Money and Banking, Commercial Banks

General Economics
Money

Money is an important and indispensable element of modern civilization. In ordinary usage, what we use to pay for things is called money. To a layman, thus, in India, the rupee is the money, in England the pound is the money.
Definition of Money

Traditionally, money has been defined on the basis of its general acceptability and its functional aspects. Thus, any thing which performed the following three function:

- Served as medium of exchange
- Served as a common measure of value
- Served as a store of values

was termed as money.
Money

According to modern economist or empiricists, however the crucial function of money is that it serves as a store of value. It thus includes not only currencies and demand deposits of banks, but also includes a host of financial assets such as bonds, government securities, time deposits of banks and equity shares which serve as a store of value.
Money

Some economists categories these financial assets as near money, distinct from pure money which refers to cash and chequable deposits with commercial banks. To them, money is what money does. In terms of financial assets it is termed as stability of the demand function, high degree of substitutability and feasibility of measuring statistical variation.
Functions of Money

- In a Static Sense
- As a medium of exchange: As a mean of payment.
- As a unit of account: Money is a common measure or common denominator of value.
Functions of Money

- As Standard of deferred payment. Money is a unit in term of which debts and future transactions can be settled.
- As a Store of Value: Keeping for future purpose.
Functions of Money

In dynamic sense

- **Direct economic trends**: Money directs idle resources into productive channels and thereby affects output, employment, consumption and consequently economic welfare of the community at large.
Functions of Money

- **As encouragement to division of labour:** In a money economy, different people tend to specialize in the different goods and through the marketing process, these goods are bought and sold for the satisfaction of multiple wants.
Function of money

Smoothens transformation of savings into investment: In a modern economy, savings and investment are done by two different sets of people—households and firms. Households save and firms invest. Saved money thus can be channelised into any productive investment.
Money Stock in India

In 1979 the RBI classified money stock in India in the following four categories.

- **M1** = Currency with the public i.e. coins and currency notes + Demand deposits of the public known as narrow money.
- **M2** = M1 + Post office savings deposits.
- **M3** = M1 + Time deposits of the public with bank called broad money.
- **M4** = M3 + Total post office deposits.
Money Stock in India

The basic distinction between narrow money (M1) and broad money (M3) is in the treatment of time deposits with banks. Narrow money excludes time deposits of the public with the banking system which broad money includes it. Not much significance is attached to M2 and M4 by the RBI. This classification was in vogue till recently. The RBI working group has now redefined its parameters for measuring money supply.
Redefined Money Stock in India

- **M1** = Currency + Demand Deposits + other deposits with RBI.
- **M2** = M1 + time liabilities portion of saving deposits with banks + Certificates of deposits issued by banks + Term Deposits maturing within a year excluding FCNR (B) deposits.
- **M3** = M2 + Term deposits with banks with maturity over one year + Call / term borrowings of the banking system.
- **M4** has been excluded from the scheme of monetary aggregates.
Commercial Banks

The main features are

- It helps to mobilize the savings of the community
- To make them available to the entrepreneurs
- To ensure safety with liquidity
Commercial Bank

- Bank assures all the above facilities further that the funds can be drawn back in case of need.
- Bank act as bridge between the user of capital and those who save but cannot use the funds themselves. The ideal resources is converted in to productive use
Role of Commercial Bank

A developing economy require a high rate of capital formation to accelerate the tempo of economic development. But the economic development depends on rate of savings. Banks offer facilities to encourage savings.
Role of Commercial Bank

- Not only mobilize savings done by several household and make them available for production and investment to entrepreneurs in various sector of the economy.

- Banks helps to increase the aggregate rate of investment in the economy.
Role of Commercial Bank

Commercial banks helps in maximum social return and this ensure optimum utilization of savings and social welfare to help desirable sector such as agriculture, small scale industry, and weaker section of society all this done after the nationalization of banks in 1969.
Function of a Bank

- **Receipt of Deposits:** Like Demand deposit or current deposit, saving deposit and fixed deposit or time deposit.

- **Lending of money:** Lending to Industrial and commercial purpose. It may be cash credit, overdrafts, loan and advances or discounting of bills of exchange. Interest rate vary according to amount and period.
Function of a Bank

Agency Service:
Collection of bills, promissory notes and cheques.
Collection of dividends, interest premiums
Purchase and sales of shares and securities
Acting as trustee
Making regular payment such as insurance premium.
Function of a Bank

General Services:
Issue of letters of credit, travellers cheques, bank draft, Circular notes. Safe keeping of valuable in safe deposit vaults
Supplying trade information and statistics conducting economic survey
Preparation of feasibility studies, project report etc.
Commercial Banking in India

- At time of independence there were 645 banks and 4,800 branch office in India. In July 1969 14 major commercial banks is nationalized, in 1980 6 more commercial banks is nationalized. In 1993 two more banks were merged. At present there are 19 nationalized banks are in India.
Causes for Nationalisation

- Private ownership of commercial banks and concentration of economic power
- Urban-bias
- Neglect of agriculture sector
- Violations of norms
- Speculative activities
- Neglects of priority sector.
Objectives of Nationalization

- Removal of control by a few
- Provision of adequate credit to agriculture and small scale industry
- Giving a professional bent to management
Objectives of Nationalization

- Encouragement of a new class of entrepreneurs.
- Provision of adequate training and as well as terms of services to bank staff.
Progress of Commercial Bank after nationalization

Expansion of Branch: The branch office has increased from 8262 in 1969 to 68,500 in 2005. Thus there were population per bank office reduced to 55,000 in 1969 to 16,000 in 2005.
Progress of Commercial Bank after nationalization

- Branch opening in rural and unbanked areas: In 1969 there were 22% of bank office in rural areas as of now it is increased to 47% in 2005.
Progress of Commercial Bank after Nationalisation

**Deposit Mobilisation:** In 1969 the total deposit mobilisation was 4,665 crore but in 2005 it was increased to 17,57,846 crores. Therefore, up to 67% of deposit has been increased over this year.
Progress of Commercial Bank after nationalization

- **Bank lending:** In 1969 the bank lend an amount of 3,399 crore but it was increase to 11,69,090 crore in 2005.

- **Promotion of new Entrepreneurship:** Through IRDP, TRYSEM, JRY, and NRY.
Drawback of Commercial Bank

- Growth is less
- Regional imbalance
- Quality service is poor
- No proper experts to improve public sector banks.
Solve the Drawback

- Spreading the activities in remote areas
- Keeping up their profitability
- Looking after the growing needs of the priority sector of the economy.
- Improving the performance of rural/semi-urban branches
- Improving the quality of loan portfolio.
Meaning and Functions of RBI

A central bank is one which constitutes the apex of the monetary and banking structure of a country and which performs, in the national economic interest. The RBI was set up in April 1935, with its central office at Calcutta, under the Reserve Bank of India Act, 1934 as a private shareholder's bank with some subscription from the government to enable those nominated by the government to be directors.
Meaning and Function of RBI

The bank was later nationalized in 1949. Presently, the Reserve Bank of India (RBI) is the central arch of the Indian Money Market. It issues notes, buys and sells government securities, regulates the volume, direction and cost of credit, manage foreign exchange and supports institutions financing different sectors.
Function of RBI

The following functions are:

- Issue of currency
- Bankers to the government
- Bankers bank
- Custodian of foreign exchange reserves
- Controller of credit
- Promotional function
- Collection and publications of data.
Commercial Banks Vs Central Bank

- Other banks are largely profit seeking institutions, the central bank is not so.
- The central bank acts as the organ of the state.
- Other bank have largely public dealings, the central bank’s dealing are with governments, central and state banks and other financial institutions.
Indian Monetary policy

Monetary policy is usually defined as the Central bank's policy pertaining to the control of the availability, cost and use of money and credit with the help of monetary measures in order to achieve specific goals.
Indian Monetary Policy

- To regulate monetary growth so as to maintain a reasonable degree of price stability and

- To ensure adequate expansion in credit to assist economic growth
Indian Monetary Policy

- To encourage the flow of credit into certain desired channels including priority and the hitherto neglected sectors; and

- To introduce measures for strengthening the banking system and creating institutions for filling credit gaps
Monetary Instrument

- Quantitative or General Measures
- Qualitative or Selective Measures

Quantitative or general measures act as a weapons have a general effect on credit regulation. They are used for changing the total volume of credit in the economy. Quantitative measures consist of (a) Bank rate policy (b) Open market operations and (c) Variable reserve requirements.
Bank rate Policy

The bank rate is the rate at which the central bank discounts the bills of commercial banks. When the central bank wishes to control credit and inflation in the economy, it raises the bank rate. Increased bank rate increases the cost of borrowings of the commercial banks who in turn charge a higher rate of interest from their borrowers. This means the price of credit will increase. On the other hand, if the central bank wishes to boost production and investment activities in the economy, it will decrease the bank rate.
Open market operation

Open market operation imply deliberate direct sales and purchases of securities and bills in the market by the central bank on its own initiative to control the volume of credit. When the central bank sells securities in the open market other things being equal, the cash reserves of the commercial banks decrease to the extent that they purchases these securities. On the other hand, open market purchase of securities by the central bank lead to an expansion of credit made possible by strengthening the cash reserves of the banks.
Variable reserve ratio

There are two types of reserves which the commercial banks are generally required to maintain 1. Cash reserve ratio, 2. Statutory liquidity ratio. Cash reserve ratio refers to that portion of total deposits which a commercial bank has to keep with the central bank in the form of cash reserves. Statutory liquidity ratio refers to that portion of total deposits which a commercial bank has to keep with itself in the form of liquid assets viz-cash, gold or approved government securities.
Monetary Instrument

- Qualitative or selective measures are generally meant to regulate credit for specific purposes. The central bank generally use the following forms of credit control.
Securing loan regulation by fixation of margin requirements

The central bank is empowered to fix the margin and thereby fix the maximum amount which the purchaser of securities may borrow against those securities. Raising of margin curbs the borrowing capacity of the security holder. This is a very effective selective control device to control credit in the speculative sphere without, at the same time, limiting the availability of credit in other productive fields.
Consumer credit regulation

- The regulation of consumer credit consist of laying down rules regarding down payments and maximum maturities of installment credit for the purchase of specified durable consumer goods. Raising the required down payment limits and shortening of maximum period tend to reduce the demand for such loans and thereby check consumer credit.
Issue of directives

The central bank also uses directives to various commercial banks. These directives are usually in the form of oral or written statements, appeals, or warning, particularly to curb individual credit structure and to restrain the aggregate volume of loans.
Rationing of credit

Rationing of credit is a selective method adopted by the central bank for controlling and regulating the purpose for which credit is granted or allocated by commercial banks.
Moral Suasion

Moral suasion implies persuasion and request made by the central bank to the commercial banks to co-operate with the general monetary policy of the former. The central bank may also persuade or request commercial banks not to apply for further accommodation from it or not to finance speculative or non-essential activities. Moral suasion is a psychological means of controlling credit; it is a purely informal and milder form of selective credit control.
Direct Action

The central bank may take direct action against the erring commercial banks. It may refuse to rediscount their papers, and give excess credit, or it may charge a penal rate of interest over and above the bank rate, for the credit demanded beyond a prescribed limit. By making frequent changes in monetary policy, it ensures that the monetary system in the economy functions according to the nation’s needs and goals.
Multiple Choice Questions

Question 1

- We can define money in an ordinary usage as
  - what we use to pay for things
  - what we use
  - what we do
  - none of the above
Multiple Choice Questions

Question 1

We can define money in an ordinary usage as

- what we use to pay for things
- what we use
- what we do
- none of the above
Question 2

Primary function of money is
- medium of exchange
- store of value
- standard of deferred payments
- none of the above
Question 2

- Primary function of money is
  - medium of exchange
  - store of value
  - standard of deferred payments
  - none of the above
Question 3

Secondary function of money

- medium of exchange
- measure of value
- store of value
- none of the above
Question 3

Secondary function of money
- medium of exchange
- measure of value
- store of value
- none of the above
Question 4

In dynamic sense money serves as

- direct economic trends
- an encouragement to division of labour
- smoothens transformation of savings into investments
- all the above
Question 4

In dynamic sense money serves as:

- direct economic trends
- an encouragement to division of labour
- smoothens transformation of savings into investments
- all the above
Question 5

- Medium of exchange is also known as
  - measure of value
  - means of payment
  - means of value
  - none of the above
Question 5

- Medium of exchange is also known as
  - measure of value
  - means of payment
  - means of value
  - none of the above
Question 6

How many alternatives measures of money supply are introduced by RBI?

- 2
- 3
- 4
- 5
Question 6

How many alternatives measures of money supply are introduced by RBI?

- 2
- 3
- 4
- 5
Question 7

- M1 includes
  - currency held by public, net demand deposits of banks other deposit if RBI
  - currency held by public, saving deposits with post office savings banks
  - currency held by public, net time deposits and total deposits with post office savings banks
  - currency held by public, net demand deposits of banks, total deposits of banks
Question 7

- **M1 includes**
  - currency held by public, net demand deposits of banks other deposit if RBI
  - currency held by public, saving deposits with post office savings banks
  - currency held by public, net time deposits and total deposits with post office savings banks
  - currency held by public, net demand deposits of banks, total deposits of banks
Question 8

The RBI calls M1 as

- narrow money
- broad money
- liquid money
- legal money
The RBI calls M1 as

- narrow money
- broad money
- liquid money
- legal money
Question 9

- The supreme monetary and banking authority in India is
  - EXIM bank
  - Foreign Exchange Banks
  - RRBs
  - RBI
Question 9

- The supreme monetary and banking authority in India is
  - EXIM bank
  - Foreign Exchange Banks
  - RRBs
  - RBI
The bank were scheduled and non-scheduled banks under the
- Reserve Bank of India Act, 1934
- Bank Regulation Act, 1949
- Negotiable Instrument Act, 1981
- Narasimhan Committee Report
Question 10

The bank were scheduled and non-scheduled banks under the

- Reserve Bank of India Act, 1934
- Bank Regulation Act, 1949
- Negotiable Instrument Act, 1981
- Narasimhan Committee Report
Question 11

Commercial bank gets its funds from

- share capital
- reserve fund
- deposits from the public
- all the above
Question 11

- Commercial bank gets its funds from
  - share capital
  - reserve fund
  - deposits from the public
  - all the above
Question 12

Liquidity rules have been formulated and enforced by the
- central government
- state government
- world bank
- reserve bank of India
Question 12

Liquidity rules have been formulated and enforced by the
- central government
- state government
- world bank
- reserve bank of India
Question 13

Statutory liquidity requirement (SLR) means

- minimum cash reserve with RBI
- minimum liquid assets in the form of cash, gold and the approved securities
- a maximum ratio of cash holding to total liabilities of bank
- a minimum ratio of cash holding to total liabilities of bank
Question 13

Statutory liquidity requirement (SLR) means

- minimum cash reserve with RBI
- minimum liquid assets in the form of cash, gold and the approved securities
- a maximum ratio of cash holding to total liabilities of bank
- a minimum ratio of cash holding to total liabilities of bank
Question 14

- The RBI issue currency on the basis of the minimum of:
  - Rs. 200 crores of gold and foreign exchange reserves, of which at least Rs. 115 crores worth of gold must be there
  - Rs. 300 crores of gold and foreign exchange reserves, of which at least Rs. 100 crores worth of gold must be there
  - Rs. 350 crore of gold and foreign exchange reserve, of which at least Rs. 115 crores worth of gold must be there
  - Rs. 400 crores of gold and foreign exchange reserve, of which at least Rs. 200 crores worth of gold must be there
Question 14

The RBI issue currency on the basis of the minimum of:

- Rs. 200 crores of gold and foreign exchange reserves, of which at least Rs. 115 crores worth of gold must be there
- Rs. 300 crores of gold and foreign exchange reserves, of which at least Rs. 100 crores worth of gold must be there
- Rs. 350 crore of gold and foreign exchange reserve, of which at least Rs. 115 crores worth of gold must be there
- Rs. 400 crores of gold and foreign exchange reserve, of which at least Rs. 200 crores worth of gold must be there
The main function of commercial bank is
- lending function
- agency services
- general services
- all the above
Question 15

The main function of commercial bank is

- lending function
- agency services
- general services
- all the above
Question 16

At present the percentage of rural bank is around ____________________

- 25%
- 44%
- 50%
- 34%
Question 16

At present the percentage of rural bank is around -----------------------------

- 25%
- 44%
- 50%
- 34%
Question 17

The Reserve bank of India is responsible for overall

- credit and fiscal policy of the economy
- debit and fiscal policy of the economy
- credit and monetary policy of the economy
- none of the above
Question 17

The Reserve bank of India is responsible for overall

- credit and fiscal policy of the economy
- debit and fiscal policy of the economy
- credit and monetary policy of the economy
- none of the above
Question 18

• Qualitative measure is also called as
  • selective measure
  • general measure
  • static measure
  • flexible measure
Question 18

- Qualitative measure is also called as
  - selective measure
  - general measure
  - static measure
  - flexible measure
Bank rate in India is around

- 8.5%
- 6%
- 10%
- 12%
Question 19

Bank rate in India is around

- 8.5%
- 6%
- 10%
- 12%
Question 20

‘The lender of last resort’ means

- The government coming to the rescue of poor farmers
- Central bank coming to the rescue of other banks in times of financial crisis
- Commercial banks coming to the rescue of small industrial units
- None of the above
Question 20

‘The lender of last resort’ means

- The government coming to the rescue of poor farmers
- Central bank coming to the rescue of other banks in times of financial crisis
- Commercial banks coming to the rescue of small industrial units
- None of the above
Question 21

- Open market operations performs
- direct sales of securities
- direct purchase of securities
- purchase and sales of bills
- all the above
Question 21

- Open market operations performs
  - direct sales of securities
  - direct purchase of securities
  - purchase and sales of bills
  - all the above
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THE END