6.

The main determinants of the supply of money are cash or deposit holding, required reserve ratio, amount of bank reserves and the high powered money. These are discussed below :

(i) *Cash or deposit holding* : People keep their resources in the form of cash or bank deposits. If people want to hold currency or cash in a larger amount, it means they want to keep smaller deposits with banks. In such a situation, bank will be able to create credit or deposits in a smaller measure and, therefore, the supply of money will be small. On the opposite, if they want to hold cash or currency in a smaller measure, it will mean that they will hold larger deposits with banks. In this case, banks will be able to create deposits or credit in a larger measure and there will be a larger supply of money.

(ii) ***Required reserve ratio*** : The required reserve ratio is that proportion of total bank deposits which is obligatory for them to hold in the form of central banking reserves. The required reserve ratio is within the control of the central bank. It may raise or lower it when it desires to do so. It is called as the Statutory Liquidity Ratio (SLR). When this ratio is raised, the commercial banks have to keep a larger proportion of their liabilities with the central bank. The amount of cash with commercial banks gets reduced. As a result, their capacity to create credit also gets reduced. On the opposite, when this ratio is lowered, the commercial banks are required to keep lesser securities with the central bank. As the amount of cash held by them gets enlarged, they become able to create credit in a greater measure. In such a situation, the supply of money gets increased. The central bank generally raises the required reserve ratio or SLR for restraining inflation and lowers it in the conditions of depression.

(iii) ***Amount of bank reserves*** : The total reserves of the commercial banks are comprised of the required reserves (RR) of commercial banks that they are required to keep with the central bank and those reserves which they hold themselves. As regards the former type of reserves, these are determined by the amount of total deposits received by banks and the level of required reserve ratio. The reserves held by commercial banks with themselves are, in fact, their excess reserves (ER).

These are equal to the difference between the total reserves of commercial banks and their required reserves. The central bank can effect changes in ER through variations in required reserves. Given the total reserves of commercial banks, the increase in required reserves leads to a reduction in ER and vice-versa. The central bank can bring about changes in commercial banks' reserves through the open market operations and changes in the bank rate. The central bank can raise the reserves of commercial banks through the purchase of securities and can reduce their reserves through the sale of securities in the open market. The increase in bank rate or the rate of discounting results in the reduction in the commercial bank reserves. On the opposite, the reduction in bank rate brings about an increase in the excess reserves of commercial banks. The variations in the amount of reserves of commercial banks have their effects upon the supply of money.

(*iv*) ***High powered money*** : The high powered money also has much impact on the supply of money in a given country. The high powered money (H) or monetary base is constituted by currency held by the public (C) and the commercial bank reserves (R).

$$H = C + R$$

If the supply of H remains the same, an increase in its demand results in a fall in the supply of money and a decrease in the demand for it causes a rise in the supply of money. On the other hand, given the demand for H, an increase in its supply sets the money supply multiplier into operation and causes a resultant increase in the supply of money. On the contrary, a reduction in the supply of H, leads to a reduction in the supply of money on account of the reverse action of the money supply multiplier.