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Department of Economic Sciences

Third Year Licence: Quantitative Economics

Teacher: Miss M. Khames

Lecture 03: Economic and Monetary Aggregates

In the complex world of finance and economics, monetary aggregates are often a topic that confounds many. Yet, their role is fundamental in understanding and influencing the economic landscape. Monetary aggregates, in essence, are various measures of the money supply within an economy. They help us gauge the amount of money circulating in a country, and they serve as an important tool for central banks, policymakers, and economists to monitor economic health and make informed decisions.

There are several types of monetary aggregates, each representing a different subset of the money supply. The most common ones include: *M0:* This is also known as the "narrow money" or "central bank money." It includes physical currency and coins in circulation, as well as the reserves held by commercial banks at the central bank. Also, *M1:* M1 extends beyond M0 by incorporating demand deposits (checking accounts) and other liquid assets that can be quickly converted to cash. It represents the most liquid portion of the money supply. Moreover, *M2:* M2 encompasses M1 and adds savings accounts, time deposits, and other near-money assets. It includes less liquid assets than M1 but still easily convertible to cash. Finally, *M3:* The broadest measure of the money supply, M3 includes M2 and large time deposits, institutional money market funds, and other large liquid assets.

Equally important, monetary aggregates play a vital role in the economy in the following ways. First, *Inflation Control:* Central banks use monetary aggregates to manage inflation. By controlling the money supply, they can influence inflation rates. If the money supply grows too rapidly, it can lead to inflation, while a tight money supply can help control inflation. Second, *Economic Stability:* An adequate money supply ensures economic stability. It supports business operations, facilitates transactions, and maintains consumer confidence. Third, *Interest Rate Determination*: Monetary aggregates influence interest rates. A larger money supply tends to result in lower interest rates, making borrowing cheaper, while a smaller money supply can lead to higher interest rates. Finally, *Monetary Policy:* Central banks, such as the Federal Reserve in the United States or the European Central Bank in Europe, use information on monetary aggregates to craft and implement monetary policy, including adjusting interest rates and managing liquidity.

Reading Comprehension:

1. Define the monetary aggregates.
2. What are the roles of the monetary aggregates in the economy?
3. Name the different types of the monetary aggregates.
4. Explain how monetary aggregates influence the interest rates.
5. How do the monetary aggregates control the inflation?
6. What is meant by M3?

Vocabulary:

1. Match the terms with their correct definitions:

Terms: Narrow Money – Inflation – Liquidity - Interest Rate

Definitions:

a. The rate at which the general level of prices for goods and services rises and subsequently, purchasing power falls.

b. The most liquid portion of the money supply.

c. The availability of cash or assets that can be quickly converted into cash.

d. A measure of the money supply that includes physical currency and coins in circulation.

2- Fill in the blanks:

1. A significant increase in the money supply can lead to \_\_\_\_\_\_\_\_, causing the prices of goods and services to rise.
2. \_\_\_\_\_\_\_\_ refers to how easily an asset can be converted into cash without losing its value.
3. The central bank closely monitors the \_\_\_\_\_\_\_\_ supply, which includes physical currency and coins, to ensure economic stability.
4. High \_\_\_\_\_\_\_\_ can discourage borrowing and slow down economic growth, while low rates often stimulate investment and consumption.
5. An increase in \_\_\_\_\_\_\_\_ can be a sign of a growing economy, while a decrease can indicate a slowdown.

Grammar: Active vs. Passive Voice

* Definition :
* *Active Voice:* In active voice, the subject of the sentence performs the action. In active voice, the doer of the action is clear, and the sentence is often straightforward. The subject comes before the verb, and the action is clear.

For example: "The company produces high-quality products."

* *Passive Voice:* In passive voice, the action is performed on the subject, and the subject receives the action. In passive voice, the focus is on the receiver of the action, and the doer of the action is often less important or even omitted. The object of the action comes before the verb, and the verb is usually a form of "be" plus the past participle.

For example: "High-quality products are produced by the company."

* Rules for Changing Voice:

To change from active to passive voice, follow these steps:

* Make the object of the action the new subject.
* Use a form of "be" (like "is," "are," "was," "were") in the correct tense.
* Add the past participle form of the main verb.

*For example,* to change "The company produces high-quality products" to passive voice:

* Object of the action becomes the subject: "High-quality products."
* Use a form of "be" in the correct tense: "are" (present tense).
* Add the past participle form of the main verb: "produced."

So, in passive voice, it becomes: "High-quality products are produced by the company."

Activity: Change the following sentences from the active voice into the passive voice.

* The central bank monitors the money supply closely.
* Policymakers use monetary aggregates to manage inflation rates.
* Investors consider the impact of monetary aggregates on financial markets.
* The company will invest in projects that stimulate monetary growth.
* The Federal Reserve adjusts interest rates based on monetary aggregates.
* Economists study the relationship between monetary aggregates and economic growth.
* Businesses rely on monetary aggregates to make financial decisions.