5. HIGH POWERED MONEY OR MONETARY BASE

The monetary base or *High Powered Money* is the money produced by the central bank and the government (paper currency and coins) and held by the public and banks.

The monetary base or high powered money (H) in a country is composed of the currency held by the public (C) and commercial banks' reserves (R).

$$H = C + R$$

The currency held by the people C is constituted by (*i*) gold stocks, (*ii*) amount of money issued by the govenment *i.e.*, coins, paper currency etc., (*iii*) the outstanding central govt. credit *i.e.*, loans, securities etc.

The commercial bank reserves (R) are constituted by the required reserve (RR) and excess reserves (ER).

$$R = RR + ER$$

The commercial bank reserves (R) are a fixed proportion (*r*) of the total bank deposits which include demand deposits (D), time deposits (T) and government deposits (G).

$$R = r(D + T + G)$$

Thus the high powered money or monetary base is comprised of money issued by the central bank and government, money held by the public (coins and paper currency) and the reserves of commercial banks.

The equilibrium level of high powered money (H) is determined by the demand for and supply of high-powered money. The demand for high-powered money is related inversely to money supply. An increase in the ratio of currency or required reserve or excess reserves to demand deposits will cause an increase in the demand for high powered money

(H_D) and vice-versa. The supply of high-powered money is controlled by the central bank. Therefore, it may be considered exogenously given. An increase in the supply of high powered money leads to an increase in money supply and vice-versa.