



ECONOMICS

BOOKS - SANDEEP GARG ECONOMICS (HINGLISH)

BANKING : COMMERCIAL BANKS AND THE CENTRAL BANK

Higher Order Thinking Skills Questions

1. Illustrate with the the help of an hypothetical numerical exapmle the process of credit creation



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2. Calculate the value of the money multiplier and total created if intial deposit is of ₹ 5000 crores and LRR is 10%.



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3. If the total deposits created by commercial banks is ₹ 1200 crores and legal reserve requirements is 25%, then calculate the amount of initial deposits .

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4. Calculate the legal reserve requirement if initial deposit of ₹ 200 crores lead to creation of total deposit of ₹ 1,600 crores.

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5. Distinguish between cash reserve ratio and statutory liquidity ratio.



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6. Whether the following changes by the Reserve Bank will increase the money supply or decrease the money supply ?

(i) Rise In Repo rate.

(ii) Purchase of Securities In the open market

(iii) RBI Increases the margin from 20% to 30%

(iv) RBI reduces the Cash reserve ratio.

A. Rise in Repo rate .

B. Purchase of Securities in the open market

C. RBI increase the margin from 20% to 30% .

D. RBI reduces the Cash reserver

Answer:



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7. The Reserve Bank of India aims to make the credit costly for the general public in order to reduce the availability of credit. What should be done ?



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8. Government of India has recently launched 'Jan -Dhan Yojina' aimed at every household in the country to have at least one bank account.

Explain how deposits made under the plan are going to affect national income of the country.



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9. Currency is issued by the central bank, yet we say that commercial banks create money. Explain. How is this money creation by commercial banks likely to affect the national income? Explain.



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10. Discuss how the central bank plays the role of 'controller of credit' in an economy ?



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11. Explain the working of money multiplier with help of a numerical example.



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1. Increase in cash reserve ratio adversely affects the capacity of commercial banks to create credit.



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2. Commercial banks do not contribute to quantum of money supply in the economy as they do not have note-issuing authority.



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3. All financial institution can also be treated as banking institutions.



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4. Purchase of securities in the open market by the commercial banks reduces their credit creating power .



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5. Cash reserve ratio and statutory liquidity ratio are fixed by the commercial banks themselves.



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6. There is an inverse relationship between legal reserve ratio (LRR) and value of money multiplier.

OR

Size of money multiplier is given by the inverse of LRR.



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7. Loans offered by commercial banks are equal to deposits received by them .



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8. RBI acts as the banker to the central government and commercial banker to the

state governments.



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9. To increase the money supply in the economy, central bank reduces the margin requirements.



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10. Repo Rate is fixed by the Central Bank, whereas, Reverse Repo Rate is fixed by the

Commercial Banks.



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11. Explain the function of a commercial bank.

Hint : Discuss Function of a Commerical Bank.



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12. What is money multiplier ? How will you determine its value ? What ratios play an important role in the determination of the

value of the money multiplier ?

Hint: Discuss Money Multiplier.



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13. What are the instruments of monetary policy of RBI? How dose RBI stabilze money supply against exogenous shocks ?

Hint: The instruments of monetary policy of RBI can be broadly classified into two-groups:

(i) Quantitative Instruments: (a) Repo Rate and Bank Rate, (b) Open Market Operation, (c)

Legal Reserve Requirements.

(ii) Qualitative Instruments: (a) Margin requirements, (b) Moral Suasion, (c) Selective Credit Controls. RBI controls the money supply and credit in the best interests of the economy. It helps to stabilize money supply against exogenous shocks. For explanation, discuss "Controller of Money Supply and Credit".



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14. Do you consider a commercial bank' creator of money in the economy ?

Hint: Yes, Commercial Bank acts as a 'creator of money' in the economy. For detailed explanation, discuss "Money Creation".



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15. What role of RBI is known as 'lender of last resort'?

Hint : When commercial banks fail to meet

their financial requirements from other sources, they approach the central bank, which gives loans and advances as lender of the last resort. If commercial banks have insufficient reserves to meet any financial obligation, then in order to avoid financial panic, there must be a guarantee that banks can get cash if they really need it. Central Bank is the only institution that performs the role of lender of last resort.



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Multiple Choice Questions Mcqs

1. Name the institution which performs the function of accepting deposits, granting loans and making investments, with the aim of earning profits .

A. Commercial Bank

B. Central Bank

C. Neither(a) nor(b)

D. Both (a) and (b)

Answer: a



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2. This function of Central Bank involves buying and selling of government securities from or to the public and commercial banks.

- A. Selective Credit Control
- B. Legal Reserve Requirements
- C. Open Market operations
- D. None of the

Answer: c



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3. Name the credit control method which refers to difference between the amount of loan and market value of the security offered by the borrower against the loan.

A. Selective Credit Controls

B. Moral Suasion

C. Margin Requirement

D. Legal Reserve Requirements

Answer: c



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4. This bank operates in public interest without any profit motive.

A. Reserve bank of india

B. State Bank of India

C. Canara Bank

D. Allahabad Bank

Answer: a



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5. Through the process of _ commerical banks are able to create credit, which is in far excess of the initial deposits.

A. Advancing of loans

B. Mona Creation

C. Accepting Deposits

D. None of the

Answer: b



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6. What will be the effect of increase in the 'Repo Rate' on the money supply ?

A. Money supply will increase

B. Money supply will decrease

C. Money supply will remain same

D. Money supply will initially increase and then it will decrease

Answer: b



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7. The ratio of total deposits that a commercial bank has to keep with Reserve Bank of India is called:

A. Statutory liquidity ratio

B. Deposit ratio

C. Cash reserve ratio

D. Legal reserve ratio

Answer: c



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8. Banks create credit :

A. Out of nothing

B. On the basis of their securities

C. On the basis of their total asset

D. On the basis of deposits

Answer: d



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9. If the total deposits created by commercial banks is ₹ 1000 crores and legal reserve requirements is 40%, then amount of intital deposits will be _.

A. ₹ 2,000 crores

B. ₹ 3,000 crores

C. ₹ 4,000 crores

D. ₹ 14, 000

Answer: c



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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

Answer: d



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11. What is the other name for 'Money Multiplier' ?

A. Credit Multiplier

B. Deposit ratio

C. Cash Reserve Ratio

D. None of these

Answer: b



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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. None of these

Answer: b



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13. The one rupee note and coins are issued by

:

A. RBI (Central Bank)

B. Commerical Bank

C. Ministry of Finance

D. Central Governmet

Answer: c



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14. Which of these is not a function of central bank ?

- A. Accepting deposit of general public
- B. Custodian of Foreign Exchange Reserves
- C. Banker's Bank
- D. Currency Government

Answer: a



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15. Other name for legal reserve requirement is _

- A. Cash reserve ratio
- B. Statutory liquidity ratio
- C. Variables reserve ratio
- D. Bank rate

Answer: c



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16. Which of the following is not the function of the Central Bank ? (Choose the correct alternative)

A. Banking facilities to government

B. Banking facilities to public

C. Lending to government

D. Lending to commercial banks

Answer: b



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17. _ refer to those deposits in which amount is deposited with bank for a fixed period of time

A. Current Deposit

B. Time Deposit

C. Demand Deposits

D. Saving Deposits

Answer: b



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18. Which of the following instrument cannot be used by Central Bank to control money supply ?

A. Open market operation

B. Bank rate

C. Repo Rate

D. Government spending

Answer: d



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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

Answer: a



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20. What is the value of money multiplier when initial deposits ₹500crores and LRR is 10%?

A. 0.1

B. 0.2

C. 10

D. 20

Answer: c



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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

Answer: a



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

- A. Commercial Bank
- B. Central Bank
- C. Both (a) and (b)
- D. Neither (a) and (b)

Answer: a



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

A. Accepting deposit

B. Advancing Loans

C. Both (a) and (b)

D. Neither (a) and (b)

Answer: c



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24. _ refer 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

Answer: b



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

- A. Reserve bank of india
- B. Ministry of Commerce
- C. Ministry of Finance
- D. Niti Aayog

Answer: c



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

A. Lends money to commercial Banks for
short-term

B. Lends money to Commercial Banks for
long-term

C. Accepts Deposits from the Commercial
Banks

D. None of these

Answer: c



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

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

Answer: b

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28. Repo rate is the rate at which :

A. Commercial Banks purchase government securities from the central bank

B. Commercial Bank can take loans from
the central banks

C. Commercial Banks can keep their
deposits with the central banks

D. Short-term loans are given by
commercial banks

Answer: b



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29. Which of the following is not a Quantitative Method of Credit by : (Choose the correct alternative)

A. Open market operation

B. Margin Requirements

C. Variables reserve ratio

D. Bank Rate Policy

Answer: b



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30. Credit creation by commercial banks is determined by: (Choose the correct alternative)

A. Cash reserve ratio (CRR)

B. Statutory liquidity ratio (SLR)

C. Initial deposits

D. Bank Rate Policy

Answer: d



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31. The central bank can increase availability of credit by: (Choose the correct alternative)

- A. Raising repo rate
- B. Raising reverse repo alternative
- C. Buying government securities
- D. Selling government securities

Answer: c



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Very Short Answer Type Questions

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



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



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3. What is a central bank?



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



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5. What do you mean by “bank of issue”?



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



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7. What are time deposits in banks?



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8. Define bank rate.



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9. What will be the effect of a rise in the bank rate on money supply?



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10. What is the meaning of open market operations?



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11. What is meant by legal reserve requirements?



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12. What is meant by Cash Reserve Ratio ?



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13. What is meant by Statutory Liquidity Ratio?





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14. What is meant by margin requirement?



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15. What is Repo Rate?



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



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17. What is Reverse Repo rate?



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18. Calculate the value of money multiplier if the legal reserve requirements are 20%.



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Short Answer Type Questions

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

OR

How do commercial banks create deposits ?

Explain

OR

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

OR

Explain money creation function of commercial banks.



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2. what is the meant by a central banks ? Why is the know as the apex body ?



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3. State the main functions of a Central Bank.



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



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5. Explain the function of a Central Bank as a between Central Bank and Commercial Banks.

OR

Explain banker to the government function of

Central Bank.

OR

Explain 'Government's Bank' function of central bank.



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

OR

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

OR

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



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



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

OR

Explain 'bank of Issue' function of central bank.



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9. Explain the 'banker's banks' and 'supervisor' function of the central bank.



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10. Explain the effect of an increase in bank rate on credit creation by commercial banks

OR

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

OR

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

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



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11. Explain the following functions of the central bank : (i) Bank of issue , (ii) Banker's bank.



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12. Calculate the total deposit created by commercial banks if reserve ratio is 10% and primary deposit is ₹ 1,250 crores.



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13. 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?



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14. Explain the components of Legal Reserve Ratio



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15. Explain the distinction between 'Statutory liquidity ratio' and 'Legal reserve ratio'



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16. Explain any two methods of credit control used by central bank.

OR

Discuss the meaning of any two methods of controlling credit which may be adopted by the central bank





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17. What is legal Reserve Ratio? Explain its components



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



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19. Explain the 'currency authority' function of central bank.



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20. Explain the role of Reserse Repo Ratio in controlling credit creation.



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21. How the following tools can be used for credit control by the central bank in an

economy: (a) Open Market Operations , (b) Margin Requirements.



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22. Explain how 'Repo Rate' can be helpful in controlling credit creation .



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23. Explain the role of Cash Reserve Ration in controlling credit creation.



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24. Explain the "varying reserve requirements " method of credit control by the central bank.



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25. How will 'Reverse Repo Rate' and 'Open Market Operations' control excess money supply in an economy?



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26. What is monetary policy ? State any three instruments of monetary policy .



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27. How will 'Reverse Repo Rate' and 'Open Market Operations' control excess money supply in an economy ?



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28. What is monetary policy ? State any three instruments of monetary policy.



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Long Answer Type Questions

1. Explain the process of money creation by the commercial banks with the help of a numerical example.



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2. Explain any two functions of central bank.



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

A.

B.

C.

D.

Answer:



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



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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.



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6. How does a central bank influence credit creation by commercial banks "through open market operation '? Expalin



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7. How is bank rate used by central bank in influencing credit creation by commercial banks ? Explain

or

How do changes in Bank Rate affect money supply in an economy ? Explain.



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8. Describe any two methods by which Reserve India can regulate money supply.



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