Chapter 13: Central Banking

Question: 1

Fill in the blank with appropriate alternatives given below

Central bank has the __________ of note issue.

Options

- monopsony
- monopoly
- duopoly
- oligopoly

Solution

Central bank has the **monopoly** of note issue.

Explanation: In India Central bank has the sole authority to issue currency notes. The central bank backs the currency it issues.

Question: 2

Fill in the blank with appropriate alternatives given below

The central bank acts as a ____________ of cash reserves of the country.

Options

- head
- leader
- custodian
- locker

Solution

The central bank acts as a **custodian** of cash reserves of the country.

Explanation: Individuals deposit their money in commercial banks. The commercial banks in turn are legally bound to deposit a certain portion of these deposits with the Central Bank. Thus, the Central Bank acts as a custodian (keeper) of the cash reserves of the country.

Question: 3

Fill in the blank with appropriate alternatives given below

Bank Rate is also called as ___________ rate.

Options

- rediscount
- market
- general
- exchange

Solution

Bank Rate is also called as **rediscount** rate.

Explanation: Bank Rate refers to the rate at which the Central Bank lends money to the commercial bank or the rate at which the Central Bank discounts the bills of the commercial banks. This rate is also called the rediscount rate.

Question: 4

Fill in the blank with appropriate alternatives given below

_____________ is the apex body of the monetary and banking systems of the nation's economy.

Options

- Commercial bank
- Central bank
- Government
- Co-operative bank

Solution

Central bank is the apex body of the monetary and banking systems of the nation's economy.

Explanation: The Central Bank is the apex institution of a country's economy. It regulates and controls the activities of all the commercial banks and other financial institutions in the country. It plays a pivotal role in the organisation and development of a sound monetary and financial system in an economy.

Question: 5

Fill in the blank with appropriate alternatives given below

Reserve Bank of India was established in ______________.

Options

- 1937
- 1939
- 1935
- 1934

Solution

Reserve Bank of India was established in **1935**.

Explanation: Reserve Bank of India, which is the central bank of India, is the apex institution of a country's monetary system. It was set up in 1935. The main objective of setting up this institution was to regulate and control the activities of the commercial banks and other financial institutions in the country.

Question: 6

Match the following:

Group A	**Group B**
1. Central bank	a. Quantitative measure of credit
2. Clearing house	b. Apex banking institution
3. Credit control	c. Deliberate buying and selling of government securities
4. Direct action	d. Selective method of credit control
5. Open market operations	e. Central bank
	f. Government
	g. S.L.R. (Statutory Liquidity Ratio)

Solution

Group A	Group B
1. Central bank	b. Apex banking institution
2. Clearing house	e. Central Bank
3. Credit control	g. S.L.R. (Statutory Liquidity Ratio)
4. Direct action	d. Selective method of credit control
5. Open market operations	c.Deliberate buying and selling of government securities

Explanations:

1. The Central Bank is the apex institution of a country's monetary system. It regulates and controls the activities of all the commercial banks and other financial institutions of the country.

2. Central Bank acts as a clearing house for the commercial banks. As a clearing house it settles inter-bank claims, reducing the need for cash reserves by the commercial banks.

3. Statutory Liquidity Ratio (SLR) is defined as the minimum percentage of assets, such as gold, cash or securities, which must be maintained by the commercial banks with the Central Bank. Central Bank uses it as a measure of credit control in the economy. High SLR implies lesser funds left for advancing credit. Thus, increasing SLR implies credit control by the central bank.

4. Direct action refers to the actions taken by central banks against commercial banks which fail to adhere to the directions of the bank. It is used as a selective credit control measure.

5. Open Market Operations refer to the buying and selling of securities either to the public or to the commercial banks in an open market.

Question: 7

State whether the following statement is TRUE or FALSE.

Credit rationing is quantitative credit control measure of Central bank.

Options

- True
- False

Solution

Credit rationing is quantitative credit control measure of Central bank.
- **False**

Explanation: Credit rationing is a qualitative method and not a quantitative method. In other words, it affects the direction and flow of credit. Under this, the Central Bank fixes the credit limit for different business activities in the economy. No commercial bank can exceed the prescribed credit limits. The main aim of loan credit rationing is to restrict the flow of credit towards speculative activities.

Question: 8

State whether the following statement is TRUE or FALSE.

Regulation of Consumer Credit is a quantitative credit control measure of Central Bank.

Options

- True
- False

Solution

Regulation of Consumer Credit is a quantitative credit control measure of Central Bank. - **False**

Explanation: Regulation of Consumer Credit is a qualitative method and not a quantitative as it regulates the credit extended to the consumers for the purchase of consumer durables. The monthly instalments or down payment amounts are altered in order to liberalise or restrict credit in the hands of a consumer.

Question: 9

State whether the following statement is TRUE or FALSE.

Bank Rate is the selective credit control measure used by the Central Bank of the country.

Options

- True
- False

Solution

Bank Rate is the selective credit control measure used by the Central Bank of the country. - **False**

Explanation: Bank Rate refers to the rate of interest at which the central bank lends money to the commercial banks or the rate at which the central bank discounts the bills of the commercial banks. This is classified as a quantitative measure of credit control since it directly affects the market interest rate and thereby the money supply in the economy.

Question: 10

State whether the following statement is TRUE or FALSE.

Central Bank also performs commercial banking business.

Options

- True
- False

Solution

Central Bank also performs commercial banking business. - **False**

Explanation: Commercial banking business implies accepting deposits from and lending deposits to the general public. The Central bank does not deal directly with the general public and does not perform any of the commercial banking functions.

Question: 11

State whether the following statements is TRUE or FALSE.

The main objective of a Central Bank is to earn profit.

Options

- True
- False

Solution

The main objective of a Central Bank is to earn profit. - **False**

Explanation: The central bank is the apex institution of a country's monetary system. The main objective of this bank is to regulate and control the activities of all the commercial banks and other financial institutions of the country. However, profit making is not the main objective of the central bank.

Question: 12

Define or Explain the following concept.

Prof. Samuelson's definition of Central Bank

Solution

According to Prof. Samuelson "Central Bank is a bank of bankers. Its duty is to control the monetary base, through the control of high powered money, to control the community's supply of money."

Question: 13

Define or Explain the following concept.

Open Market Operation

Solution

Open Market Operations refer to the buying and selling of government securities. These securities can be bought or sold to the public or to the commercial banks in an open market. Open Market Operations are used by the Central Bank to affect the money supply in the economy. The selling of securities by the RBI wipes out the extra cash balance from the economy, thereby limiting the money supply, whereas in the case of buying securities by the RBI, additional money is pumped into the economy stimulating the money supply.

Question: 14

Define or Explain the following concept.

Bank Rate

Solution

Bank Rate refers to the rate of interest at which the Central Bank lends money to the commercial banks or the rate at which the Central Bank discounts the bills of the commercial banks. This rate is also called the rediscount rate. This instrument is a key in the hands of RBI to control money supply. Change in the bank rate changes the cost of borrowings, thereby affecting money supply. An increase in the bank rate increases the cost of borrowing for the commercial banks from the Central Bank.

The commercial banks, in turn, increase the lending rate for their customers. However, this increase in the lending rate reduces the borrowing capacity of the public, thereby discouraging loans and credit.

Question: 15

Define or Explain the following concept.

Moral suasion

Solution

A persuasion technique followed by the central bank to pressurise the commercial banks to abide by the monetary policy is termed as moral suasion. This involves meetings, seminars, speeches and discussions, which explain the present economic scenario and thereby persuade the commercial banks to adapt the changes needed.

Question: 16

Define or Explain the following concept.

Cash Reserve Ratio

Solution

CRR or the Cash Reserve Ratio refers to the minimum amount of funds that a commercial bank has to maintain with the Reserve Bank of India, in the form of deposits. CRR is used to affect the lending capacity of the commercial banks. An increase in the CRR reduces the money left with the commercial bank for lending eventually leading to a decrease in the money supply.

Question: 17

Define or Explain the following concept.

Clearing House System

Solution

All the commercial banks are mandatorily required to keep a certain percentage of their deposits, other than cash reserve ratio (CRR), with the Central Bank. The Central Bank acts as a clearing house for the commercial banks. As a clearing house, it settles inter-bank claims and reduces the need for cash reserves by the commercial banks.

Question: 18

Define or Explain the following concept.

Central Bank as Bank of Issue

Solution

The Central Bank is the sole entity that can print currency notes. In other words, the central bank of a country has the exclusive authority to issue the currency (notes + coins). The currency issued by the central bank is known as 'legal tender money' i.e. the value of such currency is backed by the central bank. Since, issuance of notes is exclusively reserved for the Central bank, it is said to be the ‘Bank of Issue’.

Question: 19

Give reason or explain.

Clearing house system economises the use of cash.

Solution

All the commercial banks are mandatorily required to keep a certain percentage of their deposits with the Central Bank. The Central Bank accepts the deposits from the commercial banks and helps in the settlement of interbank claims. This is regarded as a clearing house function of commercial banks. As a clearing house it settles inter-bank claims and reduces the need for cash reserves by the commercial banks.

Question: 20

Give reason or explain.

Central Bank acts as a lender of the last resort.

Solution

The Central Bank acts as the lender of last resort for the commercial banks and the government. When a commercial bank faces financial crisis and fails to obtain funds from other sources, the Central Bank plays the vital role of ‘lender of last resort’ and provides them with financial assistance in the form of credit.

Question: 21

Give reason or explain.

The CRR affects the lending capacity of the banks.

Solution

CRR refers to the minimum portion of the total deposits that the commercial banks have to maintain with the Central Bank in the form of reserves. CRR has a great impact on the lending capacity of the banks. An increase in CRR means lesser portion of the deposits would be left for distribution as loans and a decrease in CRR means a greater portion would be available for further loans.

Suppose the total assets of a bank are worth Rs. 200 Crores and the minimum CRR is 10%, the amount that the commercial bank has to maintain with the RBI is Rs. 20 Crores. If this ratio rises to 20%, the reserve with RBI increases to Rs. 40 Crores.

Thus, less money will be left with the commercial bank for lending. This will eventually lead to considerable decrease in the money supply. Therefore, CRR is used to affect the lending capacity of the commercial banks.

Question: 22

Give reason or explain.

As a banker to the government, the Central Bank transfers government funds.

Solution

Central Bank acts as a banker to the government. On behalf of the government, the Central Bank buys and sells government securities, maintains its books of accounts, manages its public debt and also grants loans and advances to the government. Thus, as a banker to the government, the Central Bank transfers government funds by accepting receipts and making payments on behalf of the government.

Question: 23

Give reason or explain.

A Central Bank may take 'Direct Action' against the defaulting commercial banks.

Solution

Direct action refers to the actions taken by the Central Bank against commercial banks which fail to adhere to the directions of the Central bank. In other words, it refers to the actions taken by the Central Bank against defaulting commercial banks. Direct action is used as a selective credit control measure by the Central Bank. This may be achieved by either threatening the defaulting banks or by refusing them the rediscounting and loan facilities or by imposing penalties on these banks.

Question: 24

Distinguish between:

Central Bank and Commercial Bank

Solution

Basis	**Central Bank**	**Commercial Bank**
Objective	The main objective of this bank is to	The main objective

	regulate and control the functioning of the commercial banks.	of this bank is profit making.
Issue of notes	It has the exclusive right to issue currency notes and coins.	It cannot issue currency notes and coins.
Public dealing	It doesn't deal with the public directly. It acts as a banker to other banks and to the government.	It deals with the general public directly.

Question: 25

Distinguish between:

Quantitative Credit Control Measures and Qualitative Credit Control Measures

Solution

Basis	**Quantitative Credit Control Measures**	**Qualitative Credit Control Measures**
Affect	Instruments of these measures have an effect on the entire economy.	Instruments of these measures have an effect only on some individuals or parties and not on the entire economy.
Uses	These measures are used to affect the quantum of credit in the economy.	These measures are used to affect the use of credit.
Techniques	Some examples of quantitative techniques are Cash Reserve Ratio, Statutory Liquid Ratio, Bank Rate etc.	Some examples of qualitative techniques are Selective Credit Control, Moral Suasion, Rationing of Credit etc.

Question: 26

Distinguish between:

Bank Rate and Open Market Operations

Solution

Basis	**Bank Rate**	**Open Market Operations**
Meaning	It refers to the rate at which the Central bank grants loans to the commercial Banks.	It refers to the buying and selling of government securities.

Influence on the interest rate and the money supply	It affects the rate of interest directly and the money supply indirectly.	It affects the rate of interest indirectly and the money supply directly.

Question: 27

Distinguish between:

Cash Reserve Ratio and Statutory Liquidity Ratio

Solution

Basis	Cash Reserve Ratio	Statutory Liquidity Ratio
Meaning	It is the minimum amount of funds that a commercial bank has to maintain with the Reserve Bank of India in the form of deposits.	It is the minimum percentage of assets, such as gold, cash or securities, which must be maintained by the commercial banks with the Central Bank.
Affect	It affects the bank's capacity to lend.	It affects the bank's liquidity.

Question: 28

Write short note on:

Definition of a Central Bank

Solution

The Central Bank is the apex institution of a country's monetary system. It regulates and controls the activities of all the commercial banks and other financial institutions of the country. It plays a pivotal role in the organisation and development of a sound monetary and financial system in an economy. In India, the Reserve Bank of India (RBI) is the central bank. The following are some of the definitions of central bank. According to Prof. Paul.

A Samuelson "Central bank is a bank of bankers. It's duty is to control the monetary base and through the control of high powered money to control the community's supply of money" According to Prof. Hawtrey " Central Bank is that which the lender of last resort".

Question: 29

Write short note on:

Issuing Directives

Solution

Issuing Directives is another qualitative measure of credit control used by the Central Bank. Under this method, the Central Bank issues directives or orders that must be followed by the public and the commercial banks. This is done to ensure that the credit policy followed by the Central bank is consistent with the monetary policy followed by the commercial banks.

Question: 30

Write short note on:

Central Bank's measure of regulation of consumer credit

Solution

Consumer credit refers to the credit that is used by the consumers to buy consumer durable goods such as laptops, mobiles, cars etc. An increase in the amount of this credit will lead to an increase in the demand for goods. With the production of goods remaining unchanged, this increase in demand will result in a shortage of goods. Similarly, a decrease in the amount of this credit will result in decrease in the demand for goods, causing supplies to remain unsold.

Thus, the Central Bank's measure of regulation of consumer credit is used to regulate the amount of consumer credit that can be granted to ensure that the production or inventories are not affected.

Question: 31

Write short note on:

Regulation of Margin Requirements

Solution

Margin requirement implies ascertaining the value of the loan that can be granted upon the mortgage of a certain security. The banks keep a margin, which is the difference between the market value of a security and its loan value. For example, a commercial bank grants loan of Rs 80,000 against security of Rs 1,00,000. So, the margin is calculated as Rs 1, 00,000 – Rs 80,000 = Rs 20,000.

A rise in the margin requirement discourages loans. Accordingly, when the central bank decides to restrict the flow of money, then the margin requirement of loan is raised. This is referred to as 'Regulation of Margin Requirements'.

Question: 32

Write Short note on :
Cash Reserve Ratio (CRR)

Solution

CRR or the Cash Reserve Ratio refers to the minimum amount of funds that a commercial bank has to maintain with the Reserve Bank of India in the form of deposits. For example, suppose the total assets of a bank are worth Rs.200 Crores and the minimum cash reserve ratio is 10%, the amount that the commercial bank has to maintain with RBI is Rs.20 Crores. If this ratio rises to 20%, the reserve with RBI increases to Rs.40 Crores. Thus, less money will be left with the commercial bank for lending. This will eventually lead to considerable decrease in the money supply.

Question: 33

Write short note on:

Bank Rate

Solution

Bank rate refers to the rate of interest at which the Central Bank lends money to the commercial banks or the rate at which the Central Bank discounts the bills of the commercial banks. This rate is also called the rediscount rate. This instrument is a key in the hands of the RBI to control money supply. Increase in the bank rate will make the loans more expensive for the commercial banks and thereby, pressurise the banks to increase the rate of lending. The public capacity to take credit will gradually fall leading to a fall in the volume of credit demanded.

Question: 34

Write short note on:

Open Market Operations (OMO)

Solution

Open Market Operations refer to the buying and selling of government securities. These securities can be bought or sold to the public or to the commercial banks in an open market. Open Market Operations are used by the Central Bank to affect money supply in the economy. The selling of securities by the RBI will wipe out the extra cash balance from the economy, thereby limiting the money supply, whereas in the case of buying securities by RBI, additional money is pumped into the economy stimulating money supply.

Question: 35

Answer the following question:

"Central Bank of the country has the monopoly of note issue." Explain.

Solution

In India, The Central Bank is the sole entity that can print currency notes. In other words, the central bank of a country has exclusive authority to issue currency. The currency issued by the central bank is known as 'legal tender money' i.e. the value of such currency is backed by the central bank. Since, issuance of notes is exclusively reserved for the central bank, it can be said that the Central bank of a country has the monopoly over the issuance of notes.

Question: 36

Answer the following question:

How does a Central Bank (for example RBI) transfer funds from one place to another? Illustrate.

Solution

Commercial banks have to mandatorily deposit a fixed percentage of their deposits with the Central Bank. The Central Bank uses this money to settle the claims of one bank by the other. In other words, the Central Bank undertakes transfer of funds from one bank to the other to settle inter-bank claims. In addition to this, the Central Bank also buys and sells securities on behalf of the government.

By buying securities, it transfers money from the government’s account to the account of the security holders. Similarly, when it sells securities, it transfers money into the government’s account. Thus, in these ways, the Central Bank (RBI) transfers money from one place to the other.

Question: 37

Answer the following question:

Explain the Data Collection and Publicity functions of the Central Bank.

Solution

The Central Bank collects a variety of data such as information about the agricultural, industrial and financial sectors, information about the exports and imports etc. It also publishes reports on the trends in the money and capital market, trends in the price levels etc. The information collected by the Central Bank is then used by the government to formulate its monetary and fiscal policies.

Question: 38

Answer the following question:

What are the various measures of quantitative credit control?

Solution

The following are the various measures of quantitative credit control:

i. Bank Rate - Bank rate refers to the rate at which the central bank provides loans to the commercial banks. This instrument is a key at the hands of RBI to control the money supply. Changes in the bank rate change the cost of borrowings, thereby affect the money supply. An increase in the bank rate decreases the money supply and vice-versa.

ii. Open Market Operations (OMOs) - OMOs refer to the buying and selling of securities either to the public or to the commercial banks in an open market to affect the money supply in the economy. The selling of securities by RBI will wipe out the extra cash balance from the economy, thereby limiting the money supply, whereas in the case of buying securities by RBI, additional money is pumped into the economy stimulating the money supply.

iii. Cash reserve ratio (CRR) - It refers to the minimum proportion of the total deposits that the commercial banks has to maintain with the central bank in form of reserves. An increase in the CRR, would mean that banks are required to keep a greater portion in form of deposits with the central bank and the commercial banks are left with lesser amount of funds to lend out. Hence, the lending capacity of the banks is reduced, leading to fall in the money supply. On the contrary, a fall in CRR will lead to an increase in the money supply.

Question: 39

Answer the following question:

What are the various measures of qualitative credit control?

Solution

The following are the various measures of qualitative credit control:

i. Marginal Requirements - Margin requirement implies ascertaining the value of the loan that can be granted upon the mortgage of a certain security. The banks keep a margin, which is the difference between the market value of a security and its loan value. For example, a commercial bank grants loan of Rs 80,000 against security of Rs 1, 00,000. So, the margin is calculated as Rs 1, 00,000 – Rs 80,000 = Rs 20,000. When the central bank decides to restrict the flow of money, then the margin requirement of loan is raised. This is referred to as 'Regulation of Margin Requirements'.

ii. Selective Credit Control (SCC's) - An instrument of monetary policy that affects the flow of credit to particular sectors positively and negatively is known as selective credit control. The positive aspect is concerned with the increased flow of credit to the priority sectors. However, the negative aspect is concerned with measures to restrict credit to a particular sector.

iii. Moral Suasions - A persuasion technique followed by the central bank to pressurise the commercial banks to abide by the monetary policy is termed as moral suasion. This involves meetings, seminars, speeches and discussions, which explain the present economic scenario and thereby persuade the commercial banks to adapt the changes needed. In other words, this is an unofficial monetary policy that exercises the power of talk.

Question: 40

State with reason whether you agree or disagree with the following statement.

Central Bank is the Bank of Issue.

Solution

Yes, the above statement is true. The Central Bank is the sole entity that can print currency notes. In other words, the central bank of a country has the exclusive authority to issue currency (notes + coins). The currency issued by the central bank is known as 'legal tender money' i.e. the value of such currency is backed by the central bank. Since, issuance of notes is exclusively reserved for the Central Bank, it is said to be the 'Bank of Issue'.

Question: 41

State with reason whether you agree or disagree with the following statement.

A co-operative bank acts as a lender of the last resort.

Solution

No, the given statement is not correct. This is because it is the Central Bank that acts as the lender of last resort for the commercial banks and the government. When a commercial bank faces financial crisis and fails to obtain funds from other sources, the central bank plays the vital role of 'lender of last resort' and provides them with financial assistance in the form of credit.

Question: 42

State with reason whether you agree or disagree with the following statement.

Credit control is the function of the Central Bank of the country.

Solution

Yes, the above statement is correct. Credit control refers to the control on the quantum of credit and the direction of its flow in the economy. This is done to achieve growth with stability. Therefore, we can say that credit control is the function of the central bank of a country. The Central Bank can use various quantitative and qualitative measures for controlling credit in the economy.

Question: 43

State with reason whether you agree or disagree with the following statement.

Central Bank is a profit-making institution.

Solution

No, this statement is not correct. This is because the main objective of the Central Bank is to regulate and control the activities of all the commercial banks and other financial institutions of the country. It also plays a pivotal role in the organisation and development of a sound monetary and financial system in an economy. However, profit making is not the objective of the Central Bank.

Question: 44

State with reason whether you agree or disagree with the following statement.

Central Bank having monopoly of note issue is most appropriate institute of the government.

Solution

Yes, the above statement is correct. The Central Bank is the most appropriate institute of the government for issuance of notes. This is because of the following points:

i. It ensures uniformity in note making.

ii. It ensures a control on the issuance of notes and thus, controls the overall issue of currency.

iii. It increases the confidence of the public in the currency, as there is uniformity in it.

iv. Since there is just one agency for the issuance of notes, it becomes convenient for the government to supervise and monitor its operations.

Question: 45

Answer in detail.

What are the qualitative measures of credit control?

Solution

The following are the various measures of qualitative credit control:

i. Marginal Requirements - Margin requirement implies ascertaining the value of the loan that can be granted upon the mortgage of a certain security. The banks keep a margin, which is the difference between the market value of a security and its loan value. For example, a commercial bank grants loan of Rs 80,000 against security of Rs 1, 00,000. So, the margin is calculated as Rs 1, 00,000 – Rs 80,000 = Rs 20,000. When the central bank decides to restrict the flow of money, then the margin requirement of loan is raised. This is referred to as 'Regulation of Margin Requirements'.

ii. Selective Credit Control (SCC's) - An instrument of monetary policy that affects the flow of credit to particular sectors positively and negatively is known as selective credit control. The positive aspect is concerned with the increased flow of credit to the priority sectors. However, the negative aspect is concerned with measures to restrict credit to a particular sector.

iii. Moral Suasions - A persuasion technique followed by the central bank to pressurise the commercial banks to abide by the monetary policy is termed as moral suasion. This involves meetings, seminars, speeches and discussions, which explain the present economic scenario and thereby persuade the commercial banks to adapt the changes needed. In other words, this is an unofficial monetary policy that exercises the power of talk.

Question: 46

Answer in detail.

Explain the functions of the Central Bank.

Solution

The following are the seven major functions of a central bank:

i. Issue of currency notes - The central bank of a country has the exclusive authority to issue currency. The currency issued by the central bank is known as 'legal tender money' i.e. the value of such currency is backed by the central bank.

ii. Banker to the commercial banks - The central bank accepts deposits from the commercial banks and holds it as reserves for them. In addition to this:
a. Custodian of the cash reserves of the banks - Commercial banks are required to deposit a fixed percentage of their deposits with the Central Bank. These deposits can be used by the central banks to make inter-bank transfers. b. Lender of last resort - As the lender of last resort, the central bank is under the obligation to provide funds against securities to the commercial banks as and when needed by them. c. Clearing house function - Central Bank acts as a clearing house for the commercial banks. As a clearing house, it settles inter-bank claims and reduces the need for cash reserves by the commercial banks.

iii. Banker to the government - Central bank acts as a banker and financial advisor to the government. In addition to this, it buys and sells securities on behalf of the government, maintains its books of accounts, manages its public debt and also grants loans and advances to the government.

iv. Custodian of foreign exchange - All the transactions in foreign exchange are routed through the central bank and any earnings from the foreign exchange are to be deposited with the central bank. By having the custody of foreign exchange reserves, the central bank maintains exchange rate stability and promotes international trade.

v. Controller of credit - The central bank controls the supply of money and credit in an economy through various policy instruments (Qualitative and Quantitative instruments). By controlling the supply of money and credit, the central bank controls various economic variables such as prices and interest rate in the economy.

vi. Collection of data and publicity - Central banks collect different statistical information related to banking, currency and foreign exchange. Thereby, they help in the development of suitable monetary and fiscal policies.

vii. Developmental and promotional functions - In addition to the above mentioned functions, the Central bank also supports a variety of developmental and promotional activities like promoting banking habits among people, establishing specialised financial institutions, providing training to bank professionals etc.

Question: 47

Answer in detail.

Explain Regulation of consumer credit as a qualitative measure of the Central Bank of India.

Solution

Consumer credit refers to the credit that is used by consumers to buy consumer durable goods such as laptops, mobiles, cars etc. An increase in the amount of this credit will lead to an increase in the demand for such goods. With production of the goods remaining unchanged, this increase in demand will result in shortage of goods. Similarly, a decrease in the amount of this credit will result in decrease in the demand for goods, causing supplies to remain unsold.

Thus, the Central Bank's measure of regulation of consumer credit is used to regulate the amount of consumer credit that can be granted to ensure that the production or inventories are not affected. This is done by increasing or decreasing the amount of down payment or by changing the amount of instalments. Thus, if the Central Bank wants to restrict consumer credit, it can do so by either increasing the down payment or by raising the EMI (equated monthly instalments).

Similarly, if the central bank wants to encourage the buyers, it can do so by either decreasing the down payment or by lowering the EMI.