UNIT – I

Money and inflation

Functions of money · Value of money · Quantity theory · Inflation

Explanatory Lecture Slides

Money, Banking & International Trade · Major-2 · Semester II

MONEY, BANKING & INTERNATIONAL TRADE

LEARNING OBJECTIVES

Topics covered in this unit

01 **Define money and state its functions**

02 **Explain M1–M4 in outline**

03 **State cash-transaction and cash-balance quantity theories**

04 **Define inflation, types, causes, effects**

05 **Place RBI’s inflation-targeting mandate**

06 **Connect inflation to labour and contract law**

UNIT I · SYLLABUS MAP

How this unit is organised

01	02	03	04	05	06
What is money?	Functions	Quantity theory	Cash-balance	Inflation	Effects

What is money?

A generally accepted medium of exchange, with legal-tender backing in a modern State.

- Commodity, metallic, paper, deposit, electronic.
- Legal tender: Coinage Act; RBI Act s.26 — banknotes are guaranteed by the Central Government.
- PYQ: define money and explain functions (2021, 2023, 2023 Oct).
- Without money: barter needs a double coincidence of wants.

What is money?

LEGAL TENDER

- Notes: unlimited.
- Coins: limited as notified.

NOT MONEY

- Credit cards (instruction to pay).
- Gold jewellery (store, not medium in ordinary trade).

Functions of money

Primary: medium of exchange, measure of value. Secondary: store of value, standard of deferred payment. Contingent: transfer of value, distribution of social income.

- Deferred payment is why contract damages and loans are in rupees.
- A bad store (high inflation) wrecks the other functions.
- Write them in this order in the hall.

Functions of money

PRIMARY

- Exchange.
- Measure.

SECONDARY

- Store.
- Deferred payment.

Quantity theory — cash transaction

Fisher: MV = PT. Other things equal, P varies with M.

- Assumptions: V and T stable in the short run.
- PYQ: critically examine cash-transaction approach (2023).
- Criticism: V is not stable; interest and expectations matter (Keynes).
- Still the first model of ‘too much money chasing too few goods’.

Quantity theory — cash transaction

FISHER

- $M \times V = P \times T$

ATTACK

- V varies.
- T grows.
- Causation can run P → M in a credit economy.

Cash-balance approach

Cambridge: $M = kPY$. People hold a fraction k of real income as money.

- Marshall, Pigou, Robertson; later Keynes’s liquidity preference.
- PYQ: cash-balance approach (2023 Oct).
- k is the inverse of V — same family, demand-side emphasis.

Cash-balance approach

K

- Demand to hold money.

LINK TO KEYNES

- Transactions, precautionary, speculative motives.

Inflation — meaning and types

A sustained rise in the general price level. Not a one-day spike in onions.

- Demand-pull, cost-push, structural (Indian classic), hyperinflation, stagflation.
- Measures: CPI, WPI; RBI currently targets CPI.
- PYQ: define inflation, causes, effects, types (2021, 2022, 2025).

Inflation — meaning and types

DEMAND-PULL

- Too much spending.

COST-PUSH

- Wages, oil, tax, exchange-rate pass-through.

Effects of inflation — and the lawyer

Redistributes from creditors and fixed-income earners to debtors and owners of real assets.

- Contracts: gold clauses, indexation, ‘time is of the essence’ plus price-escalation in works contracts.
- Labour: dearness allowance; Code on Wages.
- Tax: bracket creep if slabs are not indexed.
- Crime and unrest if inflation is extreme — a public-order fact, not a section.

Effects of inflation — and the lawyer

LOSERS

- Pensioners.
- Holders of cash.
- Creditors on a fixed rate.

WINNERS

- Debtors.
- Real-asset owners.
- Government with public debt in nominal rupees.

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LANDMARK AUTHORITIES

Cases a KSLU answer should name

CASE

RBI v Jayantilal N. Mistry

(2016) 3 SCC 525

RBI and transparency — the monetary institution is a public authority, not a private club.

CASE

Peerless General Finance v RBI

(1992) 2 SCC 343

RBI's regulatory reach over deposit-like activities.

CASE

Internet and Mobile Assn of India v RBI

(2020) 10 SCC 438

Crypto circular struck — 'money-like' things and proportionality.

STATUTE / SECTION MAP

Provisions & materials to quote

RBI Act 1934 s.3, s.26	Bank and legal tender.
RBI Act 45ZA–	Monetary Policy Committee — inflation targeting.
Banking Regulation Act	Banks as creators of deposit money.
Coinage Act 2011	Coins as legal tender.
Contract Act s.73	Damages in money — money as standard of deferred payment.

WRITE IT IN THE HALL

10 / 16-mark frames from this unit

Q1 What is money? Explain its functions.

Q2 Critically examine Fisher’s cash-transaction quantity theory.

Q3 Examine the cash-balance approach to the value of money.

Q4 Define inflation. Explain its types, causes and effects.

BEFORE YOU CLOSE THE FILE

Unit recap

1. Money: medium, measure, store, deferred payment.
2. Fisher MV=PT; Cambridge M=kPY.
3. Inflation is sustained general rise, not one shock.
4. RBI notes are legal tender (s.26 RBI Act).
5. Inflation redistributes — that is why contracts index.