Adnan Zaylani Mohamad Zahid: Fundamentals of money - its origin, concept and operation in the modern economy

Panel presentation by Mr Adnan Zaylani Mohamad Zahid, Deputy Governor of the Central Bank of Malaysia (Bank Negara Malaysia), at the Muzakarah Cendekiawan Syariah Nusantara 2025, Bangkok, 16 July 2025.

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Presentation slides accompanying the speech

I would like to begin by expressing my sincere appreciation to the organiser INCEIF's ISRA Institute for the invitation to speak and for their efforts in convening this important forum. Events such as this play a vital role in fostering dialogue, sharing insights, and strengthening our collective resolve to advance Malaysia's Islamic financial system.

The theme of today's event, 'Transformation of an Integrated Islamic Financial System' is both timely and relevant. It invites us to reflect on the evolving dynamics of Islamic finance industry, and more importantly, how we can collectively shape a resilient and forward-looking Islamic financial ecosystem.

As we navigate an increasingly complex global environment, Malaysia's Islamic financial sector must continue to adapt, innovate, and uphold its commitment to sound governance and inclusive growth, whilst upholding the Shariah principles.

Financial innovation calls for thinking beyond tradition

The financial landscape is evolving with many technological advancements and innovations. This shift is redefining the concept of money, necessitating a deeper exploration into its modern forms and implications. We are witnessing explorative transition from traditional instruments such as cash, coins, and digital wallets to emerging use cases like Central Bank Digital Currencies (CBDCs), stablecoins and asset tokenisation.

As we delve into such advancements, Shariah considerations must be considered. Our journey may face some challenges due to our limited understanding based on traditional thinking on the nature and essence money (for example, conceptualising money as commodity). Relying solely on mainstream interpretations may present limitations, including challenges in ascertaining future-proof policy responses and Shariah considerations.

In this regard, allow me to share in this Muzakarah today, an alternative view on money. Rethinking money beyond traditional frameworks may deliver a well-informed and future-proof policymaking.

Mainstream understanding of money is based on commodity perspective

Why does money exist and how did money emerge and developed in early human societies? The most common story is probably already familiar to all of you. This narrative is also usually told in introductory economic textbooks, even in some central banks' publication.

The mainstream narrative is that – before money exists, people barter things or commodities with each other. For example, one goat is exchanged for one bushel of corn. But this system is difficult, as the 'double coincidence of wants' is difficult to achieve.

Money is said to solve this problem of 'double coincidence of wants'. Instead of every individual trying to match their commodity with other people's desired commodity, one commodity serves as a universally-accepted countervalue.

Because money facilitates market exchange, it is defined as a medium of exchange. Therefore, any medium of exchange is considered as money. However, this story is based on economists' assumption of humans as rational beings, acting as individuals solely to maximise their own utility or benefit. If we look at actual societies in history or 'primitive' societies that exist in modern times, does this story hold?

Alternative view suggests money originated as credit

A society that operates purely on a barter system never existed. In 'primitive' societies, goods are circulated via gifts or social reciprocity or redistribution mechanism. Notice that social reciprocity is a kind of debt, except that is not legally enforced and is not precisely quantified.

Money, as a unit of account, first appeared as a measure of debt. Credit relations could and did exist without markets and medium of exchange. For example, debts arising from compensation for destruction of property, blood money, or authorities' imposition of tax.

Credit system and banking predate the first coinage by thousands of years. In ancient Mesopotamia, thousands of cuneiform tablets were found, many of which are deposit receipts and monetary contracts. Sometimes, these tablets become a bearer instrument, similar to modern promissory notes.

The earliest coins found around 700 BC are made from electrum, an alloy of gold and silver from Lydia (in modern day Turkey). But this coin's value is too high for small transactions. Evidence suggests coins are first used for state's expenditures, not day-to-day activities. Thus, money in the form of coinage developed as a social and governmental phenomenon.

In reality, all monies we use today are transferable credit / IOUs

There are more than one type of money and each is used by different people:

- Currency in Circulation (CIC) - made up mostly of physical banknotes, the rest are coins.

- Bank deposits - most common type of money now. For convenience, people keep money stored electronically in their bank accounts, such as current accounts or savings accounts.

- Central bank reserves (CB reserves) - a special type of money used by commercial banks.

All these types of money are special IOUs because it is transferable to other people as everyone in the economy. Each type of money represents an IOU from one sector of the economy to another.

Each type of money is used by different people and institutions. Consumers use CIC or bank deposits to make payments to each other. Bank deposits are also used in transactions between banks and their customers.

For payments and settlement between banks, CB reserves are used. In Malaysia, these CB reserves are operated in our RENTAS system. CB reserves are also used by the central bank in their monetary operations.

Current monetary system is a credit system of assets and liabilities

All the monies we have today are financial assets. They are claims on an agent or someone else. Non-financial assets such as land or gold are not claims on anyone – they are commodities.

Because financial assets are claims, they are also financial liabilities. One person's financial asset must be someone else's or institution's debt. Commodities, or non-financial assets, do not have a corresponding debt or liability.

Money is both an asset and a liability, and the monetary system is a credit system of asset and liabilities. There is no physical form, only data points and entry balances. As this stylised diagram indicates (refer to slide 6), all the money we have today are interconnected. Each type of money is recorded twice, as assets and liabilities on different balance sheets.

Bank deposits are liabilities of commercial banks. They represent debt obligation of the commercial bank to their depositors. Physical CIC, although usually not seen by the public as liabilities, are in fact, IOUs, book-keeping entries inscribed on paper and coins.

Different types of money are issued by different issuers as liabilities

Not all money are issued by the central bank. In fact, most money in the economy are issued by the commercial banks, in the form of bank deposits. Money issued by central banks are public money, since it is backed by the state, while money issued by commercial banks are private money, as they are claims on the commercial banks themselves.

It is important here to clarify that when money is issued, either by the central bank or commercial banks, they are issued as liabilities of the issuer, not as assets.

Analogically, if a person buys a new phone on an instalment basis, he/she now owes the phone shop (the seller) and has effectively 'issued' a liability, in exchange for the new phone.

Deposit liabilities are exchanged for other IOUs. For example, when a customer deposits physical cash in a bank, the bank issues its new liability in the form of new bank deposits which is the customer's new asset. The customer will see his account credited.

Most deposits however, are created when banks make loans by creating a matching deposit in the borrower's bank account. The bank do not lend out CIC nor existing bank deposits to the borrower.

Loan does not come from existing money, but rather, loan creates new money

The money creation process by the commercial banking system is not generally understood by the public, despite numerous publications by many central banks after the global financial crisis in 2008.

One misconception still widely held is that banks simply act as intermediaries of money between savers and borrowers. In this understanding, money that is lent to the borrowers comes from existing deposits, i.e., deposits create loans. The reality is, as explained earlier, money in the form of bank deposits are created by commercial banks in their act of lending, i.e., loans create deposits.

Banks are still intermediaries, but in credit. If someone wants to buy a house from a seller, the bank intermediates between the buyer and seller, by substituting the buyer's IOU for its (the bank's) own IOU.

A second misconception is that bank lending are limited by the amount of CB reserves. The higher the reserve requirement, the lesser the money multiplies. In reality, the central bank targets the interest rate as its monetary policy tool, not the amount of reserves. Commercial banks then decide how much to lend based on profitable opportunities.

Trust ensures money in the credit-based system, works

Money, as an IOU, requires trust. An IOU is only accepted if the issuer is trustworthy. When the 'I' and the 'U' are strangers, institutions are needed to establish and maintain the trust. In this manner, any money that is issued can be used elsewhere in exchange for goods and services.

On bank deposits (commercial bank money), people must trust that it can be withdrawn for cash and the value of bank deposits stay at par to CIC. This is maintained in a few ways:

- Ensuring acceptability for tax payments. This ensures that money will always find a willing receiver, i.e., the government.

- Deposit insurance scheme provides assurance that withdrawals can always be made up to a certain amount.
- Access to central bank liquidity via various facilities. The central bank will always accommodate the banking system's need for liquidity, provided that the commercial bank is financially sound.

Most importantly, for people to use money, they must trust that its value does not change much from time to time. This monetary stability is maintained by the central bank through, first, clear objectives and second, the ability to meet the objectives, equipped with suitable tools.

Promoting monetary stability is part of key mandates of BNM

As per the Central Bank of Malaysia Act 2009 (CBA 2009), one of the principal objectives of BNM is to promote monetary stability conducive to the sustainable growth of the Malaysian economy, along with ensuring financial stability.

BNM is mandated to pursue the primary monetary stability objective of 'maintaining price stability' while giving 'due regard to the developments in the economy'.

- Price stability means preserving the domestic purchasing power which will help facilitate long-term sustainable growth and ensure that inflation is kept low and stable.
- Economic growth happens when the size of the economy increases over time measured by the gross domestic product (GDP).
- Sustainable growth is the rate at which the economy can keep growing at a steady pace over a long period to ensure positive outcomes for the economy

In essence, monetary policy is one of the primary tools to manage inflation through its effect on overall demand conditions. Although it is necessary, it is not sufficient on its own to fully address the issue. This will be complemented with other relevant measures.

Overnight Policy Rate as monetary policy tool to achieve monetary stability

BNM, through its Monetary Policy Committee (MPC), executes monetary policy responsibility by determining and adjusting the Overnight Policy Rate (OPR). The OPR is the sole indicator used to signal the stance of monetary policy and is announced through the Monetary Policy Statement (MPS).

During strong demand and high inflation, BNM raises the OPR which makes it more expensive for banks to borrow money. Consumer borrowing becomes more expensive, while savings become more attractive. These discourage spending and investment, eventually lowering demand. This dampens the pressure on prices, containing inflation.

Relying on monetary policy alone is not sufficient to address rising inflation. In addition to that, monetary policy takes effect with a lag (estimated to be up to 2 years). The outcome depends on the impact to the behaviour of banks, consumers, businesses and the overall demand. This delay means prices might continue rising for a while before stabilising.

Therefore, addressing inflation would require other complementary policy tools to influence prices borne by households, especially those affected by supply factors. For example, fiscal policy can complement monetary policy to manage inflation.

Closing

Reflecting on the updated understanding of the 'modern money as credit', this brings about the need to assess on whether there should also be an updated or alternative view on modern money and its creation from the Shariah perspective.

I believe this Muzakarah will serve as a good avenue for the great minds of the Shariah fraternity to have a meaningful discussion with regards to this pertinent topic.

There is indeed no straight forward answer to this and would require in-depth analysis and detailed assessment both from theoretical and implementation perspectives. It involves continuous dialogue with key stakeholders i.e. Shariah scholars, regulators, macro-economists, industry practitioners, as well as the public, where relevant.

To conclude, I wish to thank the organiser for having me today. It has been an honour to speak in front of esteemed and prominent Shariah leaders from various parts of the Nusantara.

I sincerely hope that my presentation today does justice to the recently published BNM Working Paper on '*Fundamentals of Modern Money and its application to Central Bank Digital Currency (CBDC) – An Exploratory Shariah Analysis'* by the research team at the Islamic Finance Department of BNM, which can be accessed publicly on the BNM Website. I wish the attendees a fruitful discussion throughout this Muzakarah, insyaAllah.

Thank you.