Msc(econ) international economics, banking, and finance

Economics, Currency

MSc(Econ) International Economics, Banking, and Finance Principles of Money & Banking Lecture Notes 1 The Definition of Money The definition of anything follows one of two procedures 1) Attach labels to real world objects — Nominalist (2) Attach labels concepts and then search for the corresponding real world entity - Empiricist Characteristics of Money 1) Medium of Exchange 2) Unit of Account 3) Store of Value Money has two meanings. As an abstract notion it is a unit of account. As a concrete notion it is a medium of exchange “ Nothing is more ultimate than money. Instead of going out of existence, unwanted money gets passed around until ceases to be unwanted" Yeager 1) Commodity Money — problem of jointness 2) Localised issue — reputation 3) Government issue — legal tender Why is private debt not money? - No market for private bills (Paul Davidson) - Legal restrictions (Neil Wallace) Money is a means of final payment — (Charles Goodhart) The separation of money from other financial assets is its superiority in liquidity. Liquidity - assert money is perfectly liquid — potential to liquidate and use in transactions - term to maturity (capital risk) Yeager distinguishes money in terms of the adjustment to market disequilibrium. A holder of unwanted money adjusts his/her holding for whatever he/she does want. So instead of going out of existence, unwanted money gets passed around until it ceases to be unwanted. So in a way a kind of Say’s Law operates with money — “ Supply creates its Own Demand" Pesek and Saving - Money is contrasted with debt - Debt pays interest while money does not - Debt is inside money 1) Non-interest bearing deposits are an asset to the holder but a liability to no one, while interest bearing deposits are a debt like a bond 2) Interest payments on deposits means that deposits loses its property of " moneyness" 3) Demarcation between money and debt Friedman and Schwartz critique - transactions services have become a ' free good' available without cost to the holder. - Moneyness is a joint product with debtedness Moneyness is measured by (Rd — Rm) where Rd is the rate of interest on deposits and Rm is some market rate of interest. It follows that debtedness is measured by Rd Newlyn Suggests the concept of neutrality. If an asset can be used in generalised exchange that does not the market for Credit. Chetty Takes an empirical approach and measures money by its estimated elasticity of substitution with currency. So if currency is C and a bank deposit is D, Where the elasticity of substitution is given by; Laumas Also follows the empirical route, where Y is nominal income , M is narrow money and NM is other measures of money. And money-ness is measured by Divisia index Aggregates the rates of growth of the ith medium of exchange weighted by its user cost. There is a resemblance to Pesek and Saving's ideas. â– di - rate of growth of the ith medium of exchange â– Di - stock of the ith medium of exchange â– marginal cost = interest income foregone = ' user cost of money' â– wi = DiUi and Ui = Rmax - Ri Model of Money by Niehans Assumptions: 1. All exchanges involve transactions costs 2. Lower transactions costs are involved with the use of xn 3. The greater the frequency of exchange, the lower the transaction cost Define an exchange relation E that is contained in the set Z of all possible exchanges By assumption 1 all transactions incur costs By assumption 2 exchanges using x3 incur lower transactions costs By assumption 3 in the limit exchange [pic]disappears and we have Clower's famous dictum that " goods buy money and money buys goods but in a monetary economy goods do not buy goods". ----------------------- [pic] [pic] [pic] [pic] [pic] [pic] [pic]