

## UNIT 7

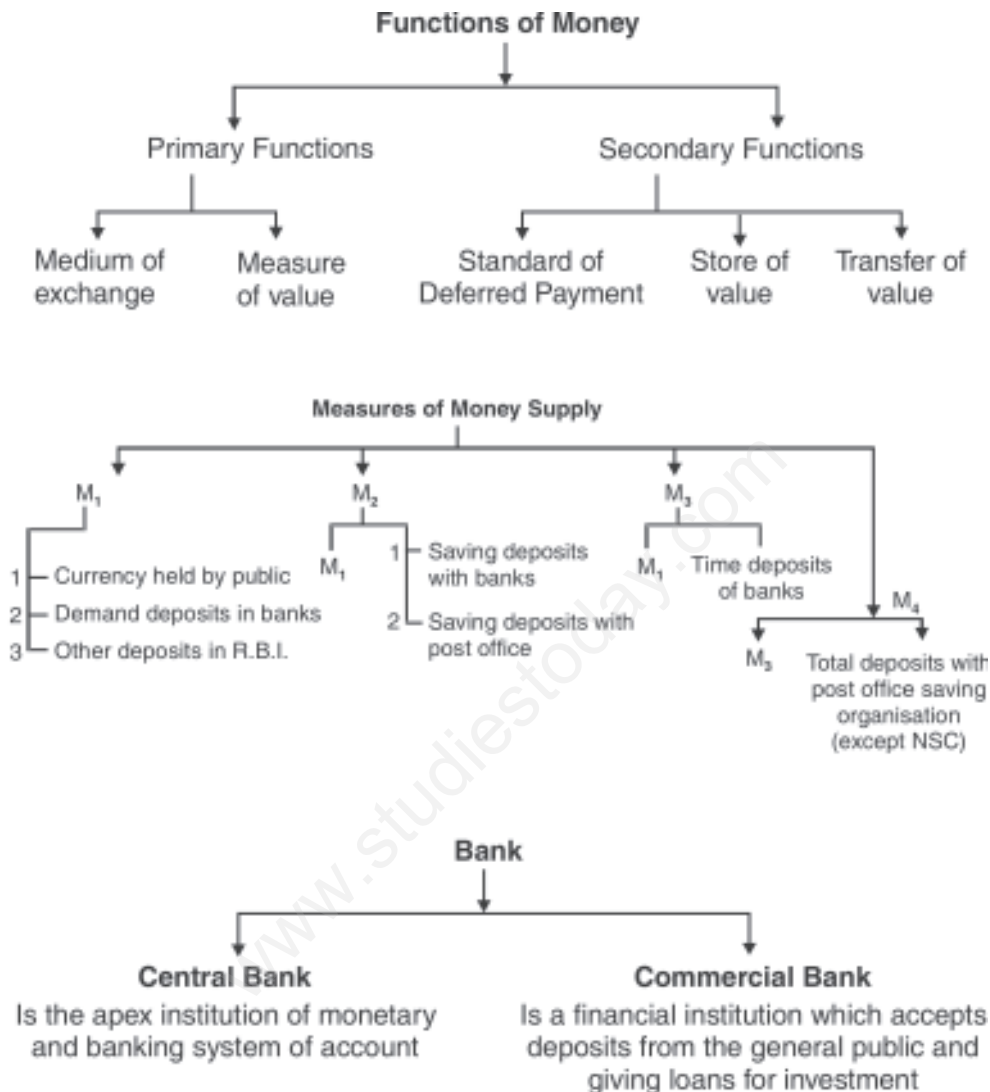
# MONEY AND BANKING

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### POINTS TO REMEMBER

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- ❑ **Money** : Money may be defined as anything which is generally acceptable as a medium of exchange and does the function of 'unit of account' and measures of value.
- ❑ **Barter Exchange** : It is a system of exchange in which transactions are made by exchange of goods.
- ❑ **Difficulties involved in the Barter Exchange**
  1. Absence of a common unit.
  2. The lack of double coincidence of wants
  3. Lacks of any satisfactory units to engage in contracts involving future payments.
  4. Does not provide for any method of storing generalised purchasing power.
  5. Lack of divisibility.
- ❑ **Supply of Money** : Total stock of money with the public at a given point of time.
- ❑ **Commercial Banks** : Commercial Banks is a financial institution who accepts deposits from the general public and provide loans facilities.
- ❑ **Central Banks** : The central Bank is the apex institution of monetary and banking system of country.



### Functions of Central Banks

1. Currency Authority
2. Banker to Govt.
3. Banker's Bank and Supervisor.
4. Lender of Last resort

5. Custodian of foreign exchange.
6. Controller of money supply and credit.

### **MONEY CREATION CREDIT CREATION BY COMMERCIAL BANKS**

$K =$

$K =$  Credit Multiplier

$R =$  Cash reserve ratio

### **VERY SHORT ANSWER TYPE QUESTIONS (1 MARK)**

1. Define money.
2. What is meant by M.
3. What is meant by the term money supply?
4. What is bank rate?  $\frac{1}{2}\%$
5. State two primary functions of money.
6. What is meant by credit creation?
7. What is credit multiplier?
8. Write two functions of central banks.
9. What is cash reserve ratio (CRR)?
10. What is statutory liquidity ratio (SLR)?
11. What is demand deposits by banks?
12. State two monetary measures of credit control by central bank.
13. What are various money stock measures?

### **H.O.T.S.**

14. What is margin requirement of loans.

**SHORT ANSWER TYPE QUESTIONS (3-4 MARKS)**

1. Explain the function of money as 'Unit of value'.
2. How does money solve the problem of double coincidence of wants?
3. Explain 'Store of value' function of money.
4. What are open market operations? What is their effect on availability of credit?
5. Explain the 'lender of last resort' function of central bank.
6. Distinguish between SLR and CRR. Explain the Role of SLR and CRR in credit control.
7. How does changes in Bank rate affect money creation by commercial Bank? Explain.
8. State the role of central Bank as a banker of the Government.
9. State any four functions of money.
10. Explain the 'Standard of deferred payment'.
11. How central bank is controller of credit?
12. Explain how does followings helps to control the credit creation.
  - (i) Open market operation
  - (ii) Margin requirement of loans

**H.O.T.S.**

13. What is meant by statutory liquidity ratio (SLR). State the effect of rise in rate of SLR on creation of credit.
14. Explain 'currency authority' and 'controller of credit' functions of central bank.
15. Explain effect of increase in bank rate on credit creation by commercial banks.

### LONG ANSWER TYPE QUESTIONS (6 MARKS)

1. Define Central Bank. What are the functions of Central Bank?
2. Explain any four functions of money.
3. How does a central bank influence credit creation by commercial banks through 'open market operation' explain.
4. Explain the process of credit creation or money creation by commercial banks with the help of numerical example.

### ANSWERS

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#### 1 MARK QUESTIONS

1. Any thing which is generally acceptable by the people as medium of exchange, measure of value, standard of deferred payment and performs the function of store of value.
2.  $M_1$  = currency held with public + demand deposit in banks + other deposit in RBI.
3. Total stock of money which are held by the public at a particular point of time in an Economy.  $\frac{1}{LRR}$
4. Rate at which central bank lends to the commercial bank.
5.
  1. Medium of Exchange
  2. Measure of value
6. Credit creation means power to expand demand deposits of Commercial Banks.
7. Credit multiplier measures, number of times deposits are multiplied as credit.

Credit multiplier =

8.
  - (i) Currency Authority
  - (ii) Controller of money and credit

9. Commercial Banks are required under law to keep a certain percentage of their total deposit in the central banks in the form of cash reserves. This is called CRR.
10. Every Commercial Bank is required to keep a fixed percentage (ratio) of its assets in liquid form, called SLR.
11. Demand deposits are deposits which can be withdrawn from bank at any time by the account holder.
12. (i) Bank Rate policy.  
(ii) Open market operation
13. Following four measures of money stock are used.  
$$M1 = C + DD + OD$$
$$M2 = M1 + \text{Saving deposit in Post Office Saving banks.}$$
$$M3 = M1 + \text{Net time deposit of banks}$$
$$M4 = M3 + \text{Total deposits with post office saving organisation (except NSC).}$$

### HOTS

14. Marginal requirement of loan means the difference in percentage between the amount of the loan and market value of the security offered by the borrower against the loan.

### HINTS

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#### 3-4 MARKS QUESTIONS

11. Quantitative measures and qualitative measures of monetary policy.
13. Increase in SLR reduces credit availability.