

## **Economics of Money and Monetary Policy**

### **I. Subject Overview and Objective**

Monetary policy is generally about policy actions taken by central banks or monetary authorities to influence the economy through causing changes in aggregate demand/expenditure by policy-induced changes in money-related factors such as interest rates, credit, exchange rates, securities prices and money market liquidity. Monetary policy has various dimensions of macroeconomic and financial stability objectives. Banking and financial markets are highly guided and influenced by the monetary policy through interest rates, market liquidity and other monetary and macro-prudential regulations because the most part of money is created and circulated through business operations of banking and financial markets. Money is the prime input for business of banking & finance. Therefore, the monetary policy directly affects the banking and finance businesses. As a result, banking and financial markets have to plan their business operations in response to or in anticipation of monetary policy actions from time to time. Therefore, this subject is designed to provide knowledge on both theory and practice of the implementation of monetary policy in the economy and this knowledge will immensely help banking and finance professionals to contribute to their employer- institutions.

### **II. Recommended Subject Coverage**

- (a) Evolution of money: Barter system, commodity money, gold standard, bank notes, fiat money, electronic money, virtual money
- (b) Functions of money and business of banks and other financial institutions on money: Functions of money, i.e., medium of exchange, unit of account, liquid store of wealth and deferred payment system, and supply of financial services to facilitate these functions
- (c) Economic role of money: Resource transfer (saver to investor), monetisation and leverage, price mechanism and markets, economic efficiency
- (d) Computation of supply of money: M1, M2, M2b and M4 and rationale
- (e) Demand for money: Transactions, precautionary and speculative demand, factors affecting demand, demand for real balances, liquidity preference and liquidity trap
- (f) Creation of money: Base money, deposit and credit, money/credit multiplier analysis, monetary survey, factors determining money supply
- (g) Determinants of interest rates: Role of interest rates, loanable funds market theory, liquidity preference theory, risk and term structure of interest rates, impact of policy rates on market interest rates, market interest rates, impact of policy rates on market interest rates, market interest rates and benchmark rates
- (h) Quantity Theory of Money and impact of the money on the economy
- (i) Monetary policy and implementation: Goals(single, dual and multiple), price/economic stability and macro-prudential, analysis, instruments, transmission mechanism, market liquidity management, targets (monetary, inflation, nominal GDP etc.), forward guidance approach, conventional and unconventional policies, communications strategies and inflation expectations, monetary policy and fiscal policy and fiscal policy co-ordination
- (j) Effects of monetary policy: Nominal and real effects, asset price bubbles and impact on banking and financial industry
- (k) Recent monetary policy trends in Sri Lanka: Relevant provisions in the Monetary Law Act, monetary policy cycles in the last two decades, instruments and goals
- (l) Recent global monetary policy trends in the UK, USA, EU and Japan: Monetary policy

cycles in the last two decades, interest rate setting mechanisms, Quantitative Easing policies (QE) and unconventional monetary policies and underlying objectives, current market expectations on monetary policy.