Currency in Circulation

Why in News?

Nearly six years and two months after the government announced **demonetisation** in 2016, currency with the public is at a new high (74% increase from the days before demonetisation was announced).

- Currency with the public is arrived at after **deducting cash with banks from total Currency in Circulation.**
- Cash in the system has been steadily rising, even though the government and the **Reserve Bank of India (RBI)** pushed for a "less cash society", digitisation of payments and slapped restrictions on the use of cash in various transactions.

What is Currency in Circulation?

- Currency in circulation **refers to cash or currency within a country that is physically used to conduct transactions** between consumers and businesses.
- Currency in circulation is an important component of a country's **money supply.**
- Monetary authorities of **central banks pay attention to the amount of physical currency** in circulation because it represents one of the most liquid asset classes.
- Currency in Circulation includes **notes in circulation, rupee coins and small coins.**
- The RBI has the **sole right to issue currency notes.** The Government of India is the issuing authority of coins and supplies coins to the Reserve Bank on demand.

What is 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.

UPSC Civil Services Examination, Previous Year Questions (PYQs)

Q1. Which of the following measures would result in an increase in the money supply in the economy? (2012)

1. Purchase of government securities from the public by the Central Bank
2. Deposit of currency in commercial banks by the public
3. Borrowing by the government from the Central Bank
4. Sale of government securities to the public by the Central Bank

Select the correct answer using the codes given below:

(a) 1 only
(b) 2 and 4 only
(c) 1 and 3 only
(d) 2, 3 and 4

Ans: (c)

- In case of public depositing money with the central bank and government selling its securities to the public, the money supply in the economy decreases. Hence, 2 and 4 are not correct.
- Ways to Increase the Money Supply in the Economy
    - Printing more money;
    - Reducing interest rates;
    - Quantitative easing;
    - Reduce the reserve ratio for lending;
    - Central Bank buying government securities; hence, 1 is correct.
    - Expansionary fiscal policy;
- The borrowing by the government from the Central Bank also results in an increase in money supply in the economy. Hence, 3 is correct. Therefore, option (c) is the correct answer.

Q2. If you withdraw `1,00,000 in cash from your Demand Deposit Account at your bank, the immediate effect on aggregate money supply in the economy will be (2020)

(a) to reduce it by `1,00,000
(b) to increase it by `1,00,000
(c) to increase it by more than `1,00,000
(d) to leave it unchanged

Ans: (d)

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