



education
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MPUMALANGA PROVINCE

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ECONOMICS NOTES
TOPIC 11: MONEY & BANKING
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TOPIC 11: MONEY AND BANKING

Description: money is anything that is generally accepted as a means of payment for goods and services.

Technical functions of money (Possible essay)

- Money has three functions which are the following:

Money is a medium of exchange:

- Money is used for paying for goods and services in the market.
- Money replaced barter trade where goods were used to pay for other goods.
- Barter trade had many disadvantages such as being time consuming. individuals had to search for people with suitable products before bartering their products,
- Money solve problems associated with bartering system as money is accepted for all products in markets all over the world.
- Money also gives a convenience as all goods are exchanged for it

Money is a unit of account:

- Money is used to measure the value of products.
- A more valuable product usually cost more money than a product of low value e.g. a piece of diamond fetches higher price than pair of shoes.
- Money is used to compare the value of various goods as all goods are expressed in money.

Money as a store of value:

- Money is durable as one can store it for a long time (unlike products used in barter trade which some may rot if stored for too long).
- Even after keeping it for a particular period, money will still be the same, therefore it can be used to preserve wealth.

Modern money (Possible essay)

- Modern money has two forms which are deposit money and Fiat money.
- **Deposit money:** is money deposited into a bank account in the form of coins, bank notes and electronic transfers.
- Electronic transfers are becoming more commonly used form of money e.g. workers receive their salaries/wages in their banks in the form of electronic transfers and people use bank cards to pay for goods and services.
- Deposit money can be transferred from one bank to another at any time of the day.
- Money that can be withdrawn without giving notice is called demand deposit. Example of demand deposit are money in savings or cheque accounts.
- Money that is deposited with a bank for a fixed period of time and can only be withdrawn after the period has expired.
- Money deposited for 12 months or less is called a short term deposit
- Money deposited for between 1 year and three years is called medium term deposit
- Money deposited for more than three years is called long term deposits

- **Fiat money:** is money in the form coins and notes which form the currency of a country.
- Fiat money is legally accepted as a means of payment in a country. This means fiat money is legal tender (legal currency).
- The SARB has the right to print the fiat money (bank notes & coins) in the country.
- The two companies through which the SARB produces money are the South African Bank Note Company and the South African mint.
- The South African Bank Note Company make notes (paper money).
- Bank notes are in the value of R10, R20, R50, R100 and R200.
- The highest coin value in South Africa is R5.
- Bank notes issued as safeguarded with some security features to prevent them being counterfeited (forged).
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- **Money associated instruments**
- Modern money can be paid or receive using different form of instruments which are:
- **Credit cards:** is a card which is issued by a financial institution such as a bank.
- It allows the holder of the card to pay for goods and services to a specified amount.
- The holder of the card then pays back the amount to the bank monthly over a specific period.
- The amount is paid back with interest added to it
- **Debit cards:** allows the consumer to buy goods and services only if the amount payable is available in the holder's bank account at the time of purchase.
- It can also be used to withdraw cash at the Automatic Teller Machines (ATM) or at the point of sale terminal e.g. checkers, Pick n' Pay.
- **Electronic Funds Transfer (EFT)**
- People use the internet banking or banking Applications (banking Apps) to send money from their bank accounts.
- People can send or receive money via the EFT.
- *(NB: cheques and postal orders are no longer used in South Africa. Cheques were discontinued in 2021 January)*

THE MONETARY SYSTEM

- In a country, the monetary system consists of the national treasury, the central bank and the financial institutions.

- **The national treasury**

- In South Africa the national treasury is the South African Revenue Services (SARS),
- The national treasury is part of the Department of Finance.
- All finances of the South African government are managed by the SARS.

- **The central bank**

- The central bank OF South Africa is the South African Reserve Bank (SARB).
- One of the functions of the SARB is to formulate and implement the monetary policy.
- Monetary policy refers to measures that are taken to influence money supply.
- The SARB also regulate the banks in the interest of depositors and the economy
- It issues licences to the banking institutions and monitors their activities

- **Financial Institutions**

- and the financial institutions are banks, insurance companies etc. which take deposits and provide loans to clients.

THE VALUE OF MONEY

- The value of money is the purchasing power of the unit of money. it refers to the number of goods and services the unit of money (rand) can buy.
- The value of money is affected by the increase in the general price levels (inflation). If inflation is high, the value of money will decrease.
- The value of money is also affected by the quantity (supply) of money available, if the quantity is too high the value of money will decline.
- The supply of money is measured by in three **categories which are**;
- **M1**: is formed by coins and bank notes in circulation (in people hands).
- Plus the money in demand deposits (savings accounts)
- **M2**: is formed by M1 plus money in short term and medium term deposits
- **M3**: is formed by M2 plus money in long term deposits.

- **Quantity theory of money:**

- It states that if the quantity of money increases, prices will increase and the value of money will decrease. This means too much money supplied leads to a decrease in value of money

- **The velocity theory of money**

- It indicates the speed with which money circulate in the economy. If the speed of money circulation is high, it shows that the level of economic activity is high.
- High velocity of money indicates that inflation is likely to be high. High inflation reduces the value of money

- Stabilising the value of money
- It is important for a country to stabilise the general price level (inflation) in order to stabilise the value of money.
- SARB uses Consumer Price Index to measure the inflation rate. Inflation is the continuous and significant increase in the general price level.
- The rise in inflation leads to low value of money.
- The SARB has an inflation target of 3% - 6%. This means the SARB would like the inflation to stay within 3-6% as this represent stable prices.
- The CPI is calculated from the base year of 2015. This means all prices are compared to the prices of 2015 to see how much they have increased in terms of percentage.
- An index of the base year (2015) is always 100. If the prices of other period are higher than that of the base year, the Index will also show increase.
- If the index goes below 100 it means the increase in prices has decreased (NB: *not that the prices have decreased, BUT the rate of increase in prices have decreased*)
- The table below shows CPI OF

Month	CPI	Inflation rate
July 2021	98.1	
July 2022	105.8	$\frac{105.8 - 98.1}{98.1} \times \frac{100}{1}$ $= 7.8\%$

- In the example the inflation has increased by 7.8% between 2021 July and 2022 July. This means prices have increased by 7.8% since 2021 July and also it means money has lost 7,8% of its value.
- 7.8% is outside the target inflation rate of 3% – 6 %, meaning inflation is out of control
- SARB applies an increase in repo rate as a measure to reduce inflation rate.

BANKING

- Banks serve as the link between people who want to save money and those who want to borrow money.
- In South Africa with have several banks with FNB, ABSA, Standard Bank, Nedbank and Capitec being the largest.
- Banks deal in money and creation of credit.
- **Basic principle of credit creation**
- From the money that clients deposited in their banking accounts, the banks create credit. This means the banks use the deposits to make loans.
- The loans are repaid with interest.
- Bank cannot lend all the money deposited with it; it has to keep a portion of those funds and this portion is called cash reserves.
- **Interest rates**
- Interest is the price of borrowing money or saving money.
- Banks often charge higher interest on loans, but pays relatively low interest on bank deposits.
- The interest rate charged on loans depends of various factors such as:
 - ♣ The period of loan
 - ♣ The risk attached to the status of the borrower
 - ♣ The credit record of the client
- Interest is calculated as a percentage of the funds borrowed
- The longer the period of the loan, the higher the interest rate.

Micro-lending activities

- Micro-lenders are businesses that give small scale credit (loans) to the members of the public.
- They more often cater for people who do not qualify to obtain loans with banks.
- Some of the people who access credit from micro-lenders are those who work in the informal sector.
- Micro-lenders often charge very high interest. Some charge up to 50% of the loan amount.
- The disadvantage of micro-lending is that due to the high interest charged, clients end up in a vicious cycle of debt.
- **Loan sharks**
- Loan sharks are unregistered, therefore illegal micro-lenders.
- They charge excessively high interest; sometimes more than 100% of the loan amount.
- They often enforce repayments with measures such as threats and violence.
- Some even demand that the client hand over their Identity documents, bank cards or social grant cards to them as security measure.

- **Regulation of Micro-lending**

- The Micro Finance Regulatory Council was established to regulate the micro-lenders and to protect the borrowers
- All micro-lenders are required to register with council.
- **The following are regulations that the lenders must follow**
- Micro-lenders must assess the financial situation of the borrower before giving out a loan.
- Interest rate should not be more than ten times the prime rate
- Consumer rights should be protected
- Micro-lenders must register with the regulatory council.

- **CENTRAL BANKING**

- South Africa 's central bank is called the South African Reserve Bank.
- It has several functions which are:

- , **Functions of the South African Reserve Bank**

- **Issues notes and coins**

- The SARB is has the sole right to issue money in South Africa.
 - The South African Mint produces coins
 - The South African Bank Note Company produces bank notes
 - All banks obtain their money from the Reserve Bank by withdrawing from their balances that are held by the Reserve Bank

- **It is the banker of the commercial banks**

- The SARB declares and keeps the minimum cash reserves that all commercial banks are required to hold to stay solvent
 - In their daily operations, banks accept cheques drawn on other banks
 - Suppose FNB accepts a cheque drawn on ABSA
 - This means ABSA Bank owes the amount of the cheque to ABC FNB
 - To clear this debt, ABSA Bank transfers the amount from its Reserve Bank's account at the Reserve Bank

- **Banker to the government**

- The Reserve Banker is the banker to the government.
 - The government, different departments, provincial governments and government owned enterprises keep their accounts with the Reserve Bank
 - In places where there is no branch of the Reserve Bank, the government and government institutions open accounts at commercial banks
 - The Reserve Bank provides the banking services to the government that the other banks provide to their clients
 - The Reserve Bank also provides financial advice to the government and its department

- **Custodian of gold and foreign reserves**

- The central bank acts as custodian of the country's assets

- Once it has been refined, the country's gold is stored in the vaults at the Reserve Bank
- Foreign reserves are also kept at the Reserve Bank
- Foreign reserves are other countries' money systems that are held in a country. So some dollars, pounds, yen and so on are kept at the Reserve Bank
- **Lender of last resort**
 - The central bank is the lender of last resort to the banks
 - When the banks have exhausted all their resources of finance and they experience a shortage of funds, they approach the Reserve Bank for loans
 - When the Reserve Bank lends money to banks it charges the repo rate
- **Credit control**
 - The important function of the central bank is to control the money supply in a country
 - If credit creation by banks is not controlled, money supply would get out of hand
 - If too much money is supplied, the value of a country's currency (such as the rand) will decrease
- **Collects Economic and statistical information**
 - The central bank collects and processes economic and statistical information
 - Once every quarter, the Reserve Bank Quarterly Bulletin, in which it provides the information about the state of the economy of the country at that time

MONETARY POLICY

- The monetary policy is formulated and implemented by the SARB.
- Inflation targeting is part of the monetary policy in South Africa.
- The SARB uses the **following monetary policy instruments** to implement the monetary policy
 - Interest rate
 - Interest rates are used to influence credit creation by making credit more expensive or cheaper.
 - **To encourage credit creation**, interest rates can be reduced.
 - This can result in an increase in aggregate demand as more people are likely to apply for loans. Increased aggregate demand leads to increased total production of goods and services.
 - **To reduce credit creation**, repo rate can be increased.
 - This can lead to a decrease in the number of loans, aggregate demand and production of goods and services.
 - Open market transactions
 - **To restrict credit**: the SARB can sell securities to the banks.
 - When banks buy these securities money flows from the banks to SARB.
 - Banks will have less money to lend and cannot give as many loans as before. This can reduce aggregate demand and supply of goods and services.
 - **To encourage credit creation**: the SARB buys securities from the banks.

- This result in money flowing into the banking system and aggregate demand and production increase.
- Moral suasion
 - The SARB consults with the banks and persuade them to act in a desirable manner suitable for prevailing economic conditions.
 - **To reduce demand for loans**, banks can be encouraged to be stricter with loan extension. This can result in aggregate demand and supply decreasing.
 - **To increase demand for loans**, the SARB can encourage the banks to be less strict in their requirements for one to qualify for a loan. This can lead to an increase in both aggregate consumption and production of goods and services.
- Cash Reserve Requirements
 - Banks are required to hold a certain minimum cash reserve in the central bank.
 - **To reduce aggregate demand**, the amount of money needed as reserves in each bank's accounts with the SARB can be increased.
 - This will result in banks having limited amounts of money to give out as credit.
 - **To increase aggregate demand**, the SARB can reduce the amount of money needed as cash reserves in each bank's account with it. This will increase the amount to be given as credit.
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- **BANK FAILURE**
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