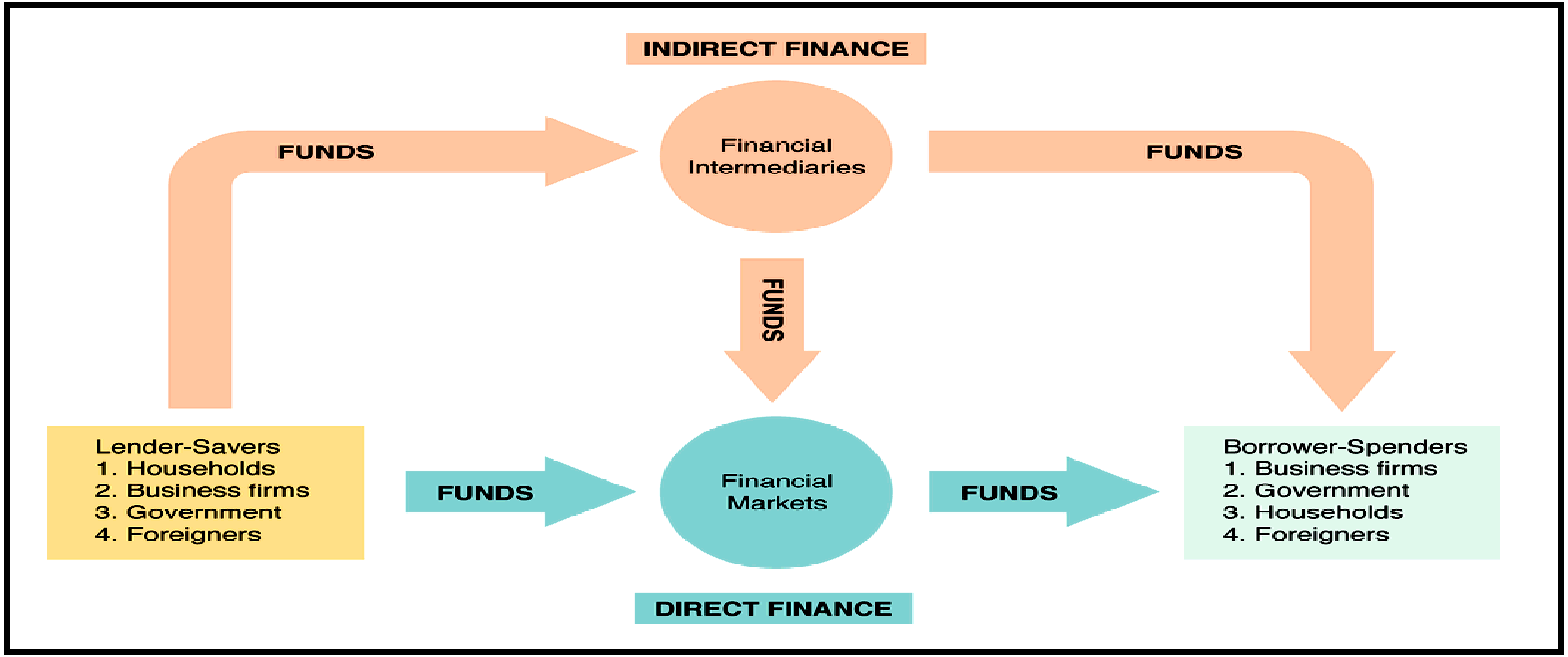
MONEY AND FINANCIAL SYSTEM: OVERVIEW OF FINANCIAL SYSTEM

- Monetary system and financial system
  - ***Monetary system:*** economy with money as the medium of transaction
  - ***Financial system:*** *a* part under the monetary economy that serves its role to facilitate the capital funding problem – *matching surplus units with those deficit units.*

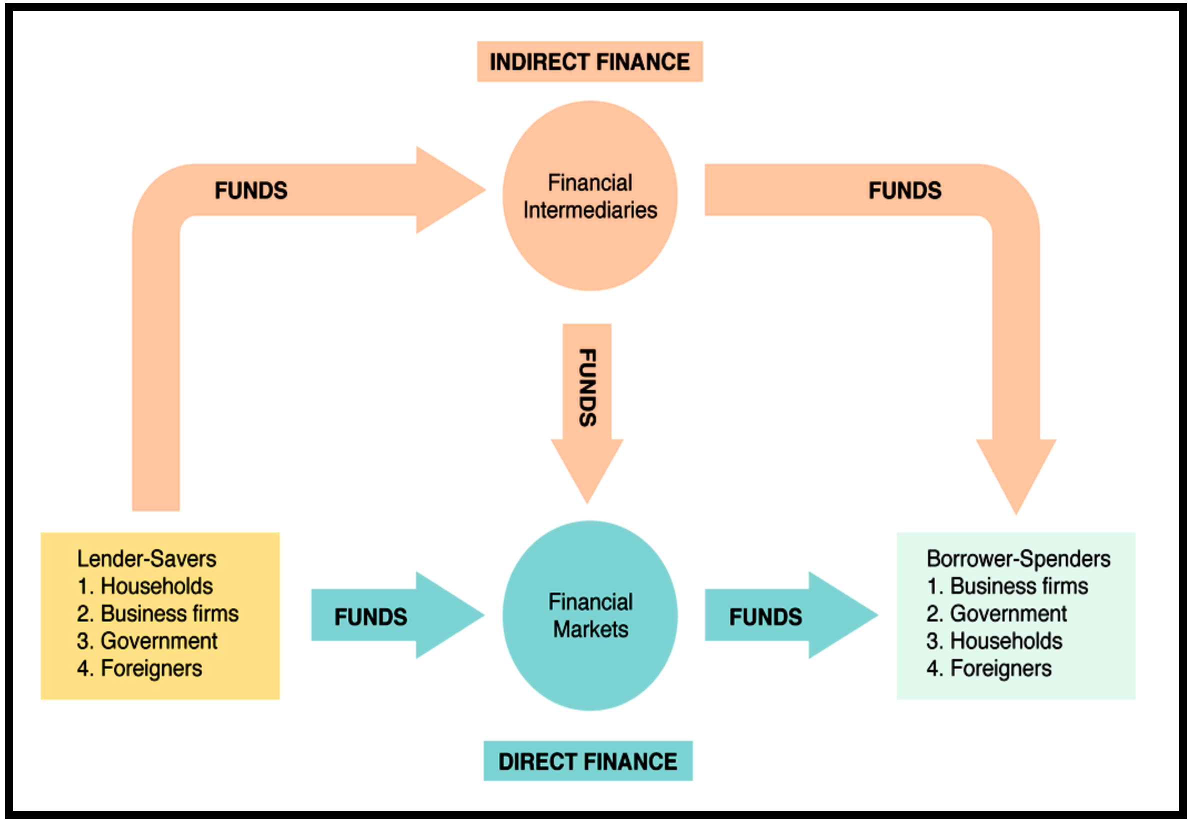
MONEY AND FINANCIAL SYSTEM

- Types of matching can be classified by the form of financings
  - **Debt-financing:** creditors and debtors → interest rate payments
  - **Equity-financing:** shareholder → profit/loss sharing
- How does the financial system facilitate these financing transactions?

MONEY AND FINANCIAL SYSTEM

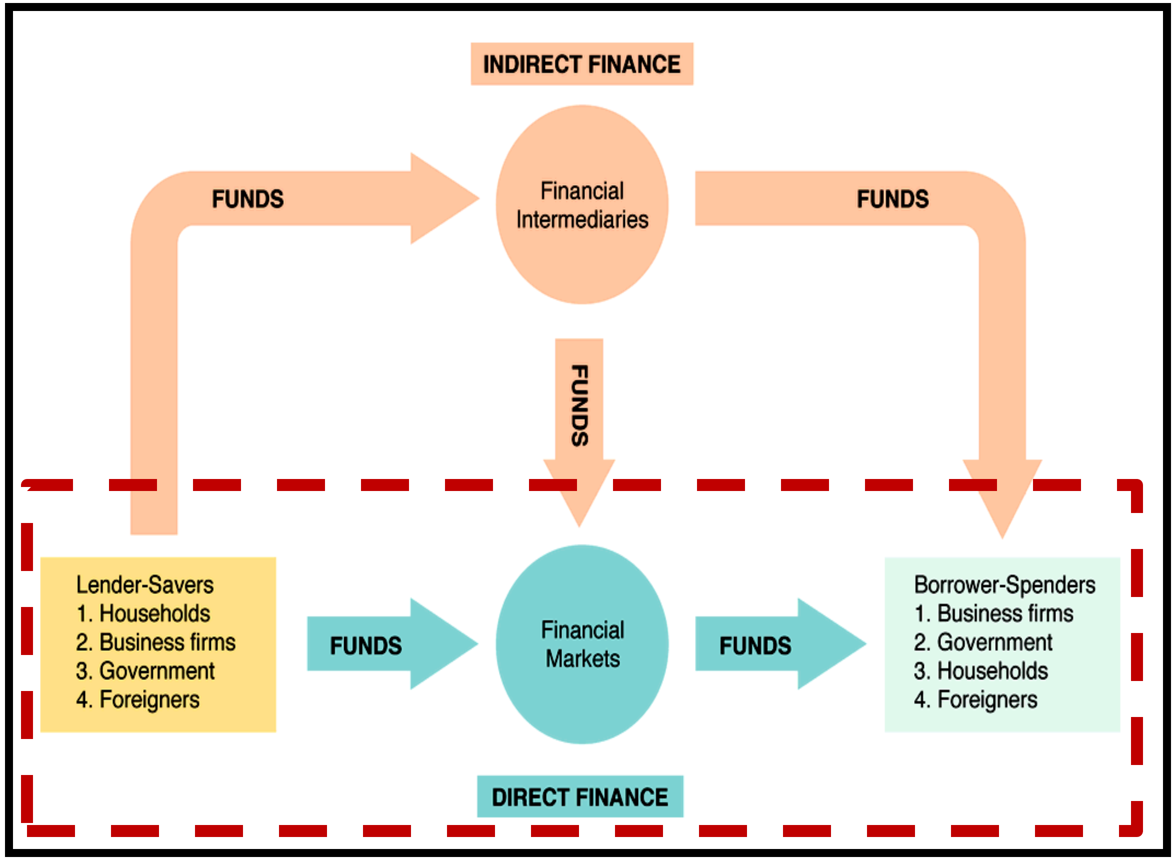


MONEY AND FINANCIAL SYSTEM



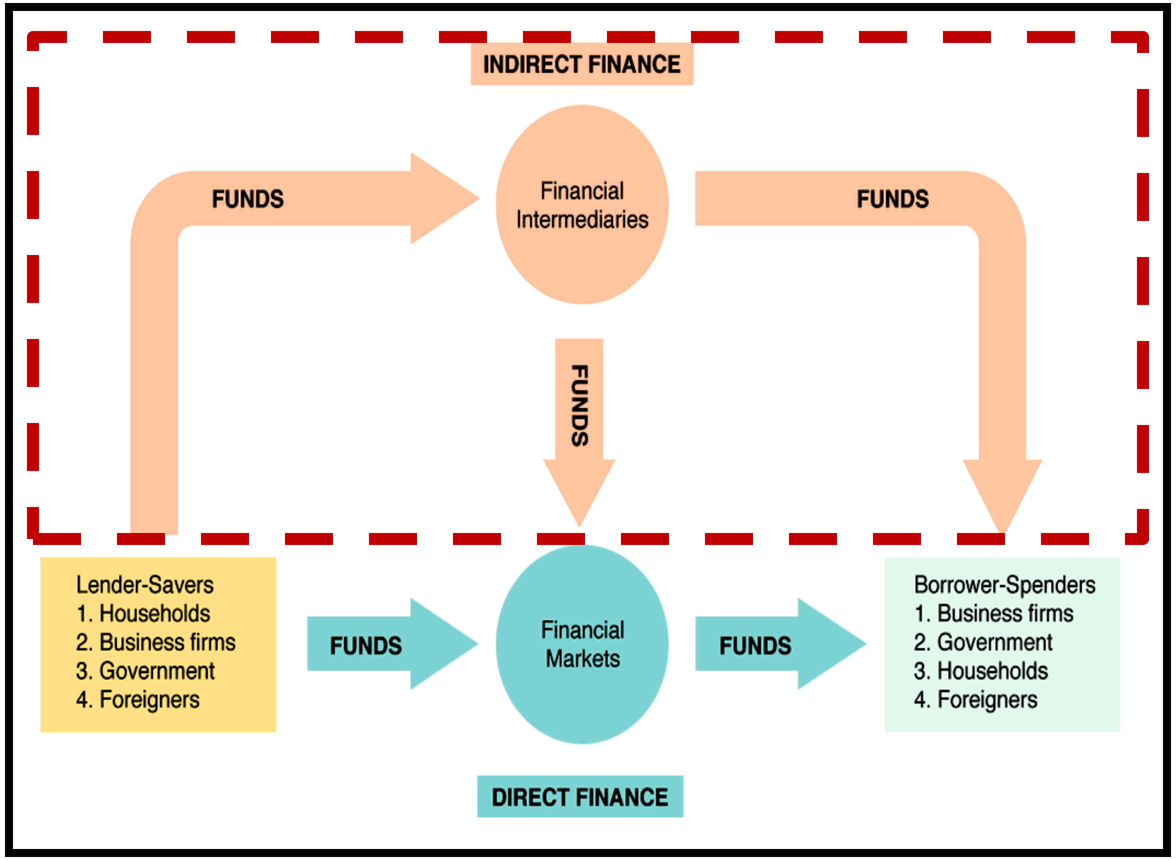
- Players in the financial system:
  - Financial markets
    - **Direct finance:** Peer-to-Peer financing
  - Financial institutions
    - **Indirect finance:** Middle-man financing

MONEY AND FINANCIAL SYSTEM



- Financial markets
  - Based on the form of issued instruments/securities:
    - Bond market: Debt
    - Stock market: Equity
  - Based on the length of financial contract
    - Money markets: less than 1 year
    - Capital markets: greater than 1 year

MONEY AND FINANCIAL SYSTEM



- **Financial institutions (or financial intermediaries)**
  - Depository institutions:
    - Commercial bank, saving unions, co-operative union, Government-sponsored bank
  - Market-security institutions:
    - Mutual funds, provident funds
    - Brokerage firm, Stock exchange of Thailand
    - Investment banks