# Money Multiplier Formula

Money multiplier is a term in monetary economics that is a phenomenon of creating money in the economy in the form of credit creation, based on the fractional reserve banking system.

Money multiplier is also known as monetary multiplier and is the maximum limit to which money supply can be affected by bringing about changes in the amount of money deposits.

Money multiplier effect is seen in commercial banks as they accept deposits and after keeping a certain amount as reserve, distribute the money as loans for injecting liquidity in the economy.

The amount of money that should be kept by commercial banks in their reserve for withdrawal purposes by the customers is referred to as the reserve ratio or required reserve ratio or cash reserve ratio.

Mathematically, money multiplier formula can be represented as

Money Multiplier = 1/ r

Where r = Required reserve ratio or cash reserve ratio

It means that if the reserve ratio is higher, then the money multiplier will be lower and the banks need to keep more reserves. As a result, they will not be able to lend more money to individuals and businesses.

Similarly, a lower reserve ratio results in a higher money multiplier which allows a lesser amount of money to be kept as reserve and more lending opportunities to the public.