3. They act as financial intermediaries between various entities, e.g. individuals and firms. They are used to make payments to different entities, for instance through the standing orders. Buyers and sellers can be linked by a commercial bank, which clears the payment to the seller when the buyer is satisfied with the goods or services.

Commercial banks are important in an economy more because they help in daily financial transactions. Firms and companies use commercial banks for financial transactions between their client's or their employees. Therefore Financial Services in the economy becomes easier when the commercial banks are operating efficiently.

Foreign exchange (Forex) can be done in these banks. International trade encourages countries to compete with each other in provisions of goods and services among countries. Most countries use their own currencies and therefore trading with other countries would require acquisition of their currencies to enhance international trading. Since each country has different currency that has different values acquiring new currency would require currency exchange transactions. Importers may require foreign currency through the exchange of their local currency; similarly exporters may be paid with foreign currency that would be exchanged into a local currency for the transactions locally. Exchange of local currency to other foreign currencies and vice-versa is referred to as foreign exchange transaction. Commercial banks in an economy offer this service. This shows that commercial banks also contribute to the international trade and foreign exchange transactions.

Consultancy to the business community especially on investment since these banks has various expertises that are used by society to enhance

Module 4: Demand for Money

4.1.The Quantity Theory of Money the Cambridge Equation.

Money can earn interest or return when it is invested and therefore it becomes important not to stock money while you can invest for return, although you may require it for daily use. Thus money can be held to do daily transactions. The amount of money held for transaction depends on the flow of spending. The higher the flow of spending the higher the amount to hold. In this case the demand of money is the money that is used for spending. The theory that deals with the flow of spending as the determinant of demand of money is called **quantity theory of money**

Demand for money can be defined as the amount of your wealth that you wish to hold as money. Symbol MD is used to represeant demand for money.

The quantity of money we would like to hold in our wallet depends on

1. **Price level:** quantity of nominal money is proportion to price level. When the prie level rises by a certain percentage, the money held will also rise by the same rate.

2. **Interest rate:** opportunity cost of holding money is the interest rate. When you hold money , you forgo the interest rates. When the interest rate is high the money held is lower and vice versa.

3. **Real GDP:** quantity of money held depends on the amount of money to be spent. When the real GDP increases then it means there will be

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Types

1. **Creeping inflation**: Common type of inflation where the rate is between 1 and 6%
2. **Hyperinflation:** this is very high inflation rates perhaps above 100% can be referred to as hyperinflation
3. **Suppressed inflation**: demand exceeds supply but the prices are controlled through the monetary policy instruments.

Effects

1. Discourage economic growth- due to uncertainty especially in long-term investments
2. Affects Balance of payment, makes more imports than exports
3. Lack of confidence in domestic currency thus reducing the money functionalities
4. Real income falls if the workers' wages and salaries are not adjusted
5. Demand pull inflation may stimulate investment thus higher employment
6. Arbitrary redistribution of income, debtors gain while creditors lose

6.4 Anti-inflation policies and practices

Monetary policy: contractionary monetary policy can be used to control inflation implemented by Central bank

1. Raising interest rates or the cost of borrowing through sale of treasury bills in open market operations (OMO).

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