Barter S & E - R & U - Very Short (Info & Con)

Q.1. Define barter system of exchange.

Ans. Barter system of exchange is the system in which goods are exchanged for goods.

Q.2. What do you understand by double coincidence of wants?

Ans. Double coincidence of wants means that (at a point of time), the two individuals are in possession of such goods which they are willing to exchange for the satisfaction of their wants.

Central Bank - Reason-Based (Comp. of Sub)

Q.1. The central bank is the banker's bank.

Ans. True. The central bank is an apex bank of all banks in the country. Because, all banks are to work according to guidelines and directives of the central bank.

Q.2. The central bank is the currency authority.

Ans. True. The central bank is the sole-issuing authority in the country. It has the exclusive right of note-issuing.

Q.3. The central bank offers loans to the government.

Ans. True. The central bank offers loans to the government against government securities or treasury bills. It is a bank to the government of the country.

Q.4. Bank rate is the rate of interest charged by the bank on commodity loans.

Ans. False. Bank rate is that rate at which central bank gives loans to the commercial banks.

Q.5. Open market operations are meant to increase or decrease the supply of money in the economy.

Ans. True. In order to increase or decrease the money supply in the economy, central bank purchases or sells securities in the open market. Supply of money increases when securities are purchased and it decreases when securities are sold by the RBI.

Q.6. Reverse repo rate is the rate at which the central bank offers short period loans to the commercial banks.

Ans. False. Reverse repo rate is the rate at which commercial banks are allowed to park their surplus funds with the RBI.

Q.7. The goal of central bank is to maximise profit.

Ans. False. The goal of central bank is to achieve stability and growth of the economy.

Q.8. Qualitative instruments control the flow of credit to select sectors of the economy.

Ans. True. Qualitative instruments focus on select sectors of the economy. These instruments control the flow of credit to select sectors not by varying policy rates and ratios, but by issuing advisories to the commercial banks.

Q.9. If reverse repo rate is 4%, then repo rate will be lower than this.

Ans. False. If reverse repo rate is 4%, then repo rate will be higher than this. Because, the standard practice is to keep 'reverse repo rate' lower than the 'repo rate'. It is like lending rate being higher than the borrowing rate by the bank.

Q.10. A fall in SLR increases money supply in the economy.

Ans. True. Money supply in the economy increases when SLR decreases, because fall in SLR enhances capacity of the commercial banks to create credit.

Q.11. In order to curb inflation, repo rate is decreased.

Ans. False. In order to curb inflation, repo rate is increased. Increase in repo rate causes increase in market interest rate (rate of interest charged by the commercial banks from the general public). Accordingly, the cost of credit (also called the cost of capital) increases. This reduces the flow of credit, as desired to curb inflation.

Q.12. To reduce money supply in the economy, securities are purchased by the central bank of the country.

Ans. False. To reduce money supply in the economy, securities are sold by the central bank. Sale of securities soaks purchasing power from the money market. When liquidity is soaked/reduced, cash reserves of the commercial banks are squeezed. Implying a check on their credit creation capacity, and a cut in money supply.

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.

Barter S & E - Reason-Based (Comp. of Sub)

Q.1. Under barter system of exchange, goods are exchanged for goods.

Ans. True. Barter system of exchange is a system in which goods are exchanged for goods.

Q.2. A common medium of exchange exists in the C-C economy.

Ans. False. A common medium of exchange does not exist in the C-C economy. It is an economy where goods are exchanged for goods.

Q.3. Double coincidence of wants is the principal feature of the barter system of exchange.

Ans. True. Double coincidence of wants is the principal feature of the barter system of exchange. This arises because goods are exchanged for goods, and there is no common medium of exchange like money.

Q.4. In the C-C economy, saving is ruled out because there is no money in this economy.

Ans. False. Saving is not ruled out in the C-C economy. Saving is possible by way of storage of goods.

Q.5. Amisha buys an ice cream from a grocery shop for ` 20 and at the same time sells the packaging material to the grocery shop for ` 200. The sale and purchase by Amisha refer to barter system of exchange as it involves double coincidence of wants.

Ans. False. Sale and purchase by Amisha does not refer to barter system of exchange. Because, both sale and purchase are done using money as a common medium of exchange.

Concept of Money - R & U - Very Short (Info & Con)

Q.1. What is meant by money?

Ans. Money can be defined as something that is generally accepted as a means of exchange and acts as a measure and as a store of value.

Q.2. Define fiat money.

Ans. Fiat money is the money issued by order of the government.

Q.3. Define fiduciary money.

Ans. Fiduciary money is the money backed with mutual trust between the payer and the payee.

Q.4. What is full bodied money?

Ans. Full bodied money refers to money in terms of coins whose commodity value is equal to the money value as and when these are issued.

Q.5. What is credit money?

Ans. Credit money is the money of which money value is more than commodity value.

Q.6. Define bank money.

Ans. Bank money is the money created by the bank in the form of demand deposits, over and above cash deposits of the people with the banks. It is a credit money and not a legal tender.

Concept of Money - Reason-Based (Comp. of Sub)

Q.1. Money is what money does.

Ans. True. Basically, money facilitates exchange of goods and services. Accordingly, money is defined as ‘anything that acts as a medium of exchange’.

Q.2. Introduction of money has removed the major drawback of double coincidence of wants in the barter system of exchange.

Ans. True. Use of money as a medium of exchange has removed the major drawback of double coincidence of wants in the barter system of exchange. With the introduction of money, acts of sale and purchase have been separated.

Q.3. Fiat money is that money which is accepted as a medium of exchange because of the trust between the payer and the payee.

Ans. False. Fiat money is that money which is issued by order/authority of the government.

Q.4. Cheques are fiat money.

Ans. False. Cheques are fiduciary money because these are accepted as a means of payment on the basis of trust, not on the basis of any order of the government.

Q.5. Commodity value of a ten rupee coin in India is more than its money value.

Ans. False. Commodity value of a ten rupee coin in India is definitely less than its money value. Otherwise, people would have melted the coins and sold them as a commodity.

Q.6. Money value of a Thousand rupee note is what is written on it.

Ans. True. Money value of money is the value which is inscribed on a coin or written on a paper note. Thus, money value of a Thousand rupee note is what is written on it.

Q.7. Money is a dynamic factor.

Ans. True. Money is a dynamic factor because it has imparted dynamism to the process of production, consumption, investment and exchange.

Q.8. Money has facilitated the sale and purchase of goods and services.

Ans. True. Money has facilitated the sale and purchase of goods and services. With the use of money as a medium of exchange, goods and services can be purchased for money any time. Similarly, goods and and services can be sold for money any time.

Q.9. Measurement of value was very difficult in the barter system of exchange.

Ans. True. Measurement of value was very difficult in the barter system of exchange because there was no common unit of value.

Q.10. Emergence of financial market increases the consumption and investment expenditure in the economy.

Ans. True. Financial market offers funds for investment as well as the purchase of consumer durables. Availability of funds through financial market has led to a multiple increase in consumption expenditure as well as investment expenditure.

Supply of Money - R & U - Very Short (Info & Con)

Q.1. Define money supply.

Ans. Money supply refers to the total quantity or stock of money available in the economy at a point of time.[Note: It does not include stock of money held by the suppliers of money, viz., the central bank, the commercial banks and the government.]

Q.2. Define M_1 measure of money supply.

Ans. M_1 = Currency (including notes and coins held by the people) + Demand deposits + Other deposits.

Q.3. What are the components of money supply?

Ans. The components of money supply are: (i) Currency held by the public, (ii) Demand deposits of the people with the commercial banks, and (iii) Other deposits (demand deposits with RBI of domestic and foreign institutions other than that of the government of the country and commercial banks within the country).

Q.4. Who are the suppliers of money in India?

Ans. Suppliers of money include: (i) the government of the country, (ii) the central bank of the country, and (iii) the commercial banks.

Q.5. What is the difference between term deposits and demand deposits?

Ans. Term deposits are always for a specific period of time called 'the term'. Cheques cannot be issued against term deposits. Demand deposits, on the other hand, are not for any specific period of time. Cheques can be issued against demand deposits.

Supply of Money - Reason-Based (Comp. of Sub)

Q.1. Demand deposits with commercial banks are a part of money supply.

Ans. True. Demand deposits with the commercial banks are a part of M_1 measure of money supply. These are chequeable deposits and therefore, serve like notes and coins.

Q.2. Money supply in the economy include only notes and coins issued by the central bank.

Ans. False. Money supply in the economy includes notes and coins with the people as well as demand deposits with the banks.

Q.3. Money can be withdrawn as and when needed by the depositors in case of term deposits.

Ans. False. Depositors cannot withdraw money as and when needed in case of term deposits because term deposits are always for a specific period of time. These are not chequeable deposits.

Q.4. Stock of money with the government is a part of money supply.

Ans. False. Stock of money with the suppliers/creators of money is not to be treated a part of money supply in the country. We know, the government is the supplier of money.

Q.5. Commercial banks are the principal suppliers of money in India.

Ans. False. RBI (Reserve Bank of India) is the principal supplier of money in India.

Q.6. Gross demand deposits are not a part of money supply while net deposits are.

Ans. True. Gross demand deposits include inter-banking claims whereas net demand deposits do not include inter-banking claims. Inter-banking claims are not a part of demand deposits of the people. Hence, only net demand deposits are taken as a part of money supply, not the gross deposits.

Q.7. Term deposits are near money, and therefore should be treated as a component of M_1 supply of money.

Ans. False. M_1 supply of money includes only most liquid components of money supply. There are those components (like currency with the people) which can be used for purpose of sale and purchase of goods any time. Term deposits are not so liquid and therefore, not included in M_1 supply of money.

Commercial Banks - R & U - Very Short (Info & Con)

Q.1. Define the term commercial bank.

Ans. Commercial banks are those financial institutions which accept deposits from the people and offer them loans for purpose of consumption and investment.

Q.2. Name the two primary functions of the commercial banks.

Ans. (i) Acceptance of deposits, and

(ii) Advancing of loans.

Q.3. Define credit multiplier.

Ans. Credit multiplier is the reciprocal of CRR. It is the number of times cash reserves of the commercial banks multiply to be equal to demand deposits.

$$\text{Credit Multiplier} = \frac{1}{\text{CRR}}$$

Example: If CRR = 5%, Credit multiplier = $\frac{1}{5\%} = 20.$

Q.4. Define primary deposits.

Ans. Primary deposits are cash deposits with the commercial banks by the people. These are reflected as a part of demand deposits of the banks.

Q.5. Define secondary deposits.

Ans. Secondary deposits are those deposits which arise on account of loans by the banks to the people. These are reflected as a part of demand deposits of the banks. These are also called derivative deposits.

Commercial Banks - Reason-Based (Comp. of Sub)

Q.1. The commercial banks generate their profits by way of 'spread'.

Ans. True. The commercial banks generate their profits by way of 'spread' which is the difference between the rate of interest charged by the banks for the loans they offer and the rate of interest paid by the banks for the deposits they accept.

Q.2. All financial institutions are banking institutions.

Ans. False. All financial institutions are not banking institutions, even when all banking institutions are financial institutions. Example: LIC is a financial institution, but not a banking institution. A financial institution is a banking institution only when: (i) it accepts deposits from the people, and (ii) offers loans to the people.

Q.3. Loans offered by the commercial banks are a part of the cash reserves of the commercial banks.

Ans. False. Loans offered by the commercial banks are a part of demand deposits of the commercial banks.

Q.4. Higher cash deposit ratio implies higher credit creation capacity of the commercial banks.

Ans. True. Higher cash deposit ratio would lead to greater cash reserves of the commercial banks. Implying higher credit creation capacity of the commercial banks.

Q.5. Both primary and secondary deposits are demand deposits.

Ans. True. Both primary and secondary deposits are demand deposits because these can be withdrawn on demand by writing cheques.

Q.6. If reserve requirement = 25% of deposits, the credit multiplier = 10.

Ans. False. If reserve requirement = 25% of deposits,

$$\text{Credit Multiplier} = \frac{1}{\text{Reserve Requirement}} = \frac{1}{25\%} = 4.$$

Q.7. CRR and SLR are the two components of LRR.

Ans. False. CRR and SLR are not the two components of LRR. These are the two variants of LRR. These cannot be added up to find LRR.

Q.8. Total demand deposits of the commercial banks is equal to the difference between the primary deposits and secondary deposits of the commercial banks.

Ans. False. Total demand deposits of the commercial banks is equal to the sum total of primary deposits and secondary deposits of the commercial banks.

Central Bank - R & U - Very Short (Info & Con)

Q.1. Define a central bank.

Ans. A central bank is an apex institution of a country that controls and regulates the cost of credit as well as the flow of credit in the economy with a view to achieving growth and stability.

Q.2. Define bank rate.

Ans. The bank rate is the rate at which the central bank of the country offers loans to the commercial banks by discounting the securities. It is also called discount rate: the rate at which securities are discounted for purpose of loans. It does not involve any collateral.

Q.3. What is repo rate?

Ans. Repo rate (or policy interest rate) is the rate of interest at which commercial banks can raise short-term loans from the central bank by offering 'unencumbered securities' as collateral.

Q.4. What is reverse repo rate?

Ans. Reverse repo rate is the rate of interest at which commercial banks can park their surplus funds with the central bank.

Q.5. Define cash reserve ratio.

Ans. Cash reserve ratio refers to the legal reserve ratio (fixed by the RBI) indicating some percentage of demand deposits of the commercial banks to be kept as cash reserves with RBI.

Q.6. Define statutory liquidity ratio.

Ans. Statutory liquidity ratio refers to liquid assets of the commercial banks which they are required to maintain (on daily basis) as a minimum percentage of their total deposits.

Q.7. Define legal reserve ratio.

Ans. Legal reserve ratio refers to CRR (as well as SLR) as fixed by the central bank and which the commercial banks are required to maintain as a percentage of their demand deposits.

Q.8. What do you mean by open market operations?

Ans. Open market operations refer to the sale and purchase of government securities in the open market by the central bank of the country.

Q.9. Define margin requirement.

Ans. Margin requirement refers to the difference between market value of the security offered for loans and the amount of loans offered by the commercial banks.

Q.10. Define moral suasion.

Ans. Moral suasion refers to persuasion as well as pressure exercised by the central bank on the commercial banks to be restricted and selective in lending during inflation, and to be liberal in lending during deflation.