

Fundamentals of Money: Its Origin, Concept and Operation in the Modern Economy

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BANK NEGARA MALAYSIA
CENTRAL BANK OF MALAYSIA



Presentation Outlines

1. Background
2. Nature and historical origin of money
3. Money in the modern economy
4. Where does money come from?
5. Trust vis-à-vis acceptability of money
6. Role of central bank in managing money (monetary policy)

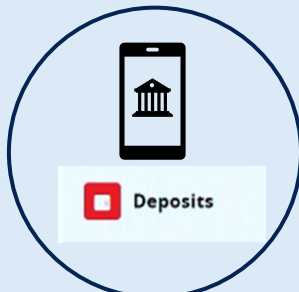
Financial innovation calls for thinking beyond tradition

Understanding money beyond traditional thinking enables forward-looking policymaking

Present



**Bank notes and
coins**



Deposits



**Electronic money
(E-money)**



*....driven by
technology
advancement &
innovation*

On-going advancements



**Central Bank
Digital Currency
(CBDC)**



Stablecoins



Asset tokenisation



Traditional thinking of money may have its limitations



Rethinking money beyond traditional frameworks will deliver well-informed & futureproof policymaking

Mainstream understanding of money is based on commodity perspective

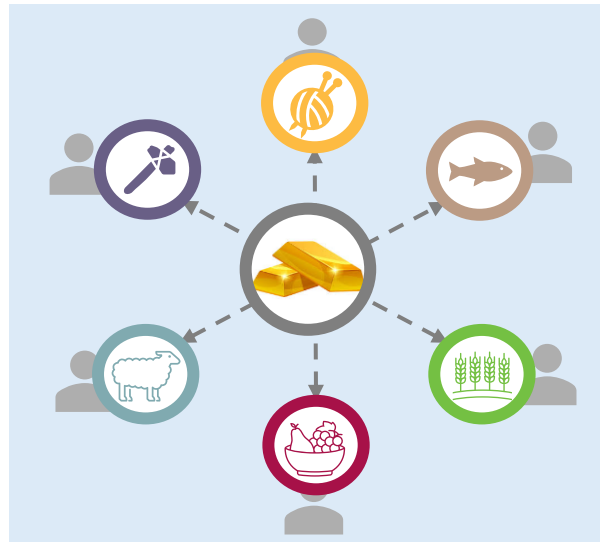
Money emerges from barter, where one commodity become money

1 First there was barter...



Money emerges from the exchange of commodities (C)

2 ...then there is money



One commodity becomes money (M)
– the essence of money is also commodity

? Assumptions and problems

- Money emerges from rational individuals, interacting in market exchange
- This ignores historical reality that suggests money originated from credit (not barter)

Sources:

1. Goodhart (2009) - *The Continuing Muddles of Monetary Theory: A Steadfast Refusal to Face Facts*
2. Ingham (2004) - *The Nature of Money*

Alternative view suggests money originated as credit

It is a social technology to facilitate social and economic exchange

What anthropology tells us...

1 A 'pure' barter system never existed

'Primitive' societies operate on gift/redistribution mechanism. Barter occurs only between strangers or when money is not available

2 Money first emerged as a measure of debt

- Debts resulted from compensation for blood or destruction of property
- Value of things are measured without the mechanism of market exchange

...complemented by what history tells us

1 Money existed thousands of years before coinage



Ancient Sumerian clay tablet
≈ 3000 BC



Lydian electrum coin
≈ 700 BC

2 The state played a crucial role in money's evolution

Coins are first used for state's expenditures, not for commercial and economic needs

Sources:

1. Davies (2002) – *A History of Money, From Ancient Times to The Present Day*
2. Graeber (2011) – *Debt: The First 5000 Years*
3. Grierson (1970) – *The Origins of Money*

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

Each money represents an IOU from one sector of the economy to another

This is money...

...these are also money

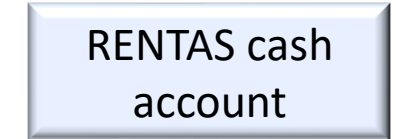
1 There is more than one type of money



Banknotes/ coins



Bank deposits



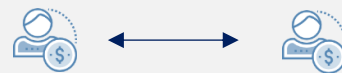
Central bank reserves

2 All monies are IOUs

Central bank's IOU

Commercial banks' IOU

Central banks' IOU



- Transactions between non-banks



- Transactions between non-banks



- Banks' loan operation
- Banks' expenses



- Interbank settlements



- Monetary policy operation
- FX intervention

3 Each money serves different function



Depositors (non-bank)



Banks

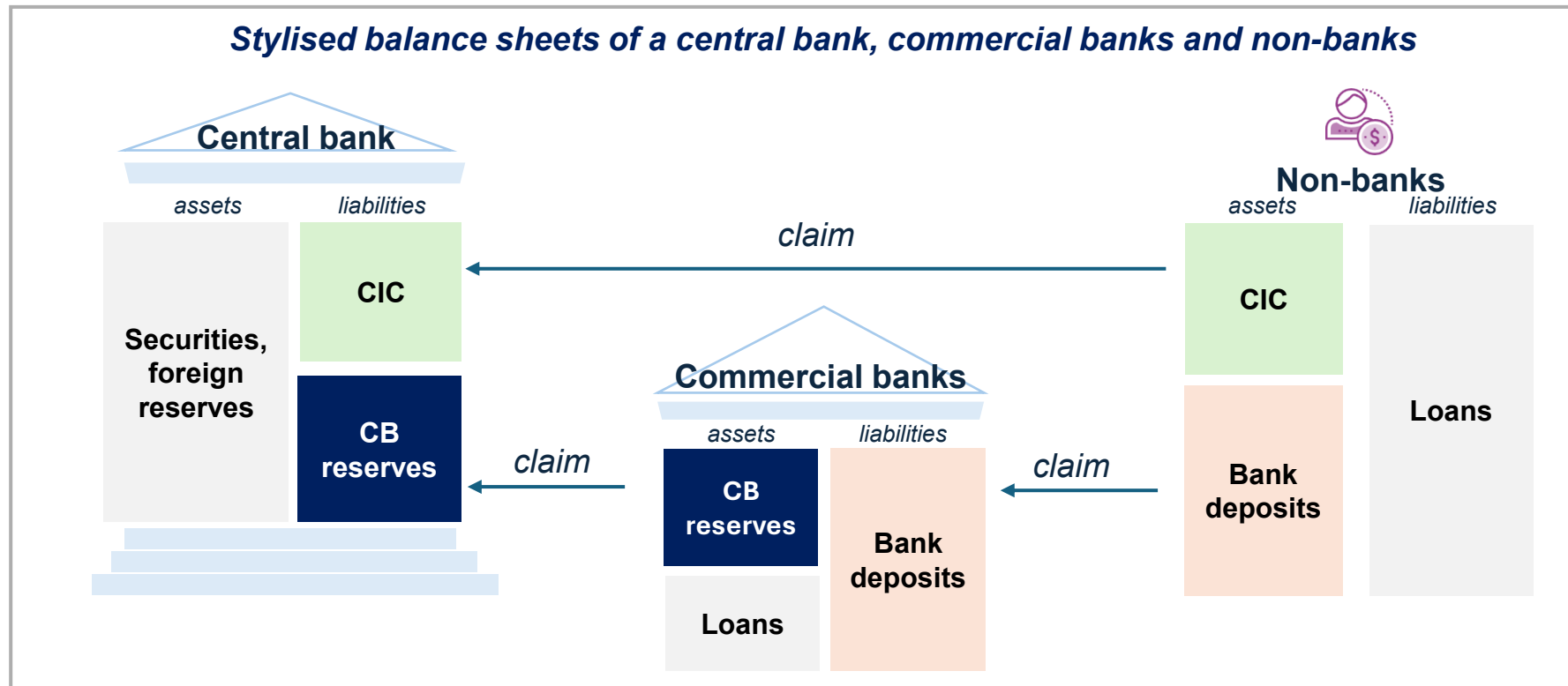


Central bank (CB)

Current monetary system is credit system of assets and liabilities

Banknotes and coins are mere physical form of credit record

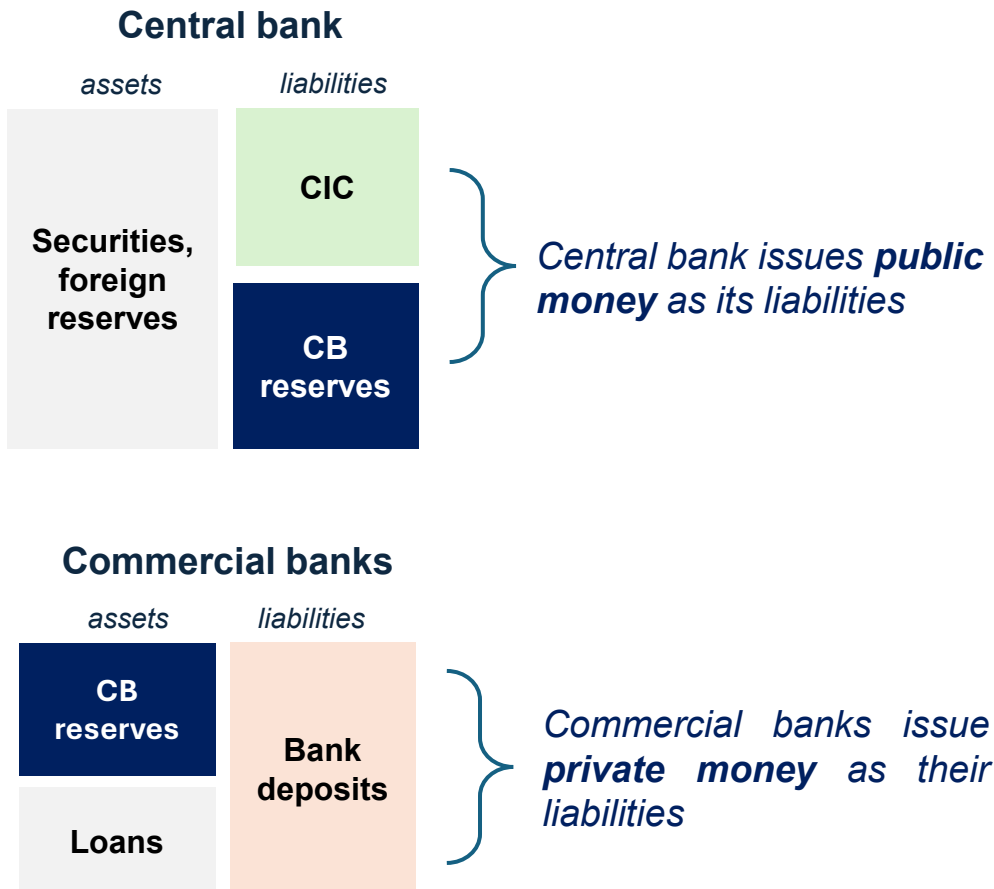
- 1 Money is both an asset and a liability e.g., **CIC** are liabilities of the central bank, asset to non-banks
- 2 Asset represents a claim on others e.g., **CB Reserves** are claims on the central bank
- 3 Liability represent a claim from others e.g., **Bank deposits** are claims from non-banks



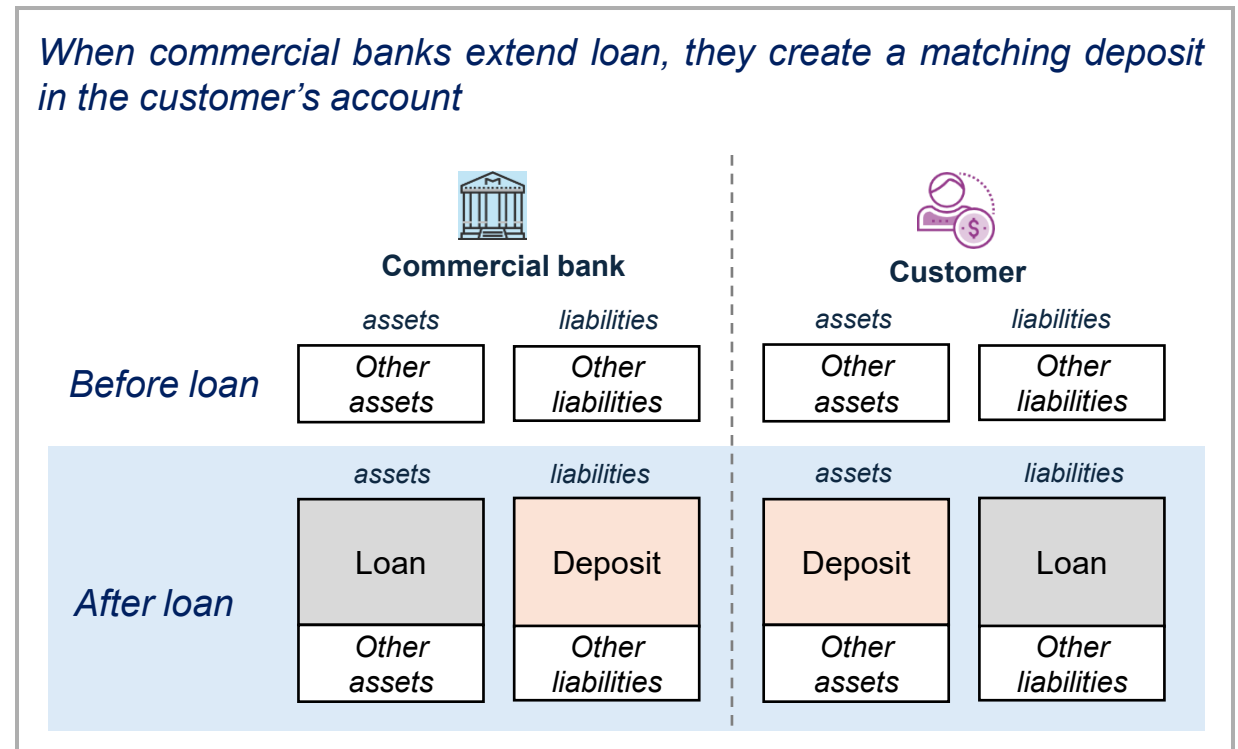
Different types of money are issued by different issuers as their liabilities

Most money today are created by commercial banks when they extend loan

1 Different money are issued by different institutions, as their liabilities



2 ≈ 94% of money are in the form of bank deposits, created primarily when banks extend loan



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

Credit creation is not constrained by the availability of existing money

Common misunderstanding on money creation

1 Bank loan comes from existing deposits, after putting some aside as reserves

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2 Commercial banks' loans are constrained by the amount of reserves

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Accurate understanding of money creation

Banks extend loans by creating bank deposits, not from existing deposits

- Loan creates deposits - banks can create deposits but not CB reserves

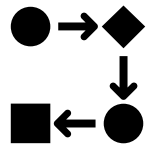
Money creation is limited by demand for credit

- The supply of money is determined by the demand of economy itself (endogenous).
- Central bank controls the interest rate, which affects demand and supply of credit

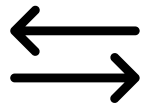
Trust ensures money in the credit-based system ‘works’

Money is used when there is trust in its future re-exchangeability

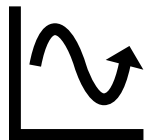
1 Trust is necessary in money’s acceptability



Trust that the **same money can be used elsewhere**



Trust that **commercial bank money is always exchangeable** with central bank money



Trust that **money’s value does not change much** from time to time.



2 Trust is better established and reinforced through institutions

Trust in money comes from trust in its issuer (e.g. central bank and other trusted institutions)

Uniformity and substitutability of money is guaranteed by:

- Acceptability to pay tax
- Insurance of bank deposits
- Access to central bank liquidity (lender of last resort)

Monetary stability is maintained by the **central bank** through :

- Clear objectives
- Appropriate tools and competence to meet the objectives

Sources:

1. Cunliffe (2021) – Do We Need Public Money?
2. King (2006) – Trusting in Money, from Kirkcaldy to the MPC
3. Ryan-Collins et al. (2011) – Where Does Money Come From?: A Guide to the UK Monetary and Banking System

Promoting monetary stability is part of key mandates of BNM

Monetary stability is achieved by clear objectives and appropriate policy tools



*"In promoting monetary stability, the Bank shall pursue a monetary policy which serves the interests of the country with the primary objective of **maintaining price stability giving due regard to the developments in the economy.**"*

Legislated in the Malaysian Central Banking Act (CBA) 2009, Part V, 22. (1)

What is the key mandate of central bank?

- As the central bank of Malaysia, BNM's mandate is to promote **monetary stability** and **financial stability**.
- This is aimed at providing the conditions suitable for **sustainable growth** of the Malaysian economy.

What is Monetary Stability?

- Monetary Stability can be understood as an environment of **stable prices** and **sustainable growth**.



Low and stable inflation – allows households and businesses to plan how much to spend, save and invest



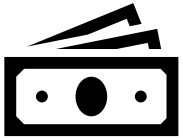
Sustainable growth – keeps economy growing at steady pace over a long period

Overnight Policy Rate as monetary policy tool to achieve monetary stability



What is OPR?

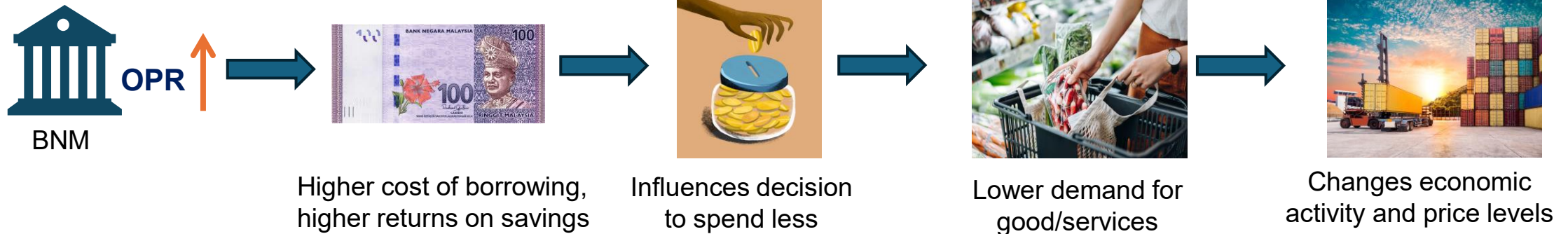
The OPR is the **benchmark policy rate** at which BNM influences the Average Overnight Rate that banks charge each other for lending/ financing



How OPR works & How does BNM influence the direction of economy by influencing the “price of money”?

By controlling OPR, BNM attempts to **influence the consumption** and **investment decisions** of individuals, firms, and eventually the economy

For example, when OPR increases...



Complemented by...

Fiscal policy

Sound capital flows management

Macroprudential measures

Closing remarks

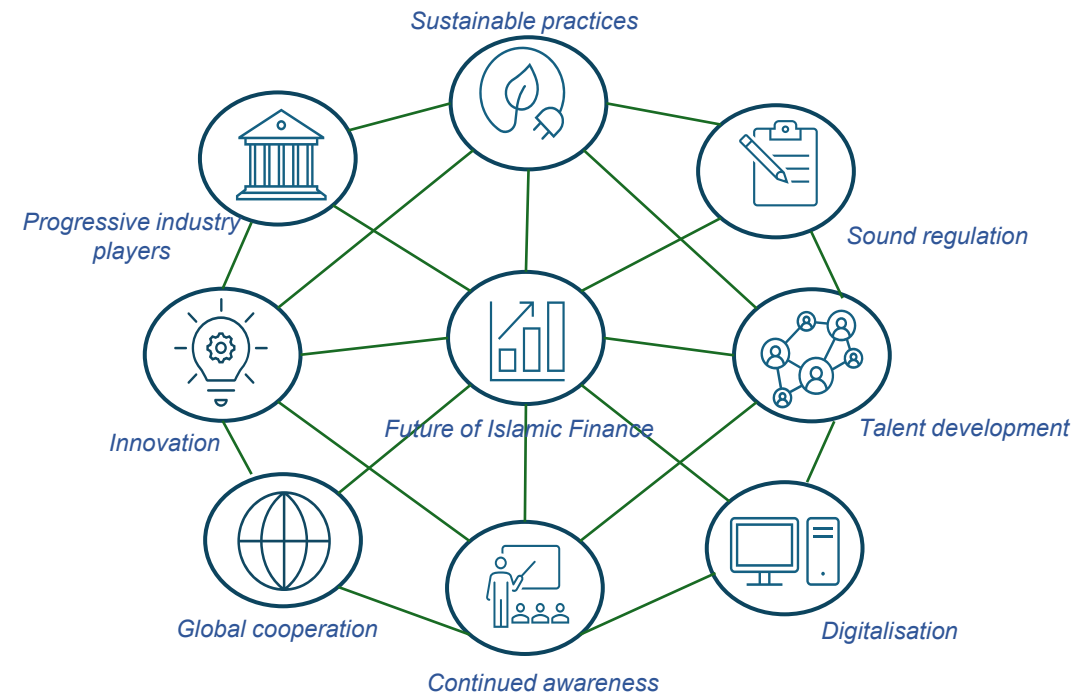


Reflecting on the updated understanding of *'modern money as credit'*, should there be updated/ alternative view(s) on modern money and its creation from Shariah perspective?

THANK YOU



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