Central Bank - HOTS & Applications

Q.1. Is money ever used as a commodity?

Ans. Money is used as a commodity when intrinsic value of money (value of the metal the coins are made of) exceeds its face value. People will then sell coins as a metal, rather than using them at their face value.Example: Silver coins in circulation during the British rule in India are now used as a commodity rather than money.

Q.2. There is no equivalent cash to the amount of demand deposits with the banks. Why should then demand deposits be taken as a part of money supply?

Ans. This is because all demand deposits are chequable deposits and can be used as money by way of issuing the cheques.

Q.3. Distinguish between 'face value' and 'intrinsic value of money'.

Ans. Face value refers to what is indicated on a note or a coin, like five rupees or ten rupees.Intrinsic value refers to market value of the material with which money is made of. In olden days, coins were made of gold and silver. Intrinsic value of a coin then implied the market value of gold or silver that the coin was made of.

Q.4. Distinguish between 'money' and 'near money'.

Ans. Money refers to notes and coins or things like cheques which are commonly accepted as a medium of exchange.Near money refers to all such financial instruments (likes Kisan Vikas Patra) which are sometimes used like money as a medium of exchange or for the store of value or for the transfer of value from one individual to the other.

Q.5. What is credit creation?

Ans. Credit creation refers to creation of demand deposits with the commercial banks on the basis of their cash reserves. Often, the deposits are created many times more than the cash reserves (the ratio between the cash reserves and deposits is called cash reserve ratio). This is based on the historical experience of the banks that cash withdrawal of funds is only a small percentage of the total demand deposits. If against the cash reserves of ₹ 100, demand deposits of ₹ 1,000 are created, it is called credit creation by a multiple of 10 or 10 is treated as credit multiplier.

Q.6. What is selective credit control?

Ans. Selective credit control refers to credit control policy of the central bank that seeks to increase the flow of credit to priority sectors of the economy. It would also mean restricting the flow of credit to certain sectors, particularly those related to speculative business activity.

Q.7. How is quantitative credit control different from qualitative credit control?

Ans. Quantitative credit control refers to overall credit control in the economy, affecting all sectors of the economy equally and without discrimination. Qualitative credit control refers to selective credit control that focuses on allocation of credit to different sectors of the economy. Flow of credit is encouraged to the priority sectors, while it is discouraged to the non-priority sectors (particularly those engaged in speculative business activity).

Q.8. While performing their primary functions of accepting deposits and making advances, the commercial banks happen to be the suppliers of money. Explain.

Ans. The commercial banks make advances many times more than cash reserves. Where does the money come from? From no where. They just open account in favour of the borrower and show his borrowing as demand deposits. The value of demand deposits far exceeds the value of cash reserves of the banks which is what adds to the supply of money in the economy. The banks arerequired to keep only a small fraction of demand deposits in the form of cash (CRR). These demand deposits serve as money as these are chequeable deposits. This is how banks happen to be the suppliers of money while they perform their primary functions of accepting deposits and making advances.