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Concept of Money Demand and Supply and It's Importance on Economic Activities

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Abstrak

Permintaan dan penawaran uang memiliki peran penting dalam aktivitas ekonomi. Teori Keynes menjelaskan terdapat motif yang mendasari seseorang dalam memegang dan menyimpan uang diantaranya transaksi, motif berjaga-jaga, dan motif spekulasi. Perubahan dalam permintaan dan penawaran uang dipengaruhi oleh berbagai faktor, termasuk regulasi. Regulasi permintaan dan penawaran uang memiliki dampak signifikan pada sirkulasi uang. Penting untuk menjaga stabilitas sirkulasi uang, karena stabilitas permintaan dan penawaran uang dapat berdampak besar pada perubahan dalam kegiatan ekonomi. Bukti empiris telah menjelaskan bahwa tingkat suku bunga dan nilai tukar mempengaruhi permintaan dan penawaran uang. Namun, perubahan dalam regulasi permintaan dan penawaran uang memiliki dampak yang terlihat pada tingkat inflasi, karena sirkulasi uang mempengaruhi harga barang dan nilai tukar.

Kata Kunci: *Permintaan Uang, Penawaran Uang, Inflasi, Suku Bunga, Nilai Tukar*

Abstract

There is a close relationship between economic activity and the demand for and supply of money. Keynes argued that people had transactional, precautionary, and speculative reasons for hoarding and preserving cash. Regulation is just one of many factors that might affect fluctuations in the money supply and demand. In a significant way, the regulation of money's supply and demand affects the flow of money. Maintaining steady money flow is crucial as fluctuations in money supply and demand can have far-reaching effects on the economy. Interest rates and currency exchange rates have been shown to influence the demand for and supply of money. However, the rate of inflation responds strongly to shifts in the control of the supply and demand for money, as the circulation of money affects the prices of products and exchange rates.

Keyword: *Money Demand, Money Supply, Inflation, Interest, Exchange Rates*

INTRODUCTION

Because it's used as a medium of exchange, money plays a crucial role in the economy. Money is essential to the economic activity of both consumers and producers. John Maynard Keynes proposed a monetary theory that examines past monetary practices. Money is accepted as an intermediary tool in the process of exchange or trade. In holding money, a person's demand is influenced by several motives. These motives include transaction motives and precautionary motives. Transaction motives are circumstances in which a person holds money with the intention of making transactions such as buying goods and services, borrowing, or renting goods. Meanwhile, the precautionary motive describes a condition in which a person saves money in anticipation of something that has not happened or is expected to occur in the future, such as health costs when entering old age (Arwin et.al, 2019).

On the other hand, the supply of money is closely related to the circulation of money. The quantity theory explains that the money supply will change under certain conditions. One of the factors that affect the money supply is the level of money circulation. If the circulation of money does not produce changes in economic activity in general, people will spend their money in the same pattern of spending, so there will be no change. Another factor affecting the money supply is achieving full employment. If all members of society had jobs, purchasing power would remain the same, and everyone would be able to meet their daily needs. Under these conditions, there will be no change in money circulation because economic activity is in a stable state (Ferdian, 2020). The supply of money is closely related to the monetary authorities or those who have control over the circulation of money. The central bank has the authority to print and withdraw

money circulating in the community. In addition, the central bank is also responsible for determining whether the money is a legal instrument of transaction. Community behavior plays a role in determining the money supply, which is reflected in how individuals spend their money. Society determines the direction of their money as a form of wealth according to their preferences and desires.

The relationship between money and buying and selling, production and consumption in society is very close. In general, it is assumed that if the number of goods produced increases, the price of goods will tend to fall, and conversely, if the quantity of goods is reduced, the price of goods can increase drastically. In this situation, it is as if the value of money is weakening, even though the nominal amount of money remains the same, because the increase in the price of goods makes the value of money decrease. This shows that the price of goods is determined by supply and demand. If there is an excess or surplus of a commodity, the item will be cheap, and conversely, if the item is scarce or limited, the price will be high. The principle of justice is also related in this case, where if an item has a high price but does not provide commensurate benefits, this condition can cause losses (Fattach, 2017).

According to the conventional economic view, the demand for and supply of money will reach a point of equilibrium at a certain interest rate. The interaction between the supply and demand for money will also affect the interest rate toward equilibrium. If interest rates are above the equilibrium level, there will be an excess supply of money. People will adjust their behavior because of the high opportunity cost. In this case, people will reduce the amount of money in their wealth portfolio and exchange it for assets that provide higher interest (Arwin et.al, 2019). In the context of a more in-depth money supply, it is assumed that in a modern economy, the money supply is the net result of the behavior of the government, including the central bank, commercial banks, and the general public. However, in terms of money circulation, the central bank has a more significant role. There are factors that can affect changes in the money supply, and these changes can be seen from changes in the net bills of the central government, net claims of private companies and individuals, and foreign assets, all of which will affect the amount of money in circulation (Susetyo & Consela, 2011). Therefore, the factors that may influence demand and supply of money aren't limited to narrow concepts, but they are indefinite and have wide range of studies.

RESEARCH METHOD

The method used in preparing this paper is descriptive qualitative using the literature review method. Descriptive qualitative methods are used to analyze and provide a detailed description of the phenomenon studied, in this case the demand for and supply of money. Several works of relevant literature are cited throughout this investigation. Books, essays, scientific journals, and current events can all be good literature sources. Reference books can be useful, especially those that cover topics like economic theory, the concept of demand and supply, and the impact of particular factors on shifts in the demand for and supply of money. Journal papers that provide a systematic overview of the relevant scientific studies are also used to fill in the gaps in our comprehension.

The current developments in the supply and demand for money and the factors that affect them are also discussed. The supply and demand for money can be better understood in real-world circumstances with the help of recent economic news, monetary policy reports, and the most recent developments in global economic activity. The purpose of this work is to use a literature review to rebuild and present data on the supply and demand for money and the factors that affect these variables. The intricate link between money demand and supply and the factors that affect it can be better understood with an in-depth review of the relevant literature.

RESULT AND DISCUSSION

A. Money Demand

The reasons people wish to have money are at the heart of the demand for money. There are three common explanations for why people engage in such behavior: transactional, preventative, and speculative. Bills, regular payments, and savings accounts, in Keynes's view, accounted for the bulk of money demand. Keynes argues that one's income level determines the relative importance they place on transactional and preventive reasons. The level of interest rates is an element that influences the demand for cash. It is hypothesized that when interest rates rise and money becomes less attractive as an investment, its demand would fall. Other factors, such as financial innovation and deregulation, must be considered in any examination of monetary demand changes. The money supply, the interest rate differential, and the interest rate elasticity are all influenced by these same elements. Therefore, the need for money is affected by various factors, such as transactional motives and precautionary motives, which are in turn tied to people's income levels. Similarly, interest rates have a significant impact on the demand for money, with higher rates typically leading to lower levels of demand. The elasticity

of interest rates, the amount of money available, and the equilibrium between interest rates are all affected by financial innovation and deregulation, which in turn affects the demand for money (Nchor & Adamec, 2016).

As a medium of exchange, money is crucial, particularly for the success of monetary policy. Good macroeconomic stability is reflected by a steady demand for money. The demand for money is considered to be based on national income, interest rates, and opportunity costs in closed economic function theory. Income, interest rates, exchange rates, and inflation are all thought to be influenced by a number of additional factors that have been identified via earlier research. Though vital to the analysis of planning for monetary policy creation, socio-economic aspects are often overlooked in such research. Spending by the government, the value of remittances, population growth, interest rates, and inflation rate are all examples of such socioeconomic issues. Research that takes into account these macroeconomic considerations can shed additional light on the process of formulating monetary policy. The need for currency and monetary policy as a whole can be profoundly affected by the aforementioned socioeconomic factors. Consequently, these socio-economic elements must be taken into account when studying the demand for money and formulating monetary policy (Roussel et.al, 2021). GDP, inflation, currency rates, government securities (treasury bills), and financial records are just few of the long-term elements that influence the demand for money. In the long run, the demand for money is affected by all of these variables. Short-term shifts in the demand for money can also be influenced by things like financial innovation, fluctuations in exchange rates, and shifts in the demand for money itself. There may be a link between these variables and subsequent shifts in the demand for money. Financial innovations, fluctuations in exchange rates, and shifts in demand for money can all have an impact on one another and on the general demand for money in the near term. Therefore, both long-term factors like GDP, inflation, exchange rates, treasury bills, and financial records, and short-term factors like financial innovations, exchange rate movements, and changes in the need for money itself, must be taken into account when studying the demand for money. The desire for money in different economic settings can be better understood if the underlying causes and relationships are clarified (Lungu et.al, 2012).

The impact of money demand on economies has been studied before, with varying results. Demand for currency can be affected by a number of variables, including the income and interest rate elasticity. In addition, developments in the financial sector and fluctuations in exchange rates may affect the demand for currency. The study's authors advocate a more

lenient monetary policy in light of the findings. In order to stimulate investment in the actual economy, a decrease in interest rates is required. This allows for enhanced economic and commercial growth. Additionally, the more advanced the state of financial innovation is, the more potential there is to enhance economic and corporate activities generally. This study has significant consequences for monetary policy, as a result. Adopting pro-liberalization measures, such as reducing interest rates and encouraging financial innovation, can be helpful in fostering economic growth and improving investment prospects (Faridi & Akhtar, 2013).

Other research indicates a link between stable money demand and steady currency exchange rates. Predictability of exchange rate changes is used here to describe the stability of money demand. A stable money demand is also crucial to accurate foreign exchange rate forecasting. Predicting and avoiding swings in exchange rates is made easier when money demand is steady. Forecasts of currency exchange rates tend to improve in precision and practicality when the economy is relatively steady. Therefore, it is crucial to keep money demand stable in order to boost prediction accuracy and control currency rate risk (Rasasi, 2020). Monetary policy that is consistent with these goals is necessary to ensure that the demand for money remains stable. In this setting, it is essential that all monetary policy parameters be held constant. By controlling the money supply, interest rates, and other variables that influence demand, sound monetary policy can help keep money demand steady. Monetary policy is to maintain price and employment stability across the economy. Long-term stability in money demand is seen to be possible with the correct monetary policy. This is crucial for avoiding unfavorable swings in the economy and keeping things stable (Asiedu et.al, 2020). Alignment and cooperation between financial instruments, particularly among banking authorities, is crucial. Aggressive monetary policy calls for much more thorough visualization and management. There are a lot of moving parts to this issue. To get there, authoritative figures and financial establishments need to work together closely. Parallel and coordinated efforts are required to meet the issues of monetary management and monetary stability. Clear financial condition visualization and complete policy control is also required. Stakeholders will be better able to assess the current financial status and take corrective action with the aid of a decent visualization. Meanwhile, full control over a comprehensive policy will ensure that the actions taken can address existing problems effectively. The problem of aggressive money circulation also requires thorough attention. This involves careful consideration of the movement of money and its impact on the economy as a whole. Wise policies and effective strategies are needed to manage money circulation so as not to cause harmful risks and

disturbances. Thus, all these issues need to be addressed in a comprehensive and collaborative approach, by involving relevant stakeholders and taking appropriate steps to maintain overall financial stability (Wijaya et.al, 2020).

B. Money Supply

The amount of cash that is readily available to the public is referred to as the money supply. The Bank of Indonesia is in charge of monetary policy, which was implemented so that the quantity of money that is circulating can be managed. The provision of money is handled primarily by the Central Bank, commercial banks, and the government. These are the three main entities involved.

Previous research has demonstrated that the amount of money available has a major bearing on a number of different aspects of the economy. Real estate prices are one of the factors that are impacted when there is an increase or decrease in the availability of money. Previous research has demonstrated that restrictions governing the supply of money play a significant role in determining the value of real estate. For this reason, it is essential to pay close attention to the enabling environment in order to guarantee efficient control of the money supply (Zhou et.al, 2014). According to the findings of other pieces of research, there is a connection that runs in the opposite direction between changes in interest rates and variations in exchange rates. On the other hand, throughout the course of a longer period of time, there is a correlation between changes in the currency exchange rate and the rate of inflation (Ali et.al, 2015). It is possible to draw the following conclusion from this body of research: the quantity of money in circulation has an effect on the rate of inflation. As a result of this, it has been suggested that a method to combat inflation would be to less frequently engage in imports and to make greater use of things that are manufactured domestically. It is hoped that efforts like these will help keep the country's exchange rate stable (Amassoma et.al, 2018).

Studies have shown that there is a link between how much money is available and how much it costs to live somewhere. Most people think that changes in the price of homes affect changes in the amount of money in circulation. Because changes in the money supply can affect many parts of the market that have to do with prices, it is important to make sure the money supply doesn't get unstable (Su et.al, 2019). In the past few years, e-money has become a good alternative to traditional fiat currencies. E-money is not that different from traditional money; the only difference is how it is sent or how it looks. Because of this, the introduction of electronic currency doesn't change how the money supply is regulated or how much money is in circulation (Nizam, 2020). In the end, we can say that there are different ways to decide the

direction of monetary policy and that it is the job of the central bank in each country to keep things stable in this area. The primary objective here is to reduce the amount of volatility in the interest rates offered by various financial institutions on the money market (Ismailov, 2020).

CONCLUSION

This study aims to examine the relationship between money supply and demand and its effects on the economy. Several factors, such as interest rates and exchange rates, have been found to consistently affect the money supply and market in previous research. These factors are crucial for understanding the workings of the money market. The rate of inflation responds strongly to shifts in the supply and demand for currency. There is a correlation between the supply and demand for money in an economy and the inflation rate, or the average annual rate of price increase. Changes in the supply and demand for money, as well as the legal frameworks that control these processes, can have a significant impact on an economy's inflation rate. This research aims to add to our understanding of monetary dynamics by analyzing the impact of monetary supply and demand on inflation. The purpose of this article is to shed light on the ways in which changes in monetary supply and demand can impact on an economy. Policymakers and economists can use the study's findings to their advantage when determining how best to implement monetary policy in order to keep the economy stable and growing.

Exploring the models put forth by famous economists is crucial for making progress in our knowledge of the interplay between money's demand and supply. Future study might build upon this foundation by investigating and analyzing these models to better understand the underlying processes at play. One of the primary goals of this study is to zero in on particulars of the money supply and demand. Researchers can learn more about the elements that affect the demand for and supply of money in different economic settings if they zero in on these specific characteristics. Some of the factors that could be studied to better understand the demand for, and supply of money include interest rates, income levels, inflation rates, and technological developments. It is essential to use appropriate approaches in addition to narrowing the scope of the investigation. Large datasets can be analyzed in the future using rigorous quantitative techniques like econometric analysis. In addition, qualitative research techniques, such as case studies and interviews, can illuminate the underlying behavioral characteristics and reasons for monetary demand and supply. The dynamics of the money supply and demand can be better understood if future study thoroughly examines the models proposed by earlier economists and employs

proper methodology. This study can help clarify the intricate workings of the monetary system, allowing policymakers to better formulate monetary policies that support economic growth and stability

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