**Economics Notes – Chapter 3 – The individual as producer, consumer and borrower**

**4.1.1 Definition of Money**

Assets that are widely used and accepted as payment

**4.1.2 Forms of Money**

1. In the past
* Commodity money – transactions made through barter trade
* Cattle
* Shells
* Tobacco
* Metallic money – more accurate measure of value
* Gold
* Silver
1. In the present
* Paper money
* Dollars, or currency
* Deposit money
* Savings
* Cheques
1. Other forms of money and terms
* Fiat money
* Money that has no intrinsic value
* It is established as money by government decree
* Near money & money substitutes
* Liquid assets convertible to money without risk of loss
* E.g. savings
* Legal tender
* Money that must be accepted by law when offered for any transaction

**4.1.3 Functions of Money**

1. Medium of exchange
* In the past, barter trade (or direct exchange) was conducted of certain goods for other goods
* However, barter is an inefficient way to trade that is time-consuming and difficult
* Money functions as a device for making transactions
* Money allows people to trade at less cost in time and effort
* Money encourages specialization
1. Unit of Account
* Money is the basic unit for measuring economic value
* E.g. All prices, wages and debts are expressed in dollars
* Single, uniform measure of value is convenient as it simplifies comparison among different goods and services
1. Store of value
* Money is a way of holding wealth
* E.g. keeping under a mattress
* E.g. receiving wages to be spent 10mins later
* Assets can be a store of value
* E.g. stocks, bonds, or real estate
1. Standard for deferred payment
* Facilitates transactions
* E.g. Credit, loans and future payments
* Promotes economic growth
* E.g. investments

**4.1.4 Factors contributing to a desirable medium of exchange**

In the context of money:

* Scarce – cannot be duplicated easily (counterfeit)
* Durability – Prevent quick deterioration (e.g. Polymer SGD notes)
* Divisibility – Many denominations (e.g. $2, $10, $50)
* Homogeneity – Uniform in quality (e.g. Specific color and design for every denomination of SGD notes)
* Portability – Ease of carrying (compared to carrying gold) – ease of transaction
* Ease of recognition – Security features to minimize counterfeiting
* Stability – Value of money do not vary much over time (exchange rate)

**4.1.5 Explain why money is more desirable than barter trade**

Examine the disadvantages of barter trade:

* No common measure of value
* Difficult to monetize the value of every commodity
* Individuals assign varying values to their own commodities against others
* Indivisibility of goods
* E.g. ½ a cow, ¼ a pair of shoes
* Imperfect market information
* Finding out who wants your commodity
* Knowing what your seller wants in exchange for your commodity

**4.2.1 Functions of Banks**

* Borrow from individuals
* Hence, banks keep a sum of money to offer loans to borrowers
* Lend to individuals
* Hence, banks keep a sum of money as liquid assets
* Banks should have the financial capacity to meet their customers’ requests to withdraw money from their accounts
* Provide financial services (E.g. purchase of stocks)

**4.2.2.1 Commercial Banks**

* Private sector bank which aim to maximize profit through the provision of banking services
* Key aim of commercial bank is to maximize profit
* Banks profit by charging higher interest from borrowers
* Banks earn most of their interest from long-term loans
* Savers/lenders earn from the low interest charged to their deposits by banks

**4.2.2.2 Three Main Functions of Commercial Banks**

1. **Accept deposits from customers**
* Deposits can be stored in:
1. Current Account
* For customers to receive and make payments
* Easy and immediate access to money
* Interest not paid on money held in current account
1. Deposit Account
* For customers to save
* A period of notice must be given before money can be withdrawn
* Interest is paid on money held in deposit account

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|  | **Current Account** | **Deposit Account** |
| **Availability of cash withdrawal** | Easy access and immediate | Period of notice to be given |
| **Interest** | Interest is not given | Interest is paid |
| **Function** | To receive and make payment | For saving |

1. **To lend**
* Banks service financial intermediaries (‘middlemen’)
* Banks channel money from savers to borrowers
* 2 ways to borrow:
1. Overdraft
* Enables a customer to spend more than what is in the account
* Interest is charged on the amount borrowed
1. Loan
* To be used for a particular purpose and for a particular period of time
* Interest is charged on the amount borrowed (lower than overdraft)
1. **Enable customers to receive and make payment**
* Banks act as agents for payments and the provision of monetary transactions
* E.g. cheques, credit cards and online banking

**4.2.2.1 Central Banks**

* A central bank is a government owned bank that provides banking services to both the government and commercial banks
* E.g. European Central Bank (ECB), Monetary Authority of Singapore (MAS), Federal Reserve of the United States (FedReserve)
* Primary function of a central bank is to manage the nation’s money supply

**4.2.2.2 Functions of Central Banks**

* Banker to the government
* Stores tax revenue paid to the government
* Makes payment for goods and services
* Banker to the commercial banks
* Enables commercial banks to settle debts or withdraw cash
* Via the holding accounts
* Lender of last resort
* Lend to banks that are short of cash
* E.g. Bailouts during the 2008-9 Financial Crisis
* Manages national debt
* Finance debt through selling government bonds
* Holds country’s foreign reserves
* Keeps foreign currency (e.g. USD) and gold
* To stabilize exchange rate of local currency – match dd/ss of SGD
* Issue bank notes
* Printing and destruction of notes and minting of coins
* Regulate circulation of notes and coins
* E.g. 1cent coins still in circulation but no longer issued
* Implementation of government policies
* Interest rate adjustments
* To manage economic stability (e.g. inflation rate)
* Control of banking system
* Represents the government during international financial meetings

**4.2.3 Savings Banks**

* To encourage savings
* Target low income group
* Enable ease of withdrawal with minimal penalties

**4.2.4 Merchant/Investment Banks**

* Act as bankers to large firms
* Accept deposits
* Allow lending
* Manage issuing of shares and other financial securities through buying and selling
* Provide advice
* Facilitate mergers and takeovers of firms

**4.3.1.1 Stock Exchange**

* Stock exchange is an organization for the sale and purchase of shares and other securities
* Stock brokers are individuals who trade on stock exchanges
* Listed companies are companies which trade shares

**4.3.1.2 Functions of Stock Exchange**

* Provide a market for the purchase and sale of shares
* In public limited companies
* Also, to facilitate the sale of bonds and other securities for government
* Purpose – to help firms and government raise finance
* Enable companies to grow externally
* Through mergers and takeovers (acquisitions)
* Merger – mutual agreement of two companies to form a new combined company
* E.g. DBS and POSB
* Disney and Pixar
* Takeover – One company purchases sufficient shares to gain control of another company
* E.g. Giant and Shop n Save
* Mobilizing savings for investment
* Savings are channeled to finance projects
* Influencing the use of savings
* Successful firms profit from the sale of shares
* Sale provides adequate finance for business expansion
* Protection of shareholders
* Listed companies must fulfil certain requirements
* Provision of an indication of economic performance
* Bullish market
* Positive market confidence in the stock market
* E.g. Price surge, increments in the market indices (e.g. STI, NASDAQ) , high share transactions
* Bearish market
* Market pessimism in the stock market
* E.g. Fall in prices, low share transactions

**4.3.1.3 Factors contributing to the purchase of shares**

* Dividend payouts
* A steady flow of income
* Only if company assures regular good dividend
* Capital gain
* Market speculation would raise prices
* Investors sell shares when price is high to reap profits
* Influence company direction
* Shareholders can direct policymaking in the company
* Facilitate takeover of a company

**4.3.1.4 Factors contributing to share price determination**

* Interest rate
* An increase in interest rate would lower share prices because:
* Higher interest rate increases the opportunity cost of holding shares
* Higher payouts by placing money in deposit account
* Expectation in the fall in share prices and dividend payments
* Higher interest rate would encourage people to save more and borrow less
* Lower consumer expenditure would lower firms’ revenue, thus lowering profit levels
* Profit record
* Profits reaped directly influence share prices
* High profits would raise share prices
* Government policy
* Favorable government policies would raise share prices
* E.g. Reduction in corporate taxes enable larger dividend payments
* Issue of new shares
* New shares would raise supply, thus resulting in fall of price, ceteris paribus
* Takeovers and other market speculations
* Cause price to rise