

UNIT 5- Explained Answers

1. **d) All of the above**
The primary functions of money are to serve as a medium of exchange, a unit of account, and a store of value. It allows for the smooth exchange of goods and services, provides a way to measure value, and retains value over time.
2. **c) The ease with which an asset can be converted into a medium of exchange**
Liquidity refers to how quickly and easily an asset can be converted into cash or a form that can be spent. Money is the most liquid asset, as it is already in the form required for exchange.
3. **d) Store of wealth**
While money is a store of value and a medium of exchange, the term 'store of wealth' typically refers to assets like real estate or stocks, which can accumulate wealth over time. Money serves as a short-term store of value rather than long-term wealth.
4. **c) Banknotes issued by Reserve Bank of India**
In India, only the Reserve Bank of India is authorized to issue banknotes. These notes are considered legal tender, meaning they must be accepted for payment of goods and services under the law.
5. **a) Issuing currency**
The most important function of the Reserve Bank of India (RBI) is to issue and manage the country's currency. This responsibility ensures a stable and secure monetary system, which is crucial for economic stability.
6. **b) Currency notes**
The Reserve Bank of India is the sole issuer of currency notes in India, except for one-rupee notes and coins, which are issued by the Ministry of Finance. This centralization helps control the money supply and inflation.
7. **a) Control inflation**
The primary objective of India's monetary policy is to control inflation. By managing the money supply, interest rates, and credit, the central bank aims to ensure price stability, which is crucial for economic growth and purchasing power.
8. **d) All of the above**
Open market operations (OMO) involve the buying and selling of government securities by the central bank. These operations are used to influence the money supply, control inflation, and manage interest rates, impacting the overall economy.
9. **d) Interest rate on loans to the government**
The interest rate on loans to the government is not a direct tool used by central banks to control money supply. Instead, the primary tools include the bank rate, open market operations, and the cash reserve ratio (CRR).
10. **d) All of the above**
The Reserve Bank of India regulates commercial banks through licensing, setting prudential norms, and capital adequacy requirements. This ensures that banks remain solvent, maintain sufficient reserves, and operate within a stable and regulated financial system.
11. **b) The rate at which the central bank lends to commercial banks**
The bank rate is the interest rate charged by the central bank on loans provided to commercial banks. This rate influences overall lending rates in the economy, impacting borrowing costs for businesses and consumers.
12. **b) The minimum percentage of a commercial bank's total deposit that must be kept in reserve**
The Cash Reserve Ratio (CRR) is the percentage of a commercial bank's total

deposits that it must keep with the central bank. This reserve is used to control the money supply and ensure banks maintain liquidity.

13. **b) Money supply includes currency in circulation, deposits, and reserve balances**
The money supply refers to the total amount of money available in the economy. It includes physical currency, deposits in commercial banks, and reserve balances maintained with the central bank, which collectively represent available money.

14. **b) Issuing currency**

Commercial banks do not have the authority to issue currency. Instead, their functions include accepting deposits, providing loans, and facilitating payment systems, while the central bank is responsible for issuing legal tender.

15. **c) Monetary policy**

The central bank controls the currency and credit system of a country through monetary policy. This policy aims to manage inflation, influence interest rates, and stabilize the economy by controlling the supply of money and credit.

16. **c) Accepting deposits**

The primary function of commercial banks is to accept deposits from individuals and institutions. These deposits are then used by banks to extend loans and create credit, facilitating economic activity and investment.

17. **c) Money multiplier effect**

Commercial banks create money through the money multiplier effect, where a portion of the deposits made by customers is kept in reserve, while the rest is lent out. This process increases the total money supply in the economy.

18. **c) Facilitating payments and credit creation**

Commercial banks play a vital role in the economy by facilitating payments through various channels, such as checks, cards, and electronic transfers. They also contribute to credit creation by lending to businesses and consumers.

19. **b) A loan that is overdue by more than 90 days**

A non-performing asset (NPA) is a loan that has not been repaid within the stipulated time frame. When loans are overdue by more than 90 days, they are classified as NPAs, indicating that the bank may not recover the full amount.

20. **b) Reserve Bank of India**

The banking sector in India is regulated by the Reserve Bank of India. The RBI sets guidelines for commercial banks' operations, monitors their solvency, and ensures that the financial system remains stable and efficient.

21. **b) To increase the money supply by purchasing government securities**

Quantitative Easing (QE) is a monetary policy in which the central bank purchases government securities to increase the money supply and stimulate economic activity. It aims to reduce interest rates and encourage lending.

22. **a) Monetary policy tools**

The central bank controls inflation primarily through monetary policy tools, such as adjusting interest rates, changing reserve requirements, and conducting open market operations. These tools affect the money supply and demand for credit.

23. **a) The ability of commercial banks to meet their liabilities**

Banking sector liquidity refers to the ability of banks to meet their short-term obligations. It ensures that commercial banks can fulfill withdrawal requests from customers, lending demands, and other financial commitments without disruptions.

24. **b) To buy or sell government securities to control money supply**

Open Market Operations (OMOs) are the buying and selling of government securities by the central bank to regulate the money supply. This tool influences the level of reserves in the banking system and helps control inflation and interest rates.

25. **d) Buying government bonds**

Indirect lending refers to the process by which commercial banks buy government bonds, which allows them to invest in secure assets that generate returns. This is different from directly lending to customers or businesses.

26. **c) They extend loans to borrowers, creating new money**

Commercial banks create credit by extending loans to borrowers. When a bank issues a loan, it does not necessarily use physical money; instead, it creates a deposit in the borrower's account, effectively increasing the money supply.

27. **b) Currency in circulation**

M1 includes the most liquid forms of money, such as currency in circulation and demand deposits. It represents money that can be immediately used for transactions, unlike other forms of money like time deposits or savings accounts.

28. **a) It is the rate at which commercial banks borrow from the RBI on a short-term basis**

The repo rate is the rate at which commercial banks can borrow short-term funds from the Reserve Bank of India by selling government securities. It directly affects the interest rates charged by commercial banks.

29. **a) Control inflation**

The primary goal of the RBI's monetary policy is to control inflation. By regulating the money supply, interest rates, and credit availability, the central bank can stabilize prices and prevent excessive inflation that harms the economy.

30. **b) Loans given to customers**

Loans given to customers are an asset for a commercial bank because they represent money owed to the bank. Banks earn interest on these loans, which is a primary source of revenue, making loans an important asset.

31. **b) Loans and advances interest**

Commercial banks earn the majority of their revenue from interest on loans and advances. They lend money at a higher interest rate than the rate at which they borrow from the central bank or depositors, thus making a profit.

32. **b) To regulate the liquidity in the banking system**

The Cash Reserve Ratio (CRR) helps regulate liquidity by determining how much of the commercial bank's deposits must be kept with the central bank as reserves. This ensures banks have enough liquidity to meet their obligations.

33. **c) Managing government debt**

Commercial banks do not manage government debt; this responsibility falls to the central bank and the Ministry of Finance. However, commercial banks may hold government securities as part of their investment portfolios.

34. **c) Monetary stability and economic growth**

The primary objective of the central bank is to maintain monetary stability and foster economic growth. This is achieved through effective monetary policies, including controlling inflation, managing interest rates, and ensuring a stable financial system.

35. **b) Actions taken by the central bank to control money supply and interest rates**

Monetary policy refers to the actions taken by the central bank to influence the money supply and interest rates in order to achieve specific macroeconomic goals, such as controlling inflation, stabilizing the currency, and promoting employment.

36. **a) It can be easily converted into goods and services**

Liquid money refers to cash or assets that are immediately available for transactions. These assets can be quickly used to buy goods and services without needing to be converted into another form of payment.

37. **c) Reserve Bank of India**

The Reserve Bank of India is responsible for regulating and supervising commercial banks in India. It sets regulations, provides licenses, and ensures that banks maintain sufficient reserves, capital adequacy, and follow prudent banking practices.

38. **a) The interest rate charged by the central bank to commercial banks for short-term loans**

The discount rate refers to the interest rate charged by the central bank to commercial banks for borrowing short-term funds. This rate influences the cost of borrowing for commercial banks and affects the broader economy.

39. **b) It decreases the money supply in the economy**

An increase in the Cash Reserve Ratio (CRR) reduces the amount of money commercial banks can lend, thus decreasing the money supply in the economy. This helps control inflation by reducing the availability of credit.

40. **c) Deposits made by customers**

Deposits made by customers are a liability for commercial banks because the bank owes the depositor the amount deposited. Banks are required to return these funds on demand, thus making deposits an important liability.

41. **d) Monitoring counterfeit currency**

The RBI's role in currency management involves issuing legal tender and monitoring the supply of currency in the economy. However, the responsibility for printing coins lies with the Ministry of Finance, and the RBI ensures that counterfeit currency is detected.

42. **d) Both a and b**

The major functions of the central bank include issuing currency notes and controlling credit creation by commercial banks. The central bank uses tools such as the bank rate, open market operations, and reserve requirements to regulate credit.

43. **b) Loans and advances interest**

The primary source of revenue for commercial banks is the interest they earn on loans and advances. This interest is higher than the interest they pay on customer deposits, allowing them to make a profit.

44. **b) Lowering interest rates and increasing money supply**

Monetary expansion refers to policies that increase the money supply and reduce interest rates. This can stimulate economic activity by making borrowing cheaper and encouraging spending and investment.

45. **b) Open market operations**

Open market operations (OMOs) are a monetary policy tool used by central banks to buy or sell government securities. OMOs influence the money supply and short-term interest rates, thus playing a key role in controlling inflation and stimulating the economy.

46. **a) Open market operations**

The central bank uses open market operations (OMO) to influence the money supply. When the central bank sells government bonds, it reduces the money supply, which helps control inflation, while buying bonds increases the money supply.

47. **c) Stabilize the currency**

The RBI manages foreign exchange reserves to stabilize the currency. By buying or selling foreign currencies, the RBI can influence the exchange rate and prevent excessive fluctuations in the value of the domestic currency.

48. **b) Assets that can be quickly converted into cash**

Liquid assets are financial instruments that can be quickly converted into cash without

a significant loss in value. These assets include bank deposits, government bonds, and stocks, all of which are easy to sell or use for transactions.

49. **d) All of the above**

The Reserve Bank of India acts as the banker to the government by managing government transactions, issuing government bonds, and advising the government on economic matters. This role is essential for maintaining financial stability.

50. **a) Purchasing a bill of exchange at a discounted value before its maturity**

Discounting of bills of exchange refers to the process by which commercial banks purchase bills of exchange from exporters or borrowers before they mature, at a discounted rate. This allows the bank to receive payment earlier and supports liquidity.