INDIAN SCHOOL AL WADI AL KABIR

Class: XII	Department: Commerce
Worksheet No: 1	**Topic: Money & Banking**

1. Commercial banks work for the purpose of:
   a. Welfare
   b. Earning profit
   c. Both a and b
   d. None of these

2. The process of money creation or credit creation is done by:
   a. Central Bank
   b. Commercial bank
   c. World Bank
   d. Rural Bank

3. Money which is accepted as a medium of exchange because of the trust between the payer and the payee is called:
   a. Full bodied money
   b. Credit money
   c. Fiat money
   d. Fiduciary money

4. Money that is issued by the authority of the government is called:
   a. Full bodied money
   b. Credit money
   c. Fiat money
   d. Fiduciary money

5. Which of the following is the component of M1 measure of money supply?
   a. Time deposit
   b. Demand deposit
   c. Cash reserves of the commercial banks
   d. None of these

6. Bank money is that money which is:
   a. Printed by RBI
   b. Printed by the government
   c. Generated in the form of credit creation
   d. None of the above

7. Demand deposits are:
   a. Chequable deposits

b. Non-chequable deposits
c. Deposits which can be withdrawn on demand
d. Both (a) and (c)

8. Supply of money is a:
a. Flow variable
b. Stock variable
c. Real flow
d. None of these

9. In India, coins are issued by:
a. State bank of India
b. Reserve bank of India
c. Ministry of finance
d. Ministry of urban development

10. Which of the following systems is followed by RBI for issuing currency?
a. Proportionate system
b. Simple deposit system
c. Minimum reserve system
d. Fixed fiduciary issue system

11. The central bank:
a. Is an apex bank
b. Is the sole agency of note –issuing
c. Focuses on stability and growth of the economy
d. All of these

12. With an increase in market rate of interest, cost of credit:
a. Decreases
b. Increases
c. Remains constant
d. None of these

13. The rate at which commercial banks are allowed to park their surplus funds with RBI is called:
a. Bank rate
b. Repo rate
c. Currency rate
d. Reverse repo rate

14. Money supply consist of:
a. Currency
b. Deposit
c. Both currency and deposits
d. None of the above

15. The rupee coin is made of:
a. Copper
b. Nickel
c. Steel
d. Iron

16. In India, suppliers of money are:
    a. Government of the country
    b. Banking system of the country
    c. Both (a) and (b)
    d. None of these

17. Rs. 10 issued by RBI is called:
    a. Fiat money
    b. High powered money
    c. Bank money
    d. (a) and (b)

18. With an increase in SLR, flow of credit in the economy:
    a. Increases
    b. Decreases
    c. Remains unchanged
    d. None of these

19. Moral suasion by RBI relates to:
    a. Pressure by the RBI to follow its directives
    b. Persuasion by the RBI to follow its directives
    c. Persuasion as well as pressure by the RBI to follow its directives
    d. None of these

20. Which of the following is the function of central bank of the country?
    a. Bank of note-issuing
    b. Lender's last resort
    c. Custodian of foreign exchange
    d. All of these

21. Liquid assets include:
    a. Unencumbered approved securities
    b. Cash
    c. Gold
    d. All of these

22. Bank rate is for:
    a. Commercial banks by the Central Government.
    b. Commercial banks by the Central Bank
    c. Central banks by the central bank
    d. Central banks by the commercial banks

23. Match the following:

1. Primary function of money	(a) Paper money
2. Indian Rupee is	(b) Bad master

3. An institution which deals with money	(c) Measure of value
4. RBI established on	(d) Bank
5. Money is a good servant but	(e) 1 April 1935.

A: 1-c, 2-a, 3-d, 4-e, 5-b

1 mark questions:

24. What is the measure of money supply in India?
    a. A: **M1= C + DD + OD (Detail in Notes)**
25. State whether money supply is a stock or flow variable. A: **(Stock)**
26. What are demand deposits?
    a. A: **Refer to class notes**.
27. What is bank money?
    a. A: It refers to demand deposits created by the commercial banks.
28. Define credit multiplier.
    a. A: **Refer to class notes**.
29. What is the value of money multiplier when initial deposits are Rs500crs and LRR is 10%?

    A: Multiplier = 1/ LRR = 10.
    So, Total deposits = 500 X 10 = 5000
30. Which function of RBI leads to uniformity in note circulation?
    a. Bank of issue

3, 4 marks questions:

31. Explain the components of Legal Reserve Ratio.
    Answer:
    Following are the components of Legal Reserve Ratio:
    (i) Cash Reserve Ratio: Cash reserve ratio (CRR) is the minimum fraction of the total deposits with the commercial banks, which they are required to keep with the central bank.

a. (ii) Statutory Liquidity Ratio: Statutory Liquidity Ratio (SLR) is the minimum fraction of the total deposits with the commercial bank, which they are required to maintain in the form of specified liquid assets.

b. If CRR or SLR is high, banks are required to keep more part of their deposits in the form of reserves or securities and will have fewer funds to lend. This will contract credit. Similarly, if CRR or SLR is low, banks are required to keep less part of their deposits in the form of reserves or securities and will have more funds to lend. This will expand credit.

32. Explain the ‘bank of issue’ function of the central bank.
Answer:
The central bank of a country is the sole note issue authority. In India, RBI as the central bank issues the notes of all denominations of the country except One Rupee note which is issued by the Ministry of Finance, Government of India. According to De Kock, the main reasons for granting power of issuing notes to central bank are:

- To maintain similarity in notes circulation and better regulation of currency
- To grant distinctive prestige to currency notes
- To avoid unnecessary credit creation by the commercial banks
- To make government inspection on issuing notes effective

33. Do you consider a commercial bank to be ‘creator of money’ in an economy?

a. A: Yes because
- Through the process of money creation, com banks are able to create credit which is in far excess of initial deposits.
- The deposits held by the banks are used for giving loans.
- Banks keep a fraction of deposits as cash reserves because a prudent banker, by his experience knows two things:
- All the depositors do not approach the bank at the same time and also do not withdraw the entire amount at one go.
- There is constant flow of deposits in the bank.

34. Explain ‘banker to the government’ function of the Central Bank. **(4)**

a. A: Central Bank acts as a banker, advisor and agent to the Central and State Governments. It carries out all banking business of the government. Government keeps their cash balances in the current account with the central bank. Similarly, central bank accepts receipts and makes payment on behalf of the governments. Also, the central bank carries out the exchange, remittance and other banking operations on behalf of the government. Central bank gives loans and advances to governments for temporary periods, as and when necessary and it also manages the public debt of the country. Further, we should remember that the central government can borrow any amount of money from RBI by selling its rupees securities to the latter.

35. Explain the 'bankers' bank'' function of the central bank.

A: Central bank is the apex bank of all the commercial banks and financial institutions in the country. It holds the same relationship with the commercial banks as commercial bank holds with its customer. The central bank accepts deposits from the commercial banks and holds it as reserves for them. The commercial banks are compulsorily required to hold a part of their deposits as reserves with the central bank in accordance with the cash reserve ratio (CRR). In addition to the CRR requirements, the commercial banks hold reserves with the central bank for clearing their settlements with other banks and to fulfil their requirements of inter-bank transfers.

36.

37. State with reasons whether you agree or disagree with the following statement.

Central Bank has control on credit creation.

A: Yes, I do agree with this statement.
The control or adjustment of credit of commercial banks by the central bank is its important function. Commercial banks create lot of credit which sometimes results in inflation. The expansion or contraction of currency and credit causes business fluctuations.
The need for credit control arises from the fact that money and credit play an important role in determining the level of incomes, output and employment.

6 marks questions:

38. How do commercial banks create deposits? Explain with a numerical example.

We assume LRR = 10%

Rounds	Deposit (Rs)	Loans (Rs)	Cash reserves(Rs)
1	1000	900	100
2	900	810	90
3	810	729	81
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Total	10000	9000	1000

- Suppose initial deposit = Rs 1000, LRR = 10%
- Banks are money required to keep only Rs 100 as cash and advance Rs 900 as loan.
- Banks do not lend this money in cash.
- Instead they open account in the name of borrowers who are free to withdraw the money (900rs) whenever they like.
- Suppose the borrowers withdraw this 900 Rs for making payments.
- Since all transactions are routed through banks so the money spent by the borrowers come back to the banks in the form of deposit accounts of those who received this payment. It will increase the demand deposits of bank by Rs 900.

- With new deposit of Rs 900, banks keep 10% as cash reserves and lends the balance Rs 810.
- Borrowers again use this money for payment and the money comes back into the accounts of those who received the payment. This time banks deposits rise by Rs 810.
- The deposits keep on increasing in each round by 90% of last round's deposits.
- At the same time, cash reserves keep on increasing by 90% of last cash reserves.
- Deposit creation comes to an end when total cash reserves become equal to initial deposits.
- As seen in the table, Banks are able to create total deposits of Rs 10000 with the initial deposit of Rs1000
- It means total deposit becomes ten times the initial deposits. Therefore, 10 times is the value of money multiplier.

39. How is 'bank rate' used by central bank in influencing credit creation by commercial banks? Explain.
    - **A**: Credit multiplier measures the amount of money that the banks are able to create in form of deposits with every initial deposit.
    - Through the process of money creation, the commercial banks are able to create credit which is in excess of initial deposits.
    - The credit creation by banks depends on credit multiplier as it is inversely related to legal resenve ratio.
    - It is legally compulsory for the banks to keep a certain minimum fraction of their deposits as reserve.
    - The fraction is called legal reserve ratio and it is fixed by the central bank. Higher the credit multiplier, higher will be the total credit created and vice-versa.

Example: Suppose the legal reserve is 0.1 and initial deposit is ₹ 1,000.
Credit Multiplier =10.1=10
Thus,
Total credit created = 10 x 1,000 = ₹ 10,000
Now suppose legal reserve is 0.5 and the initial deposit is ₹ 1,000.
Credit Multiplier =10.5=2
Thus, Total credit created = 2 x 1,000 = ₹ 2,000
It can be seen that with the same initial deposit, total credit creation decreases with a fall in the value of credit multiplier.