

Money Creation in the Modern Banking System: Practical Implications

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Abstract

Money creation is one of the most fundamental yet frequently misunderstood processes within modern economies. Contrary to the traditional perception that banks merely act as intermediaries between savers and borrowers, contemporary banking theory emphasizes the active role of commercial banks in creating money through the extension of credit. This presentation explores the mechanisms of money creation in the modern banking system, focusing on the interaction between commercial banks, central banks, financial markets, and regulatory institutions. Particular attention is devoted to the process by which bank lending generates new deposits, thereby expanding the money supply beyond the stock of physical currency issued by central banks. The presentation examines the theoretical foundations of endogenous money creation and contrasts them with the traditional money multiplier approach. It further discusses the role of central bank policies, including reserve requirements, interest rate management, and quantitative easing programs, in influencing the volume and cost of credit within the economy. Additionally, the impact of post-crisis regulatory frameworks, such as Basel III liquidity and capital requirements, on banks' capacity to create money is analyzed. From a practical perspective, the presentation highlights the implications of money creation for economic growth, inflation, financial stability, asset prices, and public debt management. It also addresses contemporary challenges arising from digitalization, fintech development, central bank digital currencies (CBDCs), and changing patterns of financial intermediation. By combining theoretical insights with real-world examples, the presentation provides a comprehensive understanding of how money is created in modern banking systems and why this process remains crucial for policymakers, financial institutions, businesses, and households. Understanding the dynamics of money creation is essential for evaluating monetary policy effectiveness and the broader functioning of contemporary financial systems.

Keywords: money creation, commercial banks, endogenous money, monetary policy, banking system, financial stability

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