

REVISION OF KEY POINTS

- **Commercial Bank** is an institution which performs the functions of accepting deposits, granting loans and making investments, with the aim of earning profits.
- **Two Essential Conditions to Become a Bank:** (i) Accepting deposits; (ii) Advancing of loans.
- **Money Creation:** Commercial banks are able to create credit which is many times more than the deposits received by banks.
- **Central Bank** is an apex body that controls, operates, regulates and directs the entire banking and monetary structure of the country.
- **Functions of a Central Bank:** (i) Currency Authority; (ii) Banker to the Government; (iii) Banker's Bank and Supervisor; (iv) Controller of Money Supply and Credit.

REVISION EXERCISE

Multiple Choice Questions (MCQs)

7. The ratio of total deposits that a commercial bank has to keep with Reserve Bank of India is called (choose the correct alternative)
(a) Statutory liquidity ratio
(b) Deposit ratio
(c) Cash reserve ratio
(d) Legal reserve ratio

8. Banks create credit:
(a) Out of nothing
(b) On the basis of their securities
(c) On the basis of their total assets
(d) On the basis of deposits

9. If the total deposits created by commercial banks is ₹ 10,000 crores and legal reserve requirements is 40%, then amount of initial deposits will be _____.
(a) ₹ 2,000 crores
(b) ₹ 3,000 crores
(c) ₹ 4,000 crores
(d) ₹ 14,000 crores

10. Which of the following will increase the money supply?
(a) Fall in repo rate
(b) Purchase of securities in open market
(c) Decrease in cash reserve ratio
(d) All of these

11. What is the other name for 'Money Multiplier'?
(a) Credit Multiplier
(b) Deposit Multiplier
(c) Cash Reserve Ratio
(d) None of these

12. In order to reduce credit in the country, RBI may:
(a) Buy securities in the open market
(b) Sell securities in the open market
(c) Reduce cash reserve ratio
(d) Reduce Repo Rate

13. The one rupee note and coins are issued by:
(a) RBI (Central Bank)
(b) Commercial Bank
(c) Ministry of Finance
(d) Central Government

14. Which of these is not a function of central bank?
(a) Accepting deposits of general public
(b) Custodian of Foreign Exchange Reserves
(c) Banker's Bank
(d) Currency Authority

15. Other name for legal reserve requirement is _____.
(a) Cash reserve ratio
(b) Statutory liquidity ratio
(c) Variables reserve ratio
(d) Bank rate

16. Which of the following functions is not performed by the Central Bank?
(a) Banker to the government
(b) Overdraft Facility
(c) Controller of money supply
(d) Banker's Bank

17. _____ refer to those deposits in which amount is deposited with bank for a fixed period of time.
(a) Current Deposits
(b) Time Deposits
(c) Demand Deposits
(d) Saving Deposits

18. Which of the following is not an instrument of monetary policy?
(a) Open market operation
(b) Bank rate
(c) Selective credit control
(d) Government spending

19. Which bank controls the banking and monetary structure of India?
(a) Reserve Bank of India
(b) State Bank of India
(c) World Bank
(d) Axis Bank

20. What is the value of money multiplier when initial deposits are ₹ 500 crores and LRR is 10%?
(a) 0.1
(b) 0.2
(c) 10
(d) 20

(CBSE, Delhi 2017)

21. What happens where there is an increase in the margin requirements?

- (a) It reduces the borrowing capacity and money supply.
- (b) Encourages people to borrow more and money supply rises.
- (c) No change in money supply.
- (d) None of these.

22. Which institution (s) performs the activity of credit creation?

- (a) Commercial Banks
- (b) Central Bank
- (c) Both (a) and (b)
- (d) Neither (a) nor (b)

23. Which of these conditions is needed for a financial institution to become a bank?

- (a) Accepting deposits
- (b) Advancing Loans
- (c) Both (a) and (b)
- (d) Neither (a) nor (b)

24. _____ refers to that portion of total deposits of a commercial bank which it has to keep with itself in the form of liquid assets.

- (a) Cash Reserve Ratio
- (b) Statutory Liquidity Ratio
- (c) Bank Rate
- (d) Repo Rate

25. Which of the following agency is responsible for issuing ₹ 1 currency note in India?

{CBSE, Sample Paper 2016}

- (a) Reserve Bank of India
- (b) Ministry of Commerce
- (c) Ministry of Finance
- (d) Niti Aayog

26. Reverse Repo Rate is the rate at which Central Bank:

- (a) Lends money to Commercial Banks for short-term
- (b) Lends money to Commercial Banks for long-term
- (c) Borrows money from Commercial Banks
- (d) None of these

27. Demand deposits include (Choose the correct alternative):

{CBSE, All India 2017}

- (a) Saving account deposits and fixed deposits
- (b) Saving account deposits and current account deposits
- (c) Current account deposits and fixed deposits
- (d) All types of deposits

28. Repo rate is the rate at which:

- (a) Commercial Banks purchase government securities from the central bank
- (b) Commercial Banks can take loans from the central bank
- (c) Commercial Banks can keep their deposits with the central bank
- (d) Short-term loans are given by commercial banks

29. Which of the following is not a Quantitative Method of Credit Control?

{CBSE, Sample Paper 2017}

- (a) Open Market Operation
- (b) Margin Requirements
- (c) Variable Reserve Ratio
- (d) Bank Rate Policy

Ans. 1. (a); 2. (c); 3. (c); 4. (a); 5. (b); 6. (b); 7. (c); 8. (d); 9. (c); 10. (d); 11. (b); 12. (b); 13. (c); 14. (a); 15. (c); 16. (b); 17. (b); 18. (d); 19. (a); 20. (c); 21. (a); 22. (a); 23. (c); 24. (b); 25. (c); 26. (c); 27. (b); 28. (b); 29. (b)

Very Short Answer Type Questions (1 Mark each)

Q. 1. What are the two essential conditions for a financial institution to become a bank?

Ans. (i) Accepting deposits; (ii) Advancing of loans.

Q. 2. Why are LIC and UTI not termed as banks?

Ans. LIC and UTI are not banks as they do not accept chequeable deposits (although they advance loans).

Q. 3. What is a central bank?

{CBSE, Delhi 2008, Foreign 2014}

Ans. A central bank is an apex body that controls, operates, regulates and directs the entire banking and monetary structure of the country.

Q. 4. Mention one main difference between a central bank and a commercial bank.

Ans. The central bank has sole monopoly in note issue, whereas, this power is not enjoyed by a commercial bank.

Q. 5. What do you mean by 'bank of issue'?

Ans. Bank of issue means a bank which has the legal right to issue currency notes.

Q. 6. How does a central bank act as the lender of the last resort?

Ans. When commercial banks fail to meet their financial requirements from other sources, they can approach the central bank for loans and advances as the lender of the last resort.

Q. 7. What are time deposits in banks?

{CBSE, All India Comptt. 2013, All India 2014}

Ans. Time deposits refer to those deposits, in which the amount is deposited with the bank for a fixed period of time.

Q. 8. Define bank rate.

{CBSE, Delhi 2009, All India Comptt. 2014 (I)}

Ans. Bank rate refers to the rate at which the central bank lends money to commercial banks as the lender of the last resort.

Q. 9. What will be the effect of a rise in the bank rate on money supply? {CBSE, Sample Paper 2008}

Ans. Money supply will reduce.

Q. 10. What is the meaning of open market operations?

Ans. Open market operations refer to sale and purchase of securities (mainly government securities) in the open market by the central bank.

Q. 11. What is meant by legal reserve requirements?

Ans. Legal reserve requirements refer to the minimum percentage of total deposits (time deposits and demand deposits), required to be kept by the commercial banks with themselves and with the central bank.

Q. 12. What is meant by Cash Reserve Ratio?

{CBSE, Sample Paper 2014, Delhi Comptt. 2016}

Ans. Cash reserve ratio refers to the minimum percentage of time and demand deposits, required to be kept by every commercial bank with the central bank.

Q. 13. What is meant by Statutory Liquidity Ratio?

{CBSE, All India Comptt. 2014 (III)}

Ans. Statutory liquidity ratio refers to the minimum percentage of time and demand deposits, required to be kept by commercial banks with themselves.

Q. 14. What is meant by margin requirement?

Ans. The difference between the market value of security offered and the value of amount lent is called margin requirement.

Q. 15. What is Repo Rate?

Ans. Repo rate is the rate at which the central bank of a country lends money to commercial banks in the event of any shortfall of funds.

Q. 16. Mention any one factor affecting credit creation by banks.

Ans. Initial Cash Deposits.

Q. 17. What is Reverse Repo rate?

{CBSE, All India Comptt. 2016}

Ans. It is the rate of interest at which the central bank (Reserve Bank) accepts deposits from the commercial banks.

Short Answer Type Questions (3-4 Marks each)

1. Explain the process of money creation by commercial banks, giving a numerical example.

{CBSE, Delhi 2010}

OR

How do commercial banks create deposits? Explain.

{CBSE, Delhi 2013 (II), All India 2017}

OR

Explain the credit creation role of commercial banks with the help of a numerical example.

{CBSE, All India 2013 (I)}

OR

Explain money creation function of commercial banks.

{CBSE, Foreign 2017}

2. What is meant by a central bank? Why is it known as the apex body?

3. State the main functions of a Central Bank.

{CBSE, Delhi 2005}

4. State any three points of distinction between Central Bank and Commercial Banks.

{CBSE, Delhi 2009}

5. Explain the function of a Central Bank as a banker to the government. {CBSE. Sample Paper 2010}

OR

Explain 'banker to the government' function of Central Bank.

{CBSE, All India 2014, Delhi 2010 (II), 2013 (I, III), 2017}

OR

Explain 'Government's Bank' function of central bank. {CBSE, Delhi 2015, Foreign 2016 (II)}

6. What are open market operations? What is their effect on availability of credit?

{CBSE, Delhi 2003, 2005, 2008}

OR

Explain the open market operations method of credit control used by a Central Bank

{CBSE. Sample Paper 2010}

OR

How does central bank control credit creation by commercial banks through open market operations?

{CBSE, All India 2013 (II)}

Explain.

OR

Explain how open market operations are helpful in controlling credit creation. {CBSE, Delhi 2016 (I)}

7. Explain the 'lender of last resort' function of the Central Bank.

{CBSE, Delhi 2010, 14}

8. Explain Central Bank's function as currency authority.

{CBSE, Delhi 2010 (III)}

OR

Explain 'bank of issue' function of central bank.

{CBSE, Foreign 2012, Delhi Comptt. 2013, All India Comptt. 2013 (III), Delhi 2015}

9. Explain the 'banker's banks' and 'supervisor' function of the central bank. {CBSE, Foreign 2007}

OR

Explain 'banker's bank' function of Central bank. {CBSE, Delhi 2012, All India 2014, 2015, 2017}

10. Explain the effect of an increase in bank rate on credit creation by commercial banks. {CBSE, Delhi 2004}

OR

What is bank rate policy? How does it work as a method of credit control?

{CBSE, Delhi 2008}

OR

How do changes in bank rate affect money creation by Commercial Banks? Explain.

{CBSE, Delhi 2010}

OR

Explain how 'bank rate' is helpful in controlling credit creation?

{CBSE, Delhi 2016 (II)}

11. Define cash reserve ratio and statutory liquidity ratio. How can they be used to control the situation of excess money supply?

12. Explain the following functions of the central bank: (i) Bank of issue; (ii) Banker's bank. {CBSE, All India 2011}

13. Calculate the total deposit created by commercial banks if reserve ratio is 10% and primary deposit is ₹ 1,250 crores. *(Ans. 12,500 crores)*

14. If total deposit created by commercial banks is ₹ 20,000 crores and the primary deposit is ₹ 2,500 crores, what is the value of money multiplier and reserve ratio? *(Ans. Money Multiplier = 8; Reserve Ratio = 12.5%)*

15. Explain the components of Legal Reserve Ratio. *{CBSE, Delhi 2012}*

16. Explain the distinction between 'Statutory liquidity ratio' and 'Legal reserve ratio'. *{CBSE, Foreign 2012}*

17. Explain any two methods of credit control used by central bank. *{CBSE, All India 2013}*

18. What is legal Reserve Ratio? Explain its components. *{CBSE, All India Comptt. 2013 (I, II)}*

19. What is Repo Rate Policy? How does it work as a method of credit control?

20. Explain the 'currency authority' function of central bank. *{CBSE, Foreign 2014}*

21. Explain the role of Reverse Repo Rate in controlling credit creation. *{CBSE, All India 2016 (I, II)}*

OR

Explain the role of reverse repo rate in controlling money supply. *{CBSE, Delhi 2017}*

22. Explain how 'margin requirements' are helpful in controlling credit creation? *{CBSE, Delhi 2016 (I, II)}*

23. Explain how 'Repo Rate' can be helpful in controlling credit creation. *{CBSE, All India 2016 (I, II)}*

24. Explain the role of Cash Reserve Ratio in controlling credit creation. *{CBSE, All India 2016 (I, II)}*

25. Explain the "varying reserve requirements" method of credit control by the central bank. *{CBSE, Foreign 2017}*

26. If Legal Reserve Ratio is 0.2 and new deposits are ₹ 1,000, explain the process of money creation by the commercial banks. *{CBSE, Delhi Comptt. 2017 (I, II)}*

27. Explain the role of statutory liquidity ratio in increasing money supply. *{CBSE, All India Comptt. 2017 (I, II)}*

Long Answer Type Questions (6 Marks each)

1. Explain the process of money creation by the commercial banks with the help of a numerical example. *{CBSE, Delhi 2011, Sample Paper 2017}*

2. Explain any two functions of central bank. *{CBSE, Delhi Comptt. 2012, 2015, 2016}*

3. Discuss the differences between a central bank and a commercial bank.

4. Briefly discuss the following functions of central bank: (i) Currency Authority; (ii) Banker to the Government; (iii) Banker's Bank and Supervisor.

5. What is meant by margin requirement? How can it be used to control the money supply? Explain it with the help of an example.

6. How does a central bank influence credit creation by commercial banks through 'open market operations'? Explain. *{CBSE, Delhi Comptt. 2011}*

7. How is 'bank rate' used by central bank in influencing credit creation by commercial banks? Explain. *{CBSE, All India Comptt. 2011}*

OR

How do changes in Bank Rate affect money supply in an economy? Explain. *{CBSE, Delhi Comptt. 2015}*

8. Describe any two methods by which Reserve Bank of India can regulate money supply. *{CBSE, Delhi Comptt. 2015}*