Money And Bank

Very Short Answer Type Questions (1Mark)

1. **Define money.**
   Ans. 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. **What is meant by M.**
   Ans. M_1 = currency held with public + demand deposit in banks + other deposit in RBI.
3. **What is meant by the term money supply?**
   Ans. Total stock of money which are held by the public at a particular point of time in an Economy.
4. **What is bank rate?**
   Ans. Rate at which central bank lends to the commercial bank.
5. **State two primary functions of money.**
   Ans. 1. Medium of Exchange
   2. Measure of value
6. **What is meant by credit creation?**
   Ans. Credit creation means power to expand demand deposits of Commercial Banks.
7. **What is credit multiplier?**
   Ans. Credit multiplier measures, number of times deposits are multiplied as credit.
   Credit multiplier = $\frac{1}{Reserve\ requirement}$
   $m = \frac{1}{R}$
8. **Write two functions of central banks.**
   Ans. (i) Currency Authority
   (ii) Controller of money and credit
9. **What is cash reserve ratio (CRR)?**
   Ans. 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. **What is statutory liquidity ratio (SLR)?**

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Ans. Every Commercial Bank is required to keep a fixed percentage (ratio) of its assets in liquid form, called SLR.

11. **What is demand deposits by banks?**

    Ans. Demand deposits are deposits which can be withdrawn from bank at any time by the account holder.

12. **State two monetary measures of credit control by central bank.**

    Ans. (i) Bank Rate policy.

    (ii) Open market operation

13. **What are various money stock measures?**

    Ans. Following four measures of money stock are used.

    M1 = C + DD + OD

    M2 = M1 + Saving deposit in Post Office Saving banks.

    M3 = M1 + Net time deposit of banks

    M4 = M3 + Total deposits with post office saving organisation (except NSC).

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Short Answer Type Questions(3-4 Marks)

1. **Explain the significance of the 'Store of Value' function of money.**

   OR

   State the importance of the 'Store of Value function of money.

   Ans. People save a part of their earnings for use in future. But in what form Money fulfills this need of the people. Money as a store of value means that money is an asset and can be stored for use in future one can hold one's earnings until the time one wants to spend it. This is the store of value function of Money.
2. **Explain the 'Unit of Account' function of money?**

   Ans. The 'Unit of Account' function of money is also called the 'measure of value' function. Money as a unit of account means a standard unit for quoting prices. It makes money a powerful medium of comparing prices of goods and services.
3. **Explain the 'Medium of Exchange' function of money?**

   Ans. Money as a medium of exchange means money as a means of payment for exchange of goods and services. Goods and services are exchanged for money when people sell things. Money is exchanged for goods and services when people buy things. The medium of exchange function of money solves the problem of double coincidence of wants inherent in the barter system of trade.
4. **Explain the "Lender of Last Resort' function of the central bank.**

   Ans. Central bank also lends money directly to commercial banks. Instead of rediscounting, central bank given loans against the bill of exchange promissory notes, treasury bills, government securities, etc. The direct lending to commercial bank is referred to as the 'lender of the last resort' function of central bank.
5. **Explain the "Government's Bank" function of a central bank.**

   Ans. A central bank conducts the banking account of government departments. It performs the same banking functions for the government as commercial bank performs for its customers. It accepts their deposits and undertakes inter-bank transfers. It also gives loans to the government. A central bank also provides various services as agent of the government. It manages public debt. It also gives advice to the government regarding money market, capital market, government loans and economic policy matters.

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Higher Order Thinking Skills

1. **What is the main function of money in an economy?**
   Ans. The main function of money in an economic system is to facilitate the exchange of Goods and services.
2. **Name the System of Note-issue in India.**
   Ans. In India, the system of note issue is the Minimum Reserve System. The RBI is required to keep minimum reserves of Rs 200 crores.
3. **Define open Market operation.**
   Ans Open Market operations refer to the purchase or sale of government securities in the open market by the central bank of the country.
4. **Name the additional facility which the businessman gets in the current deposit account of the bank.**
   Ans. The businessman gets the facility of overdraft (OD) in the current account of the bank.
5. **Money acts as a yardstick of standard measure of value to which all other things can be compared. Discuss it.**
   Ans. Money serves as a measure of value in terms of unit of account. Measurement of value Was the main difficulty of the barter system. Introduction of money has removed this difficulty. It acts as a yardstick of standard measure of value to which all other things can be compared." Money measures the value of everything or the prices of all goods and services can be expressed in terms of money. This function of money also enables the trading firms to ascertain their costs, revenues, profits and losses.
6. **The central bank acts as lender of last resort. How?**
   Ans. The central bank also acts as lender of last resort for the other banks of the country. It means that if a commercial bank fails to get financial accommodation from anywhere, it approaches the central bank as a last resort. Central bank advances loan to such a bank against approved securities. As a lender of the last resort, central bank exercises control over the entire banking system of the country.

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7. **Central bank performs the function of a clearing house. How?**
   Ans. Every bank keeps cash reserves with the central bank. The claims of banks against one another can be easily and conveniently settled by simple transfers from and to their account. Supposing, Bank A receives a cheque of Rs 10,000 drawn on Bank B and Bank B receives a cheque of Rs. 15000 drawn on Bank A. The most convenient method of settling or clearing their mutual claims is that Bank A should issue a cheque amounting to Rs 5000 in favour of Bank B, drawn on central Bank. As a result of this transference, a sum of Rs 5000 will be debited to the account of Bank A and credited to the account of B. There is not need of cash transactions between the banks concerned. It facilitates cash transaction across the entire banking system, it also reduces requirement of cash reserves of the commercial banks.
8. **All the currency issued by the central bank is its monetary liability. How?**
   Ans. The Central Bank is obliged to back the currency with assets of equal value. These assets usually consist of gold coin, gold bullion, foreign securities and the domestic government's local currency securities. The country's Central government is usually authorised to borrow money from the central bank. Government does this, by selling local currency securities to the central bank. When the central bank acquires these securities, it issues currency. Putting and withdrawing currency into and from circulation is also the job of the central bank.
9. **What is margin requirement of loans.**
   Ans. 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.

LONG ANSWER TYPE QUESTIONS (6 MARKS)

1. **What do you mean by credit/money creation? Explain the process of Money creation by the commercial banks with the help of a numerical example.**
   Ans. Money creation is a process in which a commercial bank creates total deposits many times the initial deposits.
   The capacity of commercial bank to create depends on two factors:
   1. Amount of initial fresh deposit
   2. Legal reserve ratio LRR

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Money multiplier = $\frac{1}{LRR}$

Money Creation = Initial Deposit ·

Money multiplier

The Working :

Suppose (i) Initial Deposit = Rs. 1000 (ii) LRR = 20%

As required, the bank keeps 20% ie Rs. 200 as cash reserve and lend the remaining Rs. 800. Those who borrow use the money for making payments. As assumed those who receive these payments put the money back into their bank accounts. This creates a fresh deposit of Rs. 800. The bank again keep 20% ie Rs. 160 and lend Rs. 640. In this way the money goes on multiplying leading to total money creation of Rs. 5000.

Money creation = Initial Deposit · $\frac{1}{LRR}$ = 1000 ·

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