

Chapter Money and Banking

What do you mean by money?

Money is anything which is generally accepted as a medium of exchange, measure of value, store of value and standard of deferred payments.

What do you mean by barter system and what are its limitations.

Barter system refers to exchange of goods for goods. An economy where there is direct purchase of goods and services is called barter system economy.

Some limitations:-

Lack of double coincidence of wants - Barter system can work only when both buyers and sellers are ready to exchange each other's goods.

Eg - A wants to give wheat in return of Rice
B wants to give rice but want vegetables in return.

Lack of common measure of value:- The barter system there is no common measure of value in which exchange ratio could be expressed of value in which

~~ratio~~ Eg - A has wheat and B has rice it is difficult to decide how much wheat is to give one kg of rice.

may be
quality
same
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PAGE: _____
Lack of standard of deferred Payment
Under Barter system, contract involving future payment or credit transaction can't take place easily because of certain issues like arranging same quality of goods at the time of replacement the commodity. to be repaid may gain or lose its value. So it was difficult to do deferred payment under Barter system.

Lack of store of value - Under barter system it is difficult for people to store wealth for future use because most of goods are not durable and lose value over a period of time. Also it takes a lot of efforts and time to store goods for a longer period.
Because of this goods couldn't be stored for longer period of time.

Lack of divisibility - Under barter system goods were exchange for goods but in case of some goods divisibility was not possible. Therefore, exchange was not possible.
eg - A wants to give horse and B wants elephant since elephant is bigger and can't be divided, so exchange is not possible.

What do you mean by money supply?
Money supply refers to total value of money held in public at a particular time in an economy.
Hence public include money using sector that individual and business firm but it doesn't include money in sector i.e. govt banking, system etc.

What are the different measures of money supply?
There are mainly four measures of money supply given by RBI. These include M_1 , M_2 , M_3 and M_4 .

M_1 → It is the first and basic measure of money supply which is also known as transactionary money since it can be directly be used for making transaction. Hence $M_1 = \text{Currency} + \text{demand deposits} + \text{other deposit}$

$M_1 = \text{Ce} + \text{DD} + \text{OD}$
Ce — currency and coin

DD — demand deposit with commercial bank
OD — other deposit with RBI

M_1 is the most liquid measure of money supply as all of its components can directly be used making transaction. The currency included in M_1 is also termed as Fiat money money under the order of govt. It is also termed as legal tender money.

DD — all those deposit that can encashed by issuing cheques like current acc and saving. It does not include inter bank deposit.



Other deposit include deposit held by RBI on behalf of other govt. bank.

M_2 — It is the broader concept of money supply as compared to M_1 . In addition to M_1 , it includes saving deposit with post office saving bank.

$M_2 = M_1 + \text{saving deposit with post office saving bank}$. Here a point to be noted that saving deposit with post office is not withdrawable by cheque.

M_3 — This concept is again a broader concept as compared to M_1 . In addition to M_1 , it also include not time deposit with bank that are ~~not~~ not withdrawable on demand and they can only be withdrawn after a pre-decided time period.

M_4 — This is again a broader concept of money supply which include - Total deposit with post office saving bank along with M_3 .
So, $M_4 = M_3 + \text{Total deposit with post office saving bank}$.

What are the imp. facts about measures of money supply?

In terms of liquidity M_1 is the most liquid form of money supply and M_4 being the least.

M_1 and M_2 are considered as narrow concept of money supply - M_3 and M_4

as broader concept.

M_3 is widely used as measure of money supply and it also known as aggregate monetary resource of country.

What do you mean by cashless society?

It refers to economic state where, financial transactions are not connected with money in the physical form of bank, notes or coins but to the transfer of digital inf. b/w the parties.

For ex - UPI transfer, wallet transfer, online banking etc.

Banking

What do you mean by commercial banking?

A commercial bank is a financial institution that accepts deposits and advanced loans as main functions with an objective to earn profit.

How has the introduction of plastic money enhance the convenience of both the depositor and the bank?

The introduction of plastic money in form of debit and credit cards has enhanced the convenience of both the depositor & bank this is due to portability that the plastic money possessed becoz of this the popularity of bank money (in form of checks etc). These checks can be encashed in bank only and if issued to someone actual money is transferred to instantly but it has increased over & above the bank money.

later on. In today's date the online transfers have become even more convenient

Q Explain diff. function of a commercial banks?

A The function of commercial bank can broadly be categorised —

- ① Primary Function
- ② Secondary Function
- ③ Agency Function
- ④ Utility Function

Primary Function

- Accepting deposit - It is the most imp. and traditional function of a commercial bank to accept deposit from public under various categories like:-

- Saving A/c
- Current A/c
- Fixed deposit
- Recurring deposit

- Two
no fixed
minimum
time
And it
can be
- loan
taken
person
as

- most
tradition
function
commercial

- bank
accept all
pub

- Providing loans / Advancing loans
It is the second imp function of a commercial bank in which it advances loan to the borrower under various heads like

- Cash Credit - It refers to a loan given to borrower against his current asset like share, stocks, bonds etc.

- unique to borrower

- 2
imp
of
bank
advance
to

- credit limit is sanctioned to the borrower. he may withdraw any amt upto this limit.
- Interest is charged on the ~~amt~~ ^{limit}.

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PAGE _____

In this kind of credit, a credit limit is sanctioned to the borrower and borrower may withdraw any amt within this limit. The interest is charged on the amt. actually withdrawn.

For ex - limit sanction is ~~the~~ £500, but the borrower withdraw £200, he will be paying interest on 200 only and not the total amt.

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- Demand loans - It refers to those loans which can be recalled on demand and there is no fixed maturity for these loans. The loan amt is paid in lumpsum. By crediting the a/c of borrower. These loans are taken against personal and financial asset. A point to be noted here is the interest is paid on the whole amt. Unlike cash credit.

no fixed maturity for the loan
amt is paid in lumpsum

- 3. Short term loans - These loans are given as personal loans against sum security. the purpose of these loans may be financing, working capital or other short-term needs. In this case also the entire sum is credited to the borrower a/c. He can withdraw the amt he requires at any point of time. but point to be noted here is interest is chargeable on entire amt.

These loans are given as personal loans against sum security.
Purpose - financing, working capital

Secondary Function

Overdraft Facility - It refers to a facility in which a customer is allowed to overdraw his current a/c. upto an agreed limit. This facility is given to some reliable and reputed customer for a short period of time. Customer have to give interest on the amt. overdrawn.

Customers have

customer is allowed to overdraw.

holder of BOC
- get his bill
discounted with bank
PAGE
before maturity, when
bank gives the
amt to holder
after deducting
the holder some amt of
interest

Q. Discounting of Bill of exchange

Discounting of Bill of exchange
- It refers to a facility in which the holder of Bill of exchange can get his bill discounted with bank before maturity where bank gives the amt to the holder after deducting a certain amt of commission. On maturity bank gets payment from other party who has accepted the bill.

3. Agency functions - Commercial bank perform certain function on behalf of customer in the capacity of the ^(a) agents. These functions include :-

Bank provide this facility

1. Transfer of funds - Bank provide this facility in which funds can be transferred from one place to another with help of instruments like demand drafts, online ~~transfers~~ etc.

- Banks provide
in order
provide
transfer
from
and
pr

2. Collection & payment of ^{certain} ~~various~~ items.
Commercial bank collects ^{cheque} ~~notes~~, interest, dividends, subscription on behalf of customer and also make payments like taxes, insurance premium on instruction on customer. ~~and all~~

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cheg
sub
gr

Purchase and sale of foreign exchange -
Some of the bank are authorised by central bank to deal in foreign exchange they buy & sell foreign exchange on behalf of their customers and facilitates international trade.



Trusty and executor

Some banks keep the wills of ^{their} customers as trustee, and execute them after their death as executor.

Letter of reference.

- In this bank provides inf. about economic position of their customer to traders and provide similar inf to traders to its customers.

economic
page 51

UTILITY FUNCTIONS

1. Locker facility - Bank provide facility of safety locker to keep valuable customer against certain charges.

2. Travellers cheques - Bank issue travellers cheques to their customers to avoid risk of carrying cash during their journey abroad.

3. Letter of credit - This letter is issued to customers to certify their credit worthiness so that trade is facilitated.

or provide facility of safety to keep valuable customer against cash

Q. Differentiate between demand deposit and fixed deposit.

Answer - Basics	Demand deposits	Fixed deposits
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1. Time & dimension	There is no fixed time and dimension.	There is a time & dimension
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2. Cheque facility	They are chequeable deposit	They are not chequeable deposit
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3. Interest	They carry less or no interest.	They carry generally higher interest
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4. No of transactions	Generally large no of transaction are allowed	There are hardly any transaction allowed
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- Can withdraw money anytime / no of transaction

specific time period
cheque not allowed

V. Imp

Q. Explain the process of credit creation / money creation by a commercial bank?

Ans.) Credit creation is one of the most important function of a commercial bank. Through the process of money creation can create credit which is much more than the initial deposits. To explain the process following assumption are taken—

① The entire commercial banking system is one unit that is termed as banks.

② All these receipts and payments in economy are done through bank only.

In a normal process of banking a bank accepts deposit from public which is used for giving loans. A point here to be noted is bank cannot use the whole deposit for lending and they have to keep certain percentage of deposit as reserves. That % is defined by RBI as legal reserve Ratio i.e. LRR.

To understand the process of credit creation.

Let us suppose that there is initial deposit of ₹ 1000 in bank. And LRR is 20%.

Now, Bank have to keep 20% of 1000 i.e. 200 as reserved and it is free to lend ₹ 800 to others.

Now suppose, it lends ₹ 800 which bank does not give in cash rather they open account in the name of borrower who can withdraw that much money whenever they like.

Suppose that borrower uses this money and issue a cheque of ₹ 800 in favour of other person. That person deposit a cheque in bank and bank get a fresh deposit of ₹ 800.

Now again it has to keep 20% of 800 that is 160

in to reserve and it is free to lend 640. When it lends ~~it~~ ^{that} amount a new deposit of 640 is created in the name of the borrower. This process of lending, creating, deposits keeps on going ~~until~~ ^{until} the whole amt. is ~~not~~ completely exhausted.

This process can be understood with the help of following table.

	Deposit	Loans	Reserves LRR
Initial deposit.	1000	800	200
Round 1	800	640	160
Round 11	640	512	128
TOTAL →	<u>5000</u>	<u>4000</u>	<u>1000</u>

As we can see in the table, banks are able to create TD of ~~£~~ 5000 with the initial deposit of £1000. So the total deposit have become 5 times of initial deposit.

Here, 5-time is nothing but value of money multiplier.

M.M. is $\frac{1}{LRR}$ as in this case is 20% so (0.2)
 $\therefore M.M. = \frac{1}{0.2} = 5$

26/4/22



DATE _____
PAGE _____

Economics

$$M.M = \frac{\text{Initial deposit} \times 1}{LRR}$$

- Q. Calculate the total deposit created if there is initial deposit of ₹ 1000 and LRR is 12.5%

Ans

$$\begin{aligned} &\text{Initial deposit} \times 1 \\ &\text{Total deposit} = \frac{1000 \times 1}{0.125} \\ &= 1000 \times 1 \times 10 \\ &= 10000 \end{aligned}$$

$$\begin{aligned} &12.5 \\ &1000 \times 0.125 = 125 \\ &1000 + 125 = 1125 \\ &1125 \times 0.125 = 140.625 \\ &1125 + 140.625 = 1265.625 \\ &1265.625 \times 0.125 = 158.203 \\ &1265.625 + 158.203 = 1423.828 \\ &1423.828 \times 0.125 = 177.978 \\ &1423.828 + 177.978 = 1601.806 \\ &1601.806 \times 0.125 = 200.226 \\ &1601.806 + 200.226 = 1802.032 \\ &1802.032 \times 0.125 = 225.254 \\ &1802.032 + 225.254 = 2027.286 \\ &2027.286 \times 0.125 = 253.411 \\ &2027.286 + 253.411 = 2280.697 \\ &2280.697 \times 0.125 = 285.087 \\ &2280.697 + 285.087 = 2565.784 \\ &2565.784 \times 0.125 = 320.723 \\ &2565.784 + 320.723 = 2886.507 \\ &2886.507 \times 0.125 = 360.813 \\ &2886.507 + 360.813 = 3247.32 \\ &3247.32 \times 0.125 = 405.915 \\ &3247.32 + 405.915 = 3653.235 \\ &3653.235 \times 0.125 = 456.654 \\ &3653.235 + 456.654 = 4109.889 \\ &4109.889 \times 0.125 = 513.736 \\ &4109.889 + 513.736 = 4623.625 \\ &4623.625 \times 0.125 = 577.953 \\ &4623.625 + 577.953 = 5201.578 \\ &5201.578 \times 0.125 = 650.197 \\ &5201.578 + 650.197 = 5851.775 \\ &5851.775 \times 0.125 = 731.472 \\ &5851.775 + 731.472 = 6583.247 \\ &6583.247 \times 0.125 = 822.906 \\ &6583.247 + 822.906 = 7406.153 \\ &7406.153 \times 0.125 = 925.769 \\ &7406.153 + 925.769 = 8331.922 \\ &8331.922 \times 0.125 = 1041.49 \\ &8331.922 + 1041.49 = 9373.412 \\ &9373.412 \times 0.125 = 1171.677 \\ &9373.412 + 1171.677 = 10545.089 \\ &10545.089 \times 0.125 = 1318.136 \\ &10545.089 + 1318.136 = 11863.225 \\ &11863.225 \times 0.125 = 1482.903 \\ &11863.225 + 1482.903 = 13346.128 \\ &13346.128 \times 0.125 = 1668.266 \\ &13346.128 + 1668.266 = 15014.394 \\ &15014.394 \times 0.125 = 1876.799 \\ &15014.394 + 1876.799 = 16891.193 \\ &16891.193 \times 0.125 = 2111.399 \\ &16891.193 + 2111.399 = 19002.592 \\ &19002.592 \times 0.125 = 2375.324 \\ &19002.592 + 2375.324 = 21377.916 \\ &21377.916 \times 0.125 = 2672.239 \\ &21377.916 + 2672.239 = 24050.155 \\ &24050.155 \times 0.125 = 3006.269 \\ &24050.155 + 3006.269 = 27056.424 \\ 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\times 0.125 = 52972361.333 \\ &423778890.664 + 52972361.333 = 476751251.997 \\ &476751251.997 \times 0.125 = 59593906.499 \\ &476751251.997 + 59593906.499 = 536345158.496 \\ &536345158.496 \times 0.125 = 67042394.813 \\ &536345158.496 + 67042394.813 = 603387553.309 \\ &603387553.309 \times 0.125 = 75422944.163 \\ &603387553.309 + 75422944.163 = 678810497.472 \\ &678810497.472 \times 0.125 = 84876262.184 \\ &678810497.472 + 84876262.184 = 763686759.656 \\ &763686759.656 \times 0.125 = 95595344.957 \\ &763686759.656 + 95595344.957 = 859282104.613 \\ &859282104.613 \times 0.125 = 106990262.577 \\ &859282104.613 + 106990262.577 = 966272367.19 \\ &966272367.19 \times 0.125 = 121192795.699 \\ &966272367.19 + 121192795.699 = 1087465162.889 \\ &1087465162.889 \times 0.125 = 135882695.361 \\ &1087465162.889 + 135882695.361 = 1223347858.25 \\ &1223347858.25 \times 0.125 = 152978482.281 \\ &1223347858.25 + 152978482.281 = 1376326340.531 \\ &1376326340.531 \times 0.125 = 172190792.566 \\ &1376326340.531 + 172190792.566 = 1548517133.097 \\ &1548517133.097 \times 0.125 = 193627141.637 \\ &1548517133.097 + 193627141.637 = 1742144274.734 \\ &1742144274.734 \times 0.125 = 217768034.293 \\ &1742144274.734 + 217768034.293 = 1959912309.027 \\ &1959912309.027 \times 0.125 = 244964038.628 \\ &1959912309.027 + 244964038.628 = 2204876347.655 \\ &2204876347.655 \times 0.125 = 276159543.457 \\ &2204876347.655 + 276159543.457 = 2481035891.112 \\ &2481035891.112 \times 0.125 = 310194486.389 \\ &2481035891.112 + 310194486.389 = 2791230377.501 \\ &2791230377.501 \times 0.125 = 348981297.188 \\ &2791230377.501 + 348981297.188 = 3140211674.689 \\ &3140211674.689 \times 0.125 = 392626459.311 \\ &3140211674.689 + 392626459.311 = 3532838134.0 \\ &3532838134.0 \times 0.125 = 441542516.75 \\ &3532838134.0 + 441542516.75 = 3974380650.75 \\ &3974380650.75 \times 0.125 = 496797581.344 \\ &3974380650.75 + 496797581.344 = 4471178232.094 \\ &4471178232.094 \times 0.125 = 558997279.011 \\ &4471178232.094 + 558997279.011 = 5030175511.105 \\ &5030175511.105 \times 0.125 = 628746938.876 \\ &5030175511.105 + 628746938.876 = 5658922450.0 \\ &5658922450.0 \times 0.125 = 707365306.25 \\ &5658922450.0 + 707365306.25 = 6366287756.25 \\ &6366287756.25 \times 0.125 = 795785969.531 \\ &6366287756.25 + 795785969.531 = 7162073725.781 \\ &7162073725.781 \times 0.125 = 895234215.723 \\ &7162073725.781 + 895234215.723 = 8057307941.504 \\ &8057307941.504 \times 0.125 = 1006788992.688 \\ &8057307941.504 + 1006788992.688 = 9064096934.192 \\ &9064096934.192 \times 0.125 = 1132761866.773 \\ &9064096934.192 + 1132761866.773 = 10196858800.965 \\ &10196858800.965 \times 0.125 = 1273357350.121 \\ &10196858800.965 + 1273357350.121 = 11470216151.086 \\ &11470216151.086 \times 0.125 = 1439152018.885 \\ &11470216151.086 + 1439152018.885 = 12909368170.0 \\ &12909368170.0 \times 0.125 = 1613671021.25 \\ &12909368170.0 + 1613671021.25 = 14523039191.25 \\ &14523039191.25 \times 0.125 = 1816629898.906 \\ &14523039191.25 + 1816629898.906 = 16339669090.156 \\ &16339669090.156 \times 0.125 = 2042708636.269 \\ &16339669090.156 + 2042708636.269 = 18382377726.425 \\ &18382377726.425 \times 0.125 = 2297797215.778 \\ &18382377726.425 + 2297797215.778 = 20680174942.203 \\ &20680174942.203 \times 0.125 = 2585021867.775 \\ &20680174942.203 + 2585021867.775 = 23265196810.0 \\ &23265196810.0 \times 0.125 = 2907149601.25 \\ &23265196810.0 + 2907149601.25 = 26172346411.25 \\ &26172346411.25 \times 0.125 = 3271543301.406 \\ &26172346411.25 + 3271543301.406 = 29443889712.656 \\ &29443889712.656 \times 0.125 = 3676736214.082 \\ &29443889712.656 + 3676736214.082 = 33120625926.738 \\ &33120625926.738 \times 0.125 = 4140190240.842 \\ &33120625926.738 + 4140190240.842 = 37260816167.58 \\ &37260816167.58 \times 0.125 = 4657601770.948 \\ &37260816167.58 + 4657601770.948 = 41918417938.528 \\ &41918417938.528 \times 0.125 = 5214502242.416 \\ &41918417938.528 + 5214502242.416 = 47132920180.944 \\ &47132920180.944 \times 0.125 = 5891615022.618 \\ &47132920180.944 + 5891615022.618 = 53024535203.562 \\ &53024535203.562 \times 0.125 = 6626816900.445 \\ &53024535203.562 + 6626816900.445 = 59651352104.007 \\ &59651352104.007 \times 0.125 = 7456669012.751 \\ &59651352104.007 + 7456669012.751 = 67108021116.758 \\ &67108021116.758 \times 0.125 = 8388263764.344 \\ &67108021116.758 + 8388263764.344 = 75496284881.102 \\ &75496284881.102 \times 0.125 = 9436280610.138 \\ &75496284881.102 + 9436$$

2. Initial deposit changes into total deposit of 10 times
find out LRR

Initial deposit $\times 10 = TD$

Let $TD = x$
 $TD = 10x$

$TD \times \frac{1}{LRR} = TD$

$x = \frac{1}{LRR} \times 10x$

$LRR = \frac{x}{10x} = \frac{1}{10}$

0.1 or 10%

Initial deposit creates total deposit of 4 times
find out LRR

Let $TD = x$

$TD = 4x$

$TD \times \frac{1}{LRR} = TD$

$x = \frac{1}{LRR} \times 4x$

$LRR = \frac{x}{4x} = \frac{1}{4}$

0.25 or 25%

555 x 10

1. If initial deposit increases ten fold by 100% find out LRR

$\frac{1}{100}$

Initial deposit $\times 10 = TD$

Let $TD = x$

$TD = 2x$

$TD \times \frac{1}{LRR} = TD$

$x = \frac{1}{LRR} \times 2x$

$LRR = \frac{x}{2x} = \frac{1}{2} = 50\%$

Calculate the LRR if TD of 200 leads to creation of TD of 600

$TD \times \frac{1}{LRR} = TD$

$200 \times \frac{1}{LRR} = 600$

$\frac{1}{LRR} = \frac{600}{200} = 3$

$LRR = \frac{1}{3}$

33.33%

Maintain deposit of commercial bank - Commercial bank

Order of last resort - When commercial bank

When commercial bank fail to meet their

financial requirement from other sources

they approach central bank to give

loan and advances as lender of last

resort - central bank help trust of banks

through discounting of approved bill of

exchange.

Clearing house function - Central bank holds

the cash reserve of all commercial banks

and other means it has accounts of all

the banks of it is easy for it to act

as the clearing house. Therefore, central

bank settle a/c of various bank

with each other by just passing an entry

in their accounts

Supervision - At the top most body

in the banking system are central bank

Commercial Bank

Definition

It is just a unit in

banking system of the

country and

operates under

the control of

central bank.

Ownership

It is owned by

private as well

as govt sector in

a country.

Objective

Its objective is to

provide

liquidity

to issue currency.

Central Bank

Definition

It is the top-most

body in the banking

system of a country

It is generally

owned by govt

of the country.

Its objective is to

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It doesn't deal with

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No of Bank

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like RBI, PNB, HDFC,

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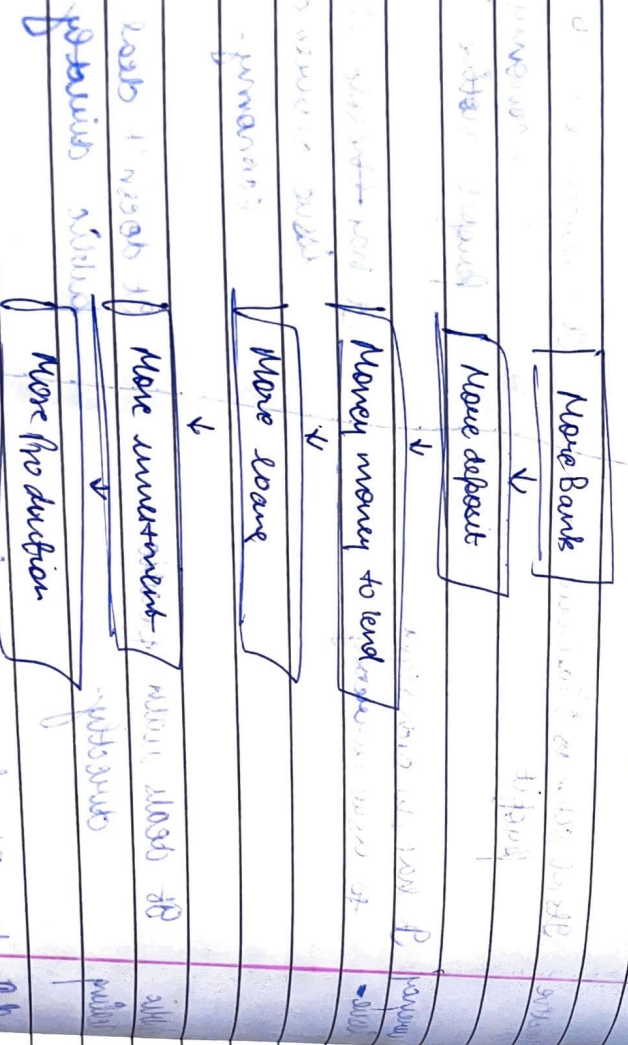
in a country

like RBI, PNB, HDFC,

Q) The reserve bank of India aims to make credit easily for general public in order to create, the availability of credit. What should be done?

→ The RBI should increase the bank rate
we separate that is the rate at which central bank lends to a commercial bank with increase in this rate credit becomes costlier for commercial bank and in turn for general public so by increasing the bank rate central bank can try make credit costlier for general public.

Govt of India has recently launched Jan Dhan Yojana aimed at every household in country to have atleast one bank a/c. Explain how deposit made under the plan are going to effect National Income of a country.



The deposit made under this scheme, are going to affect national income of country in following way:-

- More bank a/c will create more deposit for banks.
- More deposit, will increase the lending capacity of bank
- More lending capacity will increase, the loans in economy.
- More loans will lead to higher amt of investment.
- Higher amt of investment will lead to higher production of goods & services.
- Higher production means higher national income in economy.

Q How central bank plays a role of control of credit in an economy?

Ans- It is the most crucial function played by a central bank of an economy, it uses following techniques to control credit

1) Constitutive techniques - They effect the structure of credit in economy and they include

- a) Open market operation
- b) Bank rate policies
- c) Repo - rate.
- d) Marg reserve ratio

2) Collative techniques - These techniques effect the direction of credit in an economy and include

- 1) Margin requirement
- 2) Moral suasion

Q. Explain qualitative technique of central bank for controlling excess credit/inflation in an economy.

Qualitative techniques are as follows -

1) Bank rate - it is rate at which central bank lends money, to commercial bank to meet their long-term needs.

In case of excess credit central bank increases this rate which ~~too leads~~ to increase in lending rate by commercial bank & the demand for credit is discouraged to take more loan & which ~~control~~ reduces excess credit in economy.

Repo rate - It is rate at which central bank lends money to commercial bank to meet their short-term financial needs and increase in this rate ~~increases~~ increases the cost of borrowing from central bank that forces commercial banks to increase their lending rate & discourage borrowers from taking loans that reduces excess credit creation facility.

Open-market operation - It refers to buying and selling of securities of govt by central bank to public and commercial banks. When central bank sells securities it reduces the volume of commercial bank's ~~total~~ negative effect on credit creation facility.

On the other hand purchase of security by central bank increases the pressure with commercial banks as well as their ability to create credit.

ii. ~~Legal~~ Reserve Requirements. As per legal reserve requirements commercial banks are required to maintain reserves. It is quick and direct method to controlling credit, a commercial bank is required to maintain reserve on 20% of

① Cash Reserve Ratio - It represents the minimum percentage of bank's time and demand deposits to be kept by commercial bank in central bank and increases in CRR reduces the ability of commercial bank to create credit as it reduces their excess reserve.

② Statutory Liquidity Ratio (SLR) - It is the minimum percentage of net time & demand deposit which commercial bank are required to maintain in themselves. It is maintained in the form of liquid assets like current/cd in other banks, govt securities etc. An increase in SLR reduces the ability of banks to give credit as they have to keep extra cash with themselves.

Q. What are qualitative tools of central bank used for control of credit in economy?

① Following are qualitative tools:
Margin Requirements - It is the difference between amt. of loan and the net value of security offered by borrower against the loan.
For instance - The margin fixed by central bank is

40% then the commercial bank will be allowed to give loan only upto 60% of value of security.

By changing margin requirement, RBI can change the amt of loan that can be advanced. If commercial banks an increase in the margin requirement reduces the borrowing capacity. And money supply in economy. RBI can purchased diff. types of securities for diff. types of borrowers against security of some commodity.

Moralisation - It is the combination of persuasion and pressure that central bank apply on other banks so that they work according to the guidelines of the central bank. This is exercised through the discussions, letters etc. through the moralisation central bank convinces commercial banks to control credit as per the requirement of time.

Selective credit control - Here RBI gives direction to other banks to give and not to give credit for certain purposes to a particular sector. It can be used as positive as well as negative manner. In positive manner, priority is given to small scale sector whereas in negative manner it restricts flow of credit to certain sector.

National Income

It is total value of goods and services produced in an economy during a year by all residents. National income can be calculated by 3 methods.

- Product output method
- Income method
- Expenditure method

Output Method

This method will give us answer as gross value added at market price of GDP at MP following steps are used to calculate GDP.

$$\text{Gross value of output} = \text{Sales} + \text{Change in stock} \quad (\text{Closing} - \text{opening})$$

$$\text{GDP} = \text{Gross value of output} - \text{Intermediate consumption} \quad (\text{Gross value added})$$

Question

Calculate GDP from following

1. Sales - ₹5000
2. Closing stock - 2000
3. Opening stock - 1000
4. Purchase of raw material - 1500
5. Purchase of machine - 8000

GNDP
GDP

$$\begin{aligned} \text{GNDP} &= 5000 + (2000 - 1000) \\ &= 5000 + 1000 \\ &= 6000 \end{aligned}$$

6000