Gujarat Board Textbook Solutions Class 12 Economics Chapter 4 Banking and Monetary Policy

Choose the correct option for the following questions :

Question 1. What is the meaning of the word 'bank'?
(a) Money supply
(b) Stock of money
(c) Investment
(d) Commerce
Answer:
(b) Stock of money

Question 2. How many major types of deposits exist in banks in India?
(a) 2
(b) 6
(c) 10
(d) 3
Answer:
(d) 3

Question 3. Short term lending in theoretical sense is _____ for what period?
(a) Up to 1 year
(b) 1 to 3 years
(c) 1 to 5 years
(d) 5 to 15 years
Answer:
(a) Up to 1 year

Question 4. What is a central bank?
(a) A private bank
(b) An apex bank
(c) A cooperative bank
(d) A foreign bank
Answer:
(b) An apex bank

Question 5. What is the rate at which RBI borrows funds for very short term from the commercial banks is called?
(a) Repo rate
(b) Bank rate
(c) Reverse repo rate
(d) Open market rate

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Answer:
(c) Reverse repo rate

2. Answer the following questions in one line :

Question 1. Give the meaning of a bank.
Answer:
A Bank is a commercial organization functioning for profit which accepts peoples' savings in the form of deposits and pay interest in return. It ensures the safety of these deposits, lends money from these deposits to people who need money by charging them with interest, and invests the surplus funds for development of the nation.

Question 2. Give the meaning of a commercial bank.
Answer:
According to the Banking Company Act,"Commercial bank is the one which transacts the business of banking, that is, accepting deposits from the people for the purpose of lending or investment; repayable on demand or otherwise and withdrawable by cheque, draft, pay-order or otherwise.

Question 3. Give the meaning of a central bank.
Answer:
Central bank is the apex bank of the country whose function is to aid, regulate and promote the entire money/financial market and the banking sector, as well as maintain monetary/financial stability by overall economic good of the nation.

Question 4. Give the meaning of monetary policy.
Answer:
The policy undertaken by the apex bank for regulating the supply of money in order to maintain economic stability keeping into consideration the process of economic development and interest of public is called monetary policy.

Question 5. What is meant by quantitative tools of monetary policy?
Answer:
Quantitative measures are general measures that influence the overall economy i.e. measures that have an impact on the economy in general.

Question 6. What is meant by qualitative tools of monetary policy?
Answer:
[Qualitative tools of monetary policy are selected by RBI based on the impact of credit for development of certain sectors or segments of the economy.]

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3. Answer the following questions in brief :

Question 1. How did the word 'bank' originate?
Answer:
Evolution of banks:

- The word 'bank' means 'mass' or 'heap'. 'Bank' word has been originated from the French word 'banque' and Italian word 'banca' both meaning 'Bench' for money exchange.
- In Sanskrit, the word similar to bank is 'bhanda' which means collection of fund/capital.
- Traditionally, the money lenders in Europe displayed coins (currencies) of different countries in big heaps on benches or tables for lending or exchanging.
- Thus, the word bank means collection/fund/stock of money.
- The first bank to be set up in the world was 'Bank of Barcelona' in Spain in 1401.
- It was then, that the currency money was introduced in the world.

Question 2. Give an idea of the accounts of a commercial bank.
Answer:
A commercial bank is a business unit that provides banking services for profit.
(A) Primary functions:
Accepting deposits:
A bank acts as a custodian by accepting people s' savings in the form of deposits and gives interest in return.

Types of deposits a bank accepts:
There are four different ways in which a bank accepts deposits.
They are:

1. Current Account Deposits,
2. Savings Account Deposits,
3. Recurring Deposit Account and
4. Fixed Deposits.

A customer may deposit money in banks by opening any of these accounts.

1. Current account deposits:
A business, firm or an individual can open a current account with the bank. The main objective of this account is to conduct business related transactions.

- Bank provides more liquidity to current account i.e. money can be withdrawn number of times during a day.
- No interest is given to the customers of current account. At times, bank charges service charge on this account.

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- The bank also provides over-draft facility on this account i.e. the customer is able to withdraw more money than the available balance in the account
- This overdraft facility helps the business or an individual to overcome short term money deficiency.

2. Savings account deposits:

- A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account.
- Majority of people use savings account to deposit their savings as bank provides interest on this account.
- The account holder can withdraw money using cheque, withdrawal slip, debit card and credit card.

3. Recurring deposits:

- This type of deposit accounts allows people to deposit small amount of money every month.
- The deposit gradually increases and the bank provides interest on the accumulated amount.
- Some banks may charge penalty along with some interest loss if a person is not able to deposit money in this account in a particular month.

4. Fixed/ Long term deposits:

- People who want to deposit their money for long-duration opt for fixed deposits.
- These deposits are fixed in nature and thus, money cannot be withdrawn as and when required by the depositor.

Banks pay highest rate of interest as compared to other deposit accounts. Banks also provide overdraft facility on such deposits.

Question 3. Write a note on qualitative tools of monetary policy.
Answer:
Qualitative measures:

1. Collateral security:

- When bank lends money to individual, it demands some asset as mortgage for security of the loan. This is known as collateral security.
- This security can be jewelry, fixed deposits, car, house, land, etc.
- RBI promotes and encourages commercial banks to take such steps so that all the segments of people especially poor in India can attain the benefit of bank credit and hence help to improve country’s economy.

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2. Margin requirement:

- Margin requirement is the limit that is set by RBI for granting loans against security.
- An individual is offered only certain percentage of the total value of the asset (security) as loan.

3. Ceiling on credit:

- RBI fixes a limit on the loans that the commercial banks can give to the people.
- In other words, commercial banks cannot exceed the maximum limit (ceiling) that the RBI has fixed for specific categories.

4. Discriminatory interest rates:

- Banks charges different rate of interest on different types of loans and advances and also charges differently to different economic class of people.
- For example, the bank may charge less interest rate on the loan given to a farmer for agricultural development and may charge more interest rate on the loan given to a businessman.

Question 4. Explain the functions of a central bank in short.
Answer:
Definition:
R. P. Kent defines a central bank as "the institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare."

Meaning:

- A central bank is a bank that manages, evaluates and regulates the banking activity in a country.
  All the countries in the world have a central bank.
- In India, RBI i/e. Reserve Bank of India is the Central bank.

Functions of central bank:

(a) Central bank protects the interest and rights of customers of all banks.
(b) Central bank maintains financial stability for better economy by regulating all. the financial transactions of the country.
(c) Central bank has the authority to maintain the value of currency in a country.
(d) Central bank also makes monetary policy whose rules apply to all the banks in a country.
(e) Central bank helps, regulates and promotes the entire money market and banking sector. Money market is where financial instruments like Treasury bills, commercial paper,

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etc. with high liquidity and very short term maturities are traded.
(f) Central bank also provides financial advice and suggestions to the government of a country.

4. Give answers to the point for the following questions :

Question 1. State the difference between a commercial bank and a central bank.
Answer:

Point of difference	Commercial bank	Central bank
(1) Working objective	To earn profit	Public welfare and economic development
(2) Dealing with people	Directly deals with people	Does not directly deal with people
(3) Issue of currencies	Does not issue currency	Issue currency except Re 1 currency note and currency coins
(4) No. of banks in a country	There are many commercial banks in a country	There is only one central bank in a country (in India – Reserve Bank of India)
(5) Superior – subordinate	Commercial banks are subordinate to central bank	Central bank is the Apex Bank in India.

Question 2. List down the primary and secondary functions of commercial banks and explain each of those in one sentence.
Answer:
Functions of commercial banks:
The functions of commercial banks can be divided into (A) Primary functions and (B) Secondary functions. Let us understand each in brief.

Primary functions:
Accepting deposits:
A bank acts as a custodian by accepting people s' savings in the form of deposits and gives interest in return.

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Different types of deposits:
There are four different ways in which a bank accepts deposits.
They are:

1. Current Account Deposits,
2. Savings Account Deposits,
3. Recurring Deposit Account and
4. Fixed Deposits.

A customer may deposit money in banks by opening any of these accounts.

1. Current account deposits:
A business, firm or an individual can open a current account with the bank. The main objective of this account is to conduct business related transactions.

2. Savings account deposits:

- A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account.
- The account holder can withdraw money using cheque, withdrawal slip, debit card and credit card.

3. Recurring deposits:

- This type of deposit accounts allows people to deposit small amount of money every month.
- The deposit gradually increases and the bank provides interest on the accumulated amount.

4. Fixed/ Long term deposits:

- People who want to deposit their money for long duration opt for fixed deposits.
- These deposits are fixed in nature and thus, money cannot be withdrawn as and when required by the depositor.
- Banks pay highest rate of interest as compared to other deposit accounts.

2. Providing credit facilities:

- Banks provide credit facilities to different individuals such as farmers, different professionals, etc. who are in need of money.
- Under this system, the needy ones borrow from the bank and the bank charges interest for the credit facility that it provides. The interest charges depends on the purpose of credit i.e. whether the credit is used for personal use, agricultural activity or business activity.

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3. Payment and withdrawal facilities:
A bank provides easy payment and withdrawal facility to its customers.

The various facilities are cheque, withdrawal slips and drafts, pay order, ATM Facilities (Automatic Teller Machine), internet banking, debit card and credit card.

4. Credit creation:
Credit creation is the power of commercial banks to expand deposits, through loans, advances and investments. In other words, on the basis of cash deposits of the customers in the bank, the bank makes loans and advancement and thus increases the money supply in the market.

5. Inter-banking transactions:

- A bank can provide short or long-term credit in the form of loans or advance to the other bank as and when required.
- Short term credit is provided by one bank to another through central bank and is called 'call money' and the interest rate of call money is called 'call money rate'

(B) Secondary functions:
1. Agency and utility services:
Under this a bank provides various facilities to its customers as follows:

1. Letter of credit – Bank acts as a mediating agent for payment between exporter (in India) and Importer (in foreign country) especially when the parties are unknown to each other.
2. Underwriting services
3. To pay tax challans
4. Safe deposit vaults (lockers) – to store precious jewelry and documents safely"
5. Micro finance facilities – providing finance to small business for overall development of the community and economy as a whole

2. Provide various facilities with changing time:

- In today's scenario, banks have shifted from physical presence to digitalization i.e. services in electronic form.
- The transfer of money from one customer of a bank to the other customer of the same or different bank is made easy by using electronic medium (done through facilities like NEFT and RTGS) without using cheques.

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Question 3. List down the quantitative and qualitative tools of monetary policy and explain each of those in one sentence.
Answer:
(A) Quantitative measures:
The quantitative measures of bank control are discussed below.

1. Bank rate:

- Bank rate is the rate of interest which Reserve Bank of India charges on the loans and advances that it gives to the commercial banks for long term.
- At times, the commercial banks have shortage of funds and due to this reason, they borrow money which has to be repaid back with interest within the stipulated time period.

2. Repo rate and reverse repo rate:

- When banks need money they approach RBI. The rate at which banks borrow money from the RBI by selling their surplus government securities to RBI is known as "Repo Rate."
- Reverse Repo rate is a short term borrowing rate at which RBI borrows money from commercial banks.
- Here, the RBI sells certain government securities to the commercial banks with an agreement of purchasing them back at a discounted rate at the end of short term period.

3. Stabilization under emergency situation:

- At times there might occur some emergency of acute shortage of cash with the commercial banks.
- Under such situations there is a special window for banks where RBI provides money to commercial banks against approved government securities.
- This rate is higher than repo rate and is known as 'Marginal standing facility'. This helps in stabilizing the inflation under emergency situation.

4. Cash Reserve Ratio (CRR):

- Cash Reserve Ratio is the specified percentage of the total deposits of customers of the commercial bank that the bank has to maintain with the RBI.
- The increase or decrease in the rate of CRR directly effects controlling inflation and deflation respectively.

5. Statutory Liquidity Ratio (SLR):
Statutory Liquidity Ratio is the percentage of total deposits (25% or more) that the

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commercial banks have to maintain with RBI in form of cash, gold and government-approved securities.

6. Open Market Operation (OMOs):

- When RBI purchases or sells government securities/bond in the open market it is called Open Market Operations (OMOs).
- The sale or purchase made by RBI affects the inflation.

7. Sterilization of RBI accounts against shocks arising from the excessive increase or decrease in amount of foreign exchange:

Sterilization is a form of monetary action in which a central bank seeks to limit the effect of inflows and outflows of money supply in the economy.

(B) Qualitative measures:
1. Collateral security:

- When bank lends money to individual, it demands some asset as mortgage for security of the loan. This is known as collateral security.
- This security can be jewelry, fixed deposits, car, house, land, etc.
- RBI promotes and encourages commercial banks to take such steps so that all the segments of people especially poor in India can attain the benefit of bank credit and hence help to improve country's economy.

2. Margin requirement:

- Margin requirement is the limit that is set by RBI for granting loans against security.
- An individual is offered only certain percentage of the total value of the asset (security) as loan.

3. Ceiling on credit:

- RBI fixes a limit on the loans that the commercial banks can give to the people.
- In other words, commercial banks cannot exceed the maximum limit (ceiling) that the RBI has fixed for specific categories.

4. Discriminatory interest rates:

- Banks charges different rate of interest on different types of loans and advances and also charges differently to different economic class of people.
- For example, the bank may charge less interest rate on the loan given to a farmer for agricultural development and may charge more interest rate on the loan given to a businessman.

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5. Answer the following questions in detail :

Question 1. Give the meaning of a commercial bank and explain its functions.
Answer:
Functions of commercial banks:
A commercial bank is a business unit which provides banking services for profit.
(A) Primary functions:
1. Accepting deposits:
A bank acts as a custodian by accepting people s' savings in the form of deposits and gives interest in return.

Types of deposits a bank accepts:
There are four different ways in which a bank accepts deposits.They are:

1. Current Account Deposits,
2. Savings Account Deposits,
3. Recurring Deposit Account and
4. Fixed Deposits.

A customer may deposit money in banks by opening any of these accounts.

1. Current account deposits:
A business, firm or individual can open a current account with the bank. The main objective of this account is to conduct business related transactions.

- Bank provides more liquidity to current account i.e. money can be withdrawn number of times during a day.
- No interest is given to the customers of current account. At times, bank charges service charge on this account.
- The bank also provides over-draft facility on this account i.e. the customer is able to withdraw more money than the available balance in the account
- This overdraft facility helps the business or an individual to overcome short term money deficiency.

2. Savings account deposits:

- A savings account is an account provided by a bank for individuals to save money and earn interest on the cash held in the account.
- Majority of people use savings account to deposit their savings as bank provides interest on this account.
- The account holder can withdraw money using cheque, withdrawal slip, debit card and credit card.

3. Recurring deposits:

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- This type of deposit accounts allows people to deposit small amount of money every month.
- The deposit gradually increases and the bank provides interest on the accumulated amount.
- Some banks may charge penalty along with some interest loss if a person is not able to deposit money in this account in a particular month.

4. Fixed/ Long term deposits:

- People who want to deposit their money for long duration opt for fixed deposits.
- These deposits are fixed in nature and thus, money cannot be withdrawn as # and when required by the depositor.

Banks pay highest rate of interest as compared to other deposit accounts. Banks also provide overdraft facility on such deposits.

2. Providing credit facilities:

- Banks provide credit facilities to different individuals such as farmers, different professionals, etc. who are in need of money.
- Under this system, the needy ones borrow from the bank and the bank charges interest for the credit facility that it provides. The interest charges depends on the purpose of credit i.e. whether the credit is used for personal use, agricultural activity or business activity.
- The credit can be for short term (up to 1 year), medium-term (1 year – 5 years), or long-term (5 years – 15 years).

3. Payment and withdrawal facilities:

- A bank provides easy payment and withdrawal facility to its customers.
- The various facilities are cheque, withdrawal slips and drafts, pay order, ATM Facilities (Automatic Teller Machine), internet banking, debit card and credit card.

4. Credit creation:

- Credit creation is the power of commercial banks to expand deposits, through loans, advances and investments.
- In other words, on the basis of cash deposits of the customers in the bank, the bank makes loans and advancement and thus increases the money supply in the market.
- They advance much more than what they collect from people in the form of deposits, thus, creating credit in the economy.
- Through the process of credit creation, commercial banks provide finance to all sectors of the economy thus, making them more developed.
- When the credit creation of bank increases, the supply of money in the economy increase and vice – versa.

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5. Inter-banking transactions:

- A bank can provide short or long term credit in the form of loans or advance to the other bank as and when required.
- Short term credit is provided by one bank to another through central bank and is called 'call money' and the interest rate of call money is called 'call money rate'

(B) Secondary functions:

1. Agency and utility services:
Under this a bank provides various facilities to its customers as follows:

1. Letter of credit – Bank acts as a mediating agent for payment between exporter (in India) and Importer (in foreign country) especially when the parties are unknown to each other.
2. Underwriting services .
3. To pay tax challans
4. Safe deposit vaults (lockers) – to store precious jewelry and documents safely
5. Micro finance facilities – providing finance to small business for overall development of the community and economy as a whole

2. Provide various facilities with changing time:

- In today's scenario, banks have shifted from physical presence to digitalization i.e. services in electronic form.
- The transfer of money from one customer of a bank to the other customer of the same or different bank is made easy by using electronic medium (done through facilities like NEFT and RTGS) without using cheques.
- Customers can now buy movie ticket, goods, and make payments through internet banking or mobile banking.
- DEMAT account is also one of the latest facilities provided by banks in which the customers can hold buy or sell shares and debentures through electronic form.

Question 2. Give the meaning of a central bank and explain its functions.
Answer:
(I) Definition and meaning of Central bank:
Definition:
R. P. Kent defines a central bank as "the institution charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare."

Meaning:

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- A central bank is a bank that manages, evaluates and regulates the banking activity in a country.
  All the countries in the world have a central bank.
- In India, RBI i/e. Reserve Bank of India is the Central bank.

(II) Functions of Reserve Bank of India:
We can classify the functions of RBI into:
(A) Monetary functions and
(B) Non-monetary functions.

(A) Monetary functions (Monetary responsibilities):
1. Bank of issue:

- In every country, the Central bank of the country is empowered fully or partially for issuing/making of the currency.
- RBI is authorized to issue all the currency notes except for ₹ 1 currency note and the currency coins.
  It is the Finance Ministry of Government of India who issues Rs 1 note currency and currency coins.
- The distribution of all the currencies including Re 1 currency note and currency coins lies in the hands of RBI.

2. Banker to the government:

- RBI is a banker to government i.e. it works as a bank for the government.
- It maintains all the banking accounts of the government departments.
- As a banker, RBI gives loan to government, deposits money of the government, gives cash for payments of salaries and wages to staff, collects cheques, etc.

3. Bankers' bank and lender of last resort:

- RBI functions as banker to all the scheduled banks in India.
- The three functions as a banker to banks are:
  (a) Manages cash reserves of banks
  (b) Determines direction of credit as well as directs credit policy.
  (c) Determines rate of interest for all banks i.e. interest rates for saving deposits, fixed deposits, loans, etc.
- RBI also lends money to scheduled banks in case of emergency.

4. Controller of credit:
RBI controls credit creation of the banks by various monetary policy tools like Repo rate, Reverse repo rate, SLR, CRR etc.

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5. Custodian of foreign exchange reserves:

- RBI holds all the important foreign exchange reserves/currencies like U.S dollars, British pounds, gold, etc. in its custody.
- RBI maintains these reserves with them so as to maintain the value of rupee as compared to other currencies under the fixed exchange rate process of IMF (International Monetary Fund).
- Fixed exchange rate regime is when the value of a country's currency, in relation to the value of other currencies, is maintained at a fixed conversion rate by the central bank of a country.
- RBI maintains the value of rupee in the world economy by buying and selling these foreign exchange reserves in the open market.

(B) Non-monetary functions of Reserve Bank of India:

1. Regulatory and supervisory functions:
RBI- controls all the functions of commercial and cooperative banks. It supervises various functions like:
(a) licensing of banks,
(b) branch expansion,
(c) liquidity of their assets and
(d) management and methods of working.

2. Promotional functions:

- In India, there are many people who still do not hold bank accounts. Due to this, these people are forced to do all the dealings of money, credit in the unorganized money market.
- This creates problem for the RBI to find out exact National Income of country as they do*not have any track of the money transacted.
- Thus, due to the above mentioned problems faced by RBI, it has to do promotional activities of banks
- RBI encourages people to open bank account and also promotes banks to open their branches in the rural areas where people staying there can take benefit of banking services
- It also promotes setting up of cooperative banks for the interest of people.

(3) Financial inclusion and development:

- Owing to India's highly diversified economy, it becomes difficult for RBI to reach to all sections of people.
- Thus, RBI promotes Financial Inclusion which means providing banking services to low income segments of society at an affordable price.

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- It provides special credit facilities to agriculture, small scale industries, self-employed people and cottage industries.
- RBI also manages the Prime Minister Jan Dhan Yojna.
- RBI has made its website very user friendly. It publishes various banking related information and statistics as well as articles of experts on its website. Such publication helps people to promote research related to banking and bringing monetary improvement in the country.

Question 3. Explain the quantitative measures of monetary policy in detail.
Answer:
Quantitative measures:

- Quantitative measures are general measures that influence the overall economy i.e. measures that have an impact on the economy in general.
- They are not bifurcated based on sectors or segments in the economy. They have a common impact in all the sectors.

(A) Quantitative measures of bank control are discussed below:
1. Bank rate:

- Bank rate is the rate of interest which Reserve Bank of India charges on the loans and advances that it gives to the commercial banks for long term.
- At times, the commercial banks have shortage of funds and due to this reason, they borrow money which has to be repaid back with interest within the stipulated time period.
- If the bank rate is increased, commercial banks will borrow less money as it is expensive to borrow. Also, they will offer less amount of loan that too at higher rate of interest to their customers. The customers will then not be willing to take loans. Hence demand of goods and services will come down and inflation will be controlled.
- Thus, bank rate acts as a quantitative measure to control inflation in the economy.

2. Repo rate and reverse repo rate:

- RBI has stopped using bank rate as an instrument to regulate money supply. It now uses repo rate and reverse repo rate.
- When banks need money they approach RBI. The rate at which banks borrow money from the RBI by selling their surplus government securities to RBI is known as "Repo Rate."
- Banks enter into an agreement with the RBI to repurchase the same pledged government securities at a future date at a pre-determined price.
- 'Repo rate' is short form of 'Repurchase Rate'. Generally, these loans are for short durations up to 2 weeks. This means a bank may even take up loan for as low as 1 day.

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- Thus, we can say that the Banks sell government securities to RBI in order to raise money for a very short term with a condition to repurchase them at some discount. Such a discounting rate is repurchase rate/repo rate.

Repo rate as a measure to control inflation:

- In case of inflation in the economy the RBI increases repo rate.
- Increasing repo rate discourages commercial banks to take loans as they would have to pay more interest to the RBI.
- Increase in repo rate forces commercial banks to increase interest rate of the loans it provides to the customer. Customers then borrow less money due to increased rates.
- This in turn reduces the purchasing power of the people thereby, reducing supply of money in the economy. Thus, increase in repo rate helps to curb inflation in the economy

Reverse repo rate:

- Reverse Repo rate is a short term borrowing rate at which RBI borrows money from commercial banks.
- Here, the RBI sells certain government securities to the commercial banks with an agreement of purchasing them back at a discounted rate at the end of short term period.
- RBI borrows money from commercial banks in two conditions:
  1. when they require additional funds and
  2. when they feel, there is too much money floating in the economy.
- Increase in reverse repo rate leads to increase in the incentives or interest that the commercial banks receive from RBI.
- Thus, the commercial banks will prefer giving loan to RBI instead of people. This will in turn reduce the supply of money in the market and thus, help in controlling inflation in the economy.
- It is a vice versa situation if the reverse repo rate is reduced i.e. it helps in controlling the deflation.

3. Stabilization under emergency situation:

- At times there might occur some emergency of acute shortage of cash with the commercial banks.
- Under such situations there is a special window for banks where RBI provides money to commercial banks against approved government securities.
- This rate is higher than repo rate and is known as 'Marginal standing facility'. This helps in stabilizing inflation under emergency situation.

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4. Cash Reserve Ratio (CRR):

- Under the RBI Act, 1934, all commercial banks have to keep certain minimum cash reserves with the RBI.
- Cash Reserve Ratio is the specified percentage of the total deposits of customers of the commercial bank that the bank has to maintain with the RBI.
- Initially CRR was decided to be 5% of demand deposits and 2% of term deposits.
- Since 1962, CRR is variable from 3% to 15% of the total deposits of individual banks.
- The main reason behind the cash reserves of commercial banks is to have enough liquidity in the market.
- The increase or decrease in the rate of CRR directly effects controlling inflation and deflation respectively.
- Higher CRR leads to more reserve with RBI..This lessens the total deposits of the commercial banks which forces them to provide less credit/loan to people.
- Due to less credit in the economy, people have less supply of money which in turn controls the inflation and increases economic stability.

5. Statutory Liquidity Ratio (SLR):

- Statutory Liquidity Ratio is the percentage of total deposits (25% or more) that the commercial banks have to maintain with RBI in form of cash, gold and government-approved securities.
- If the SLR is high, instead of banks giving loans and advances to customers, it will buy government securities.
- These government securities help RBI to fulfill the government expenses. A high SLR reduces the capacity of banks to give loans to customers thereby, reducing the supply of credit/money in the economy,
- A low SLR increases the capacity of banks to give loans thus increasing credit creation in the economy.

6. Open Market Operation (OMOs):

- When RBI purchases or sells government securities/bond in the open market it is called Open Market Operations (OMOs).
- When RBI purchases government bonds from the open market, the money supply in the economy increases thus controlling the effects of depression in the economy.
- When RBI sells government bonds in the open market, there is a decrease in money supply which controls the inflation in the economy.

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7. Sterilization of RBI accounts against shocks arising from the excessive increase or decrease in amount of foreign exchange:

- Sterilization is a form of monetary action in which a central bank seeks to limit the effect of inflows and outflows of money supply in economy.
- When there is excess inflow of foreign exchange in India because of business activities, RBI sells government bonds in the open market so as to balance the amount of inflow of foreign exchange and vice versa.
- RBI does this to keep its balance sheet unchanged owing to excessive foreign exchange. Thus, it sterilizes its balance sheet against external shocks.

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