Ecs 1601 summary

Study Unit 1
Interdependence of major sectors, markets and flows in a mixed economy

FOREIGN SECTOR
- All the counties in the world
- SA = open economy
- Imports = Goods and Serv produced in other countries, sold in SA
- Exports = Goods and Serv produced in SA, sold in other countries

PUBLIC SECTOR
Government:
(Make choices best for country)
- All political officials on all levels
- Public Sector

FINANCIAL SECTOR
- Financial institutes = middle man between savers (surplus units) and borrowers (deficit units)
- When someone borrows savings and buy capital goods (called formation) = form of investment
- Interest is earned by lender

Aggregate (Total) spending of SA consists of:
C+I+G+X-Z

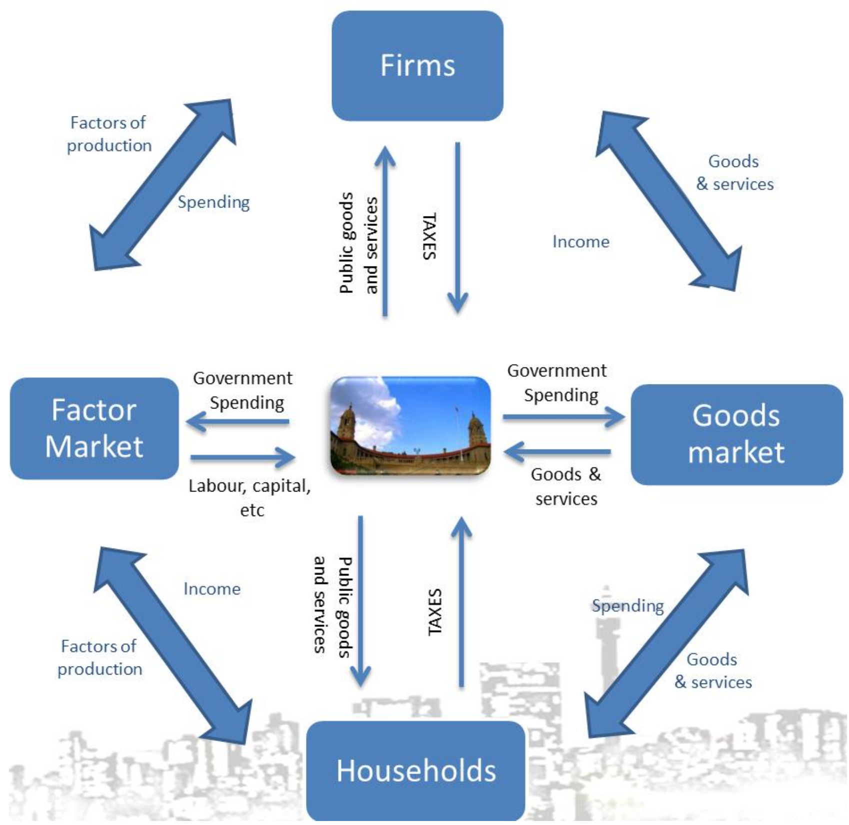
Take note of Symbols:
G = Government (expense)
Z = Imports (SA on foreign prod)
X = Exports (Foreign on our prod)
C = Consumption (household spend)
I = Investment (Firms spend)

Affect on income-spending flow:

Leakage:	Injection:
Taxes	G Spending
Savings	Investment
Imports	Exports

THREE MAJOR FLOWS:
- Production
- Income
- Spending

Flow Variable vs Stock Variable
Flow = measured over time
Stock = measured on specific time



Household: (Rational – make choices best for them)
- Group of people that make economic choices together
- Consume Goods and Service
- To get money, they sell FoP (Labour)

Firms: (Rational - make choices best for them)
- Use FoP to produce goods and service
- Profit = revenue - cost

Study Unit 2
The Monetary Sector

BARTER SYSTEM:
- Goods exchanged for other goods (apples for milk)
- Inefficient & High transaction cost

Double coincides of wants:
- Someone that has a lot of something but needs something else

Cheques & Debit Cards:
- Not money
- Transfers demand deposit from one person to another.

Measuring Money:
- **M1 = Conventional system**
Coins and notes used by public plus demand deposits (Cheque and transmission dep) M=C+D
- **M2 = Broader Def**
M1 including short and medium term deposits
- **M3 = Most comprehensive**
M2 including all long term deposits (Store of value function of money)

MONEY:
- Anything generally acceptable as payment for goods and service or settlement of debt.
- Unit of account
- Store of value
- NOT income or wealth

Money should be:
- Divisible
- Uniform
- Durable

Credit Cards:
- Fast way to acquire small loan from bank.
- Bank pays on your behalf, you repay the bank

Financial Intermediaries:
- Real & Financial sector
- Real & Financial transactions
- Fin transaction = no goods or service are exchanged
- Fin Intermediaries act as middle man between surplus units (savers) and deficit unit (borrowers)

SARB:
- **Formulate & implement monetary policy**
- Main instrument = repo rate (accommodation / refinancing system)
- Fin intermediaries (Banks) lend money to public at interest rate
- Banks need to borrow money from SARB at repo rate
- Repo rate influences interest rate
- SARB can also set cash reserve requirements or use open market transactions
- **Service to Government**
- Banker & Advisor (G banks with SARB. SARB give fin advice)
- Custodian of Gold and FOREX reserves (also formulates exchange rate policies)
- Admin of Exchange control (keeps eye on FOREX leaving the country)
- Provide economic & statistic services
- Collects, processes, interprets and publish economic stats.
- Maintain financial stability
- Supervise banks to ensure healthy banking system
- Oversees National Payment system (NPS) to manage risk in banking system
- Only Institution to make and destroy currency
- Serves as bank for other banks
- Set the cash reserve requirements
- Act as Clearing bank (settle obligations between banks)
- Lender-of-last-resort (Banks can borrow from SARB)

Study Unit 2

The Monetary Sector *Continued..*

Supply of Money

(in order to examine quantity of money supplied)

- Only work with M1
- Assume only banks can hold deposits
- Assume central bank that controls activities of banks

Three things regarding supply of Money

1. Role of banks in money creation process
- Bank allows public to create demand deposits (Cheque accounts)
- Demand deposits are created by giving bank money in turn for a cheque book
- Or bank will lend you the money that someone else saved.

2. Reserve asset position & credit multiplier
- Example: David saves R10 000 with East Bank. The cash reserve requirement (set by SARB) is 2.5% - What is the change in the cash reserve:
- Calculation: $\Delta R = b(\Delta D)$ | 00.25 x 10 000 = 250

3. Other factors that influence money supply
- Transactions with other countries (Rand vs Euro)
- Foreign transactions are influenced via gold and forex reserves

Demand for Money

- Amount that people want in the form of money
- Cash earns no interest
- Opportunity cost for holding money in cash (e.g. wallet) is the interest rate that could've been earned.

John Maynard Keynes

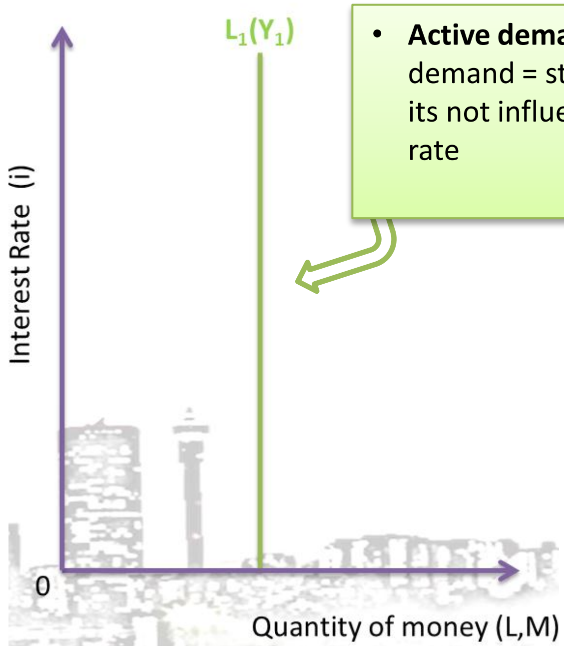
(Reasons for keeping cash instead of investing it..)

1. ACTIVE BALANCES:
- Transaction demand for money (Buy goods / service)
- Precautionary demand for money (unsure of future, unforeseen expenses)

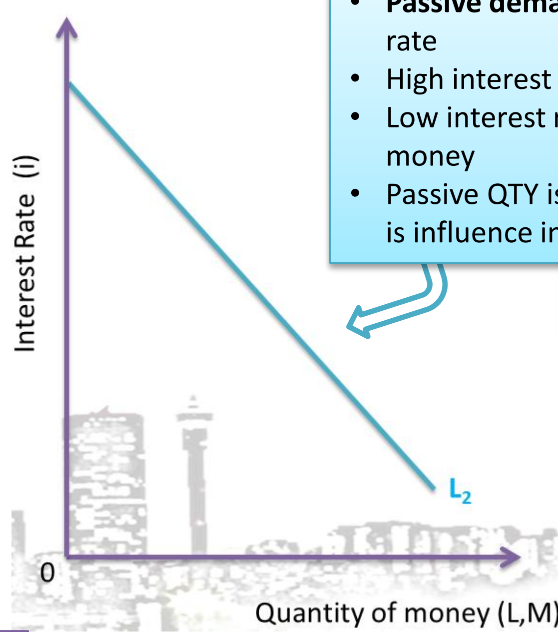
2. PASSIVE BALANCES:
- Speculative motive – has to do with opportunity cost of holding cash instead of investing.

THE GRAPHS OF ACTIVE AND PASSICE BALANCES (DEMANDS)

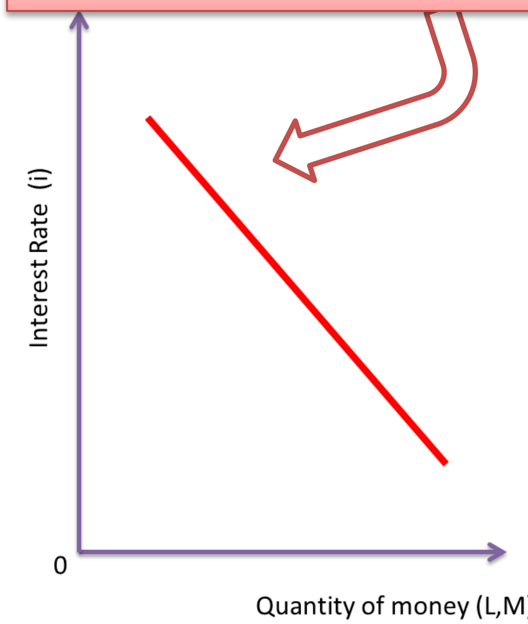
- **Active demand** of money demand = straight line because its not influences by interest rate



- **Passive demand** = determined by interest rate
- High interest rate = low demand for money
- Low interest rate – high demand for money
- Passive QTY is negative sloping because it is influence inversely by interest rate

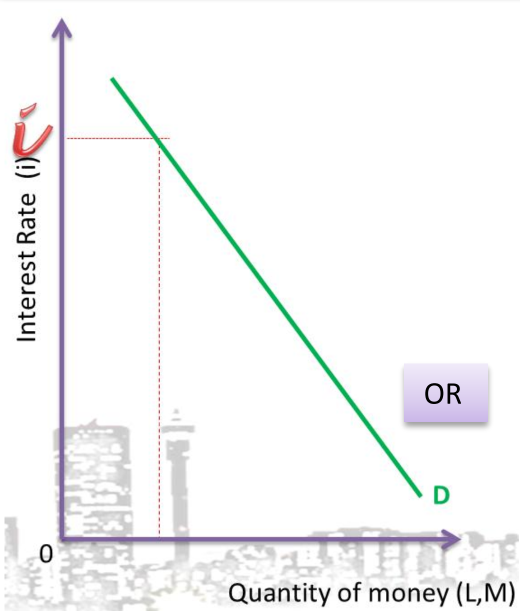


- **ACTIVE + PASSIVE = TOTAL DEMAND FOR MONEY**

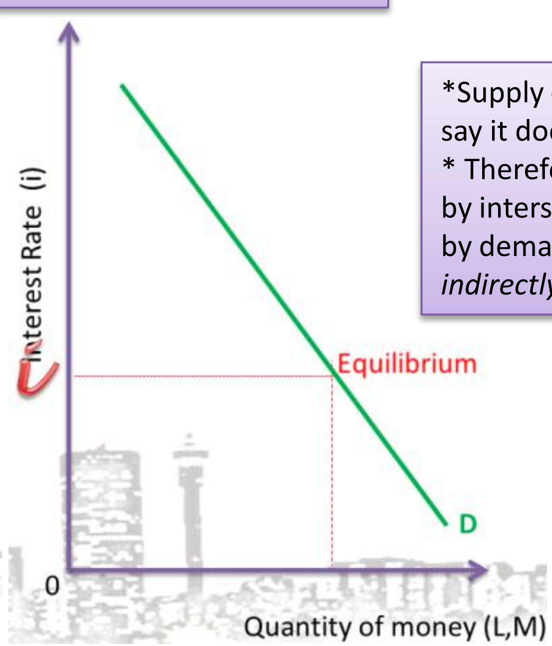


Equilibrium in the money market

(where demand and interest rate meet)



OR



*Supply chain is very complex (one might say it doesn't exist)

* Therefor equilibrium is NOT determined by intersection of supply and demand but by demand for money and interest rate *(as indirectly determined by SARB)*

Instruments of Monetary Policy

Key Market-orientated policy instruments:

- **Accommodation policy**

SARB sets cash reserve requirements (min % that banks my lend out) If more many is drawn from bank than they have available then bank lends from SARB. SARB also influence the interest rate by changing the repo rate

- **Open-market policy**

If SARB would like to decrease amount of money in economy, they write out Treasury Bills (Interest yielding investment). SARB sell bond to public so they withdraw money from the public

- **Public debt management**
- **Intervention of foreign exchange markets**