Ist Internal,2019
B.Com 1nd Year
Indian Banking and finance
Set A
Solution

Multiply Choice Questions **[1*10=20]**

1. a
2. b
3. d
4. a
5. a
6. C
7. A
8. C
9. A
10. B

Long answer

Q1. What do you understand by bank? Evaluate their functions in Indian contest?

Bank is such a financial institution which collects money in current, savings or fixed deposit account; collects cheques as deposits and pays money from the depositors account through cheques."

-----Sir John Pagette.

- Issue of Currency:
  The central bank is given the sole monopoly of issuing currency in order to secure control over volume of currency and credit. These notes circulate throughout the country as legal tender money. It has to keep a reserve in the form of gold and foreign securities as per statutory rules against the notes issued by it.

- Banker to Government
  Central bank functions as a banker to the government—both 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.

- Banker's Bank and Supervisor:
  There are usually hundreds of banks in a country. There should be some agency to regulate and supervise their proper functioning. This duty is discharged by the central bank.

- Controller of Credit and Money Supply:
  Central bank controls credit and money supply through its monetary policy which consists of two parts—currency and credit. Central bank has monopoly of issuing notes (except one-rupee notes, one-rupee coins and the small coins issued by the government) and thereby can control the volume of currency.

- Exchange Control:
  Another duty of a central bank is to see that the external value of currency is maintained. For instance, in India, the Reserve Bank of India takes steps to ensure external value of a rupee. It adopts suitable measures to attain this object. The exchange control system is one such measure.

Q2. What is the different commercial bank in India? Also evaluate the role of commercial bank in developing economy?

Role of commercial banks in economic development of a country

1. Capital Formation

Banks play an important role in capital formation, which is essential for the economic development of a country. They mobilize the small savings of the people scattered over a wide area through their network of branches all over the country and make it available for productive purposes.

Now-a-days, banks offer very attractive schemes to attract the people to save their money with them and bring the savings mobilized to the organized money. If the banks do not perform this function, savings either remains idle or used in creating assets, which are low in scale of plan priorities.

2. Creation of Credit

Banks create credit for the purpose of providing more funds for development projects. Credit creation leads to increased production, employment, sales and prices and thereby they cause faster economic development.

3. Channelizing the Funds to Productive Investment

Banks invest the savings mobilized by them for productive purposes. Capital formation is not the only function of commercial banks. Pooled savings should be distributed to various sectors of the economy with a view to increase the productivity of the nation. Then only it can be said to have performed an important role in the economic development of the nation.

Commercial Banks aid the economic development of the nation through the capital formed by them. In India, loan lending operation of commercial banks subject to the control of the RBI. So our banks cannot lend loan, as they like.

4. Fuller Utilization of Resources

Savings pooled by banks are utilized to a greater extent for development purposes of various regions in the country. It ensures fuller utilization of resources.

5. Encouraging Right Type of Industries

The banks help in the development of the right type of industries by extending loan to right type of persons. In this way, they help not only for industrialization of the country but also for the economic development of the country. They grant loans and advances to manufacturers whose products are in great demand. The manufacturers in turn increase their products by introducing new methods of production and assist in raising the national income of the country.

6. Bank Rate Policy

Economists are of the view that by changing the bank rates, changes can be made in the money supply of a country. In our country, the RBI regulates the rate of interest to be paid by banks for the deposits accepted by them and also the rate of interest to be charged by them on the loans granted by them.

7. Bank Monetize Debt

Commercial banks transform the loan to be repaid after a certain period into cash, which can be immediately used for business activities. Manufacturers and wholesale traders cannot increase their sales without selling goods on credit basis. But credit sales may lead to locking up of capital. As a result, production may also be reduced. As banks are lending money by discounting bills of exchange, business concerns are able to carryout the economic activities without any interruption.

8. Finance to Government

Government is acting as the promoter of industries in underdeveloped countries for which finance is needed for it. Banks provide long-term credit to Government by investing their funds in Government securities and short-term finance by purchasing Treasury Bills.

9. Bankers as Employers

After the nationalization of big banks, banking industry has grown to a great extent. Bank's branches are opened in almost all the villages, which leads to the creation of new employment opportunities. Banks are also improving people for occupying various posts in their office.

10. Banks are Entrepreneurs

In recent days, banks have assumed the role of developing entrepreneurship particularly in developing countries like India. Developing of entrepreneurship is a complex process. It includes the formation of project ideas, identification of specific projects suitable to local conditions, inducing new entrepreneurs to take up these well-formulated projects and provision of counseling services like technical and managerial guidance.

Banks provide 100% credit for worthwhile projects, which is also technically feasible and economically viable. Thus commercial banks help for the development of entrepreneurship in the country.

Q3.Discuss the instruments of monetary policy adopted by RBI?

The Reserve Bank of India

The RBI is the central bank of India. It was established in 1935 under a special act of the parliament. The RBI is the main authority for the monetary policy of the country. The main functions of the RBI are to maintain financial stability and the required level of liquidity in theeconomy.

The RBI also controls and regulates the currency system of our economy. It is the sole issuer of currency notes in India. The RBI is the central banks that control all the other commercial banks, financial institutes, finance firms etc. It supervises the entire financial sector of the country.

1] Open Market Operations

Open Market Operations is when the RBI involves itself directly and buys or sells short-term securities in the open market. This is a direct and effective way to increase or decrease the supply of money in the market. It also has a direct effect on the ongoing rate of interest in the market.

Let us say the market is in equilibrium. Then the RBI decides to sell short-term securities in the market. The supply of money in the market will reduce. And subsequently, the demand for credit facilities would increase. And so correspondingly the rate of interest would also see a boost.

On the other hand, if RBI was purchasing securities from the open market it would have the opposite effect. The supply of money to the market would increase. And so, in turn, the rate of interest would go down since the demand for credit would fall.

2] Bank Rate

One of the most effective instruments of monetary policy is the bank rate. A bank rate is essentially the rate at which the RBI lends money to commercial banks without any security or collateral. It is also the standard rate at which the RBI will buy or discount bills of exchangeand other such commercial instruments.

So now if the RBI were to increase the bank rate, the commercial banks would also have to increase their lending rates. And this will help control the supply of money in the market. And the reverse will obviously increase the supply of money in the market.

3] Variable Reserve Requirement

There are two components to this instrument of monetary policy, namely – The Cash Reserve Ratio (CLR) and the Statutory Liquidity Ratio (SLR). Let us understand them both.

Cash Reserve Ratio (CRR) is the portion of deposits with the commercial banks that it has to deposit to the RBI. So CRR is the percent of deposits the commercial banks have to keep with the RBI. The RBI will adjust the said percentage to control the supply of money available with the bank. And accordingly, the loans given by the bank will either become cheaper or more expensive. The CRR is a great tool to control inflation.

The Statutory Liquidity Ratio (SLR) is the percent of total deposits that the commercial banks have to keep with themselves in form of cash reserves or gold. So increasing the SLR will mean the banks have fewer funds to give as loans thus controlling the supply of money in the economy. And the opposite is true as well.

4] Liquidity Adjustment Facility

The Liquidity Adjustment Facility (LAF) is an indirect instrument for monetary control. It controls the flow of money through repo rates and reverse repo rates. The repo rate is actually the rate at which commercial banks and other institutes obtain short-term loans from the Central Bank.

And the reverse repo rate is the rate at which the RBI parks its funds with the commercial banks for short time periods. So the RBI constantly changes these rates to control the flow of money in the market according to the economic situations.

5] Moral Suasion

This is an informal method of monetary control. The RBI is the Central Bank of the country and thus enjoys a supervisory position in the banking system. If there is a need it can urge the banks to exercise credit control at times to maintain the balance of funds in the market. This method is actually quite effective since banks tend to follow the policies set by the RBI.

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Multiply Choice Questions

1. d

2. a

3. c

4. b

5 d

6 . a

7. c

8 c

9 . c

10. c

Long questions

Q1. Write a essay on the nationalization of commercial banks in India?

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Banks provide 100% credit for worthwhile projects, which is also technically feasible and economically viable. Thus commercial banks help for the development of entrepreneurship in the country.

Q2. What are the main functions of bank? Explain the role of bank in developing economy?

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Q3. Define monetary policy? Discuss the objective of monetary policy?

Monetary policy is the policy adopted by the monetary authority of a country that controls either the interest rate payable on very short-term borrowing or the money supply, often targeting inflation or the interest rate to ensure price stability and general trust in the currency

1. Monetary policy is the process by which a central bank (Reserve Bank of India or RBI) manages money supply in the economy.

2. The objectives of monetary policy include ensuring inflation targeting and price stability, full employment and stable economic growth.

3. The money supply can be directly affected through reserve ratios or open market operations and can be indirectly affected by using key interest rates to influence the cost of credit.

4. An easy or expansionary monetary policy is implemented by reducing statutory bank reserves or lowering key interest rates and improving market liquidity to encourage economic activity.

5. A contractionary or tight monetary policy reduces liquidity and increases interest rates which has a negative impact on both production and consumption and therefore, economic growth.