

Module –V (06 Hours)

Inflation-Meaning of inflation, types, causes, measures to control inflation.

National Income-Definition, Concepts of national income, Method of measuring national income.

Banking -Commercial bank, Functions of commercial bank, Central bank, Functions of Central Bank.

Books Recommended for reading

1. Macro Economics by S.P.Gupta, TMH
2. Money, Banking International Trade by D.M.Mithani, Himalaya

Inflation

- Inflation refers to the rise in the prices of most goods and services of daily or common use, such as food, clothing, housing, recreation, transport, consumer staples, etc.
- Inflation may be defined as ‘a sustained upward trend in the **general level of prices**’ and not the price of only one or two goods.
- ***G. Ackley defined inflation as ‘a persistent and appreciable rise in the general level or average of prices’. In other words, inflation is a state of rising prices, but not high prices.***
- Inflation as “ a state in which the value of money is falling i.e. prices are rising”.
- Inflation is a ***purely monetary phenomenon.***

Demand Pull Inflation Vs Cost- Push Inflation

- According to the demand-pull theory, prices rise in response to **an excess of aggregate demand over existing supply of goods and services**. The demand pull theorist point out that inflation (Demand-pull) be caused by
 - ✓ **an increase in the quantity of money**, when the economy is operating at full employment level. As the quantity of money increases, the rate of investment will fall and, consequently, **investment will increase**. This **increased investment expenditure will soon increase the income of the various factors of production**. As a result, aggregate consumption expenditure will increase leading to an effective increase in the **effective demand**. With the economy already operating at the full employment level, this will immediately, raise prices, and inflationary forces may emerge.
 - ✓ Thus, when the general monetary demand rises faster than the general supply, it pulls up prices commodity prices and factor prices.
 - ✓ Demand pull inflation, therefore, manifests itself when there is active cooperation or passive collusion, or a failure to take counteracting measures by monetary authorities.

Demand Pull Inflation

Demand-pull or just demand inflation may be defined as a situation where the total monetary demand persistently exceeds prices at current prices, so that prices are pulled upwards by the continuous upward shift of the aggregate demand function. By using the aggregate demand and supply curves, in Fig. 4, the demand-pull process can be graphically illustrated.

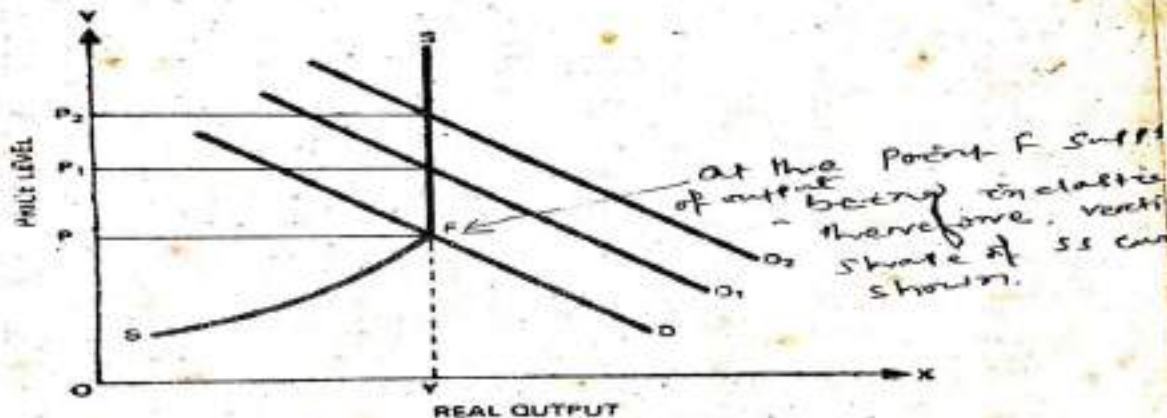


Fig. 4. Demand-pull Inflation.

In Fig. 4, the X-axis measures real output, and the Y-axis measures the price level. Curves D, D₁ and D₂ represent the aggregate demand curves. The SS curve represents the aggregate supply function, which slopes upward from left to right and, at point F it becomes a vertical straight line. The point F suggests that the real economy has reached a level of full employment. Hence, the real output tends to be fixed or inelastic at this point. Assuming that the D curve intersects the S curve at point F, the real output or the income is, at full employment and the price level is OP. When there is an increase in the aggregate demand function beyond D, either due to an increase in autonomous investment (I), or because of an increase in the propensity to consume (C), or government spending (G), represented by a shift in the aggregate demand curve, such as D₁, D₂, the supply of total real output being inelastic, the price level tends to rise from P to P₁ and then to P₂.

Cost-push Inflation

inflation.

Cost-Push Inflation

A group of economists hold the opposite view that the process of inflation is initiated not by an excess of general demand but by an increase in costs, as factors of production try to increase their share of the total product by raising their prices. Thus, it has been viewed that a rise in prices is initiated by growing factor costs. Therefore, such a price rise is termed as "cost-push" inflation as prices are being pushed up by the rising factor costs.

Cost-push inflation, or cost inflation, as it is sometimes called, is induced by the wage-inflation process. It is believed that wages constitute nearly seventy per cent of the total cost of production. This is specially true for a country like India, where labour intensive techniques are commonly used. Thus, a rise in wages leads to a rise in the total cost of production and a consequent rise in the price level, because fundamentally, prices are based on costs. It has been said that a rise in wages causing a rise in prices may, in turn, generate an inflationary spiral because an increase would motivate the workers to demand higher wages. Indeed, any autonomous increase in costs, such as a rise in the prices of imported components or an increase in indirect taxes (excise duties, etc.), may

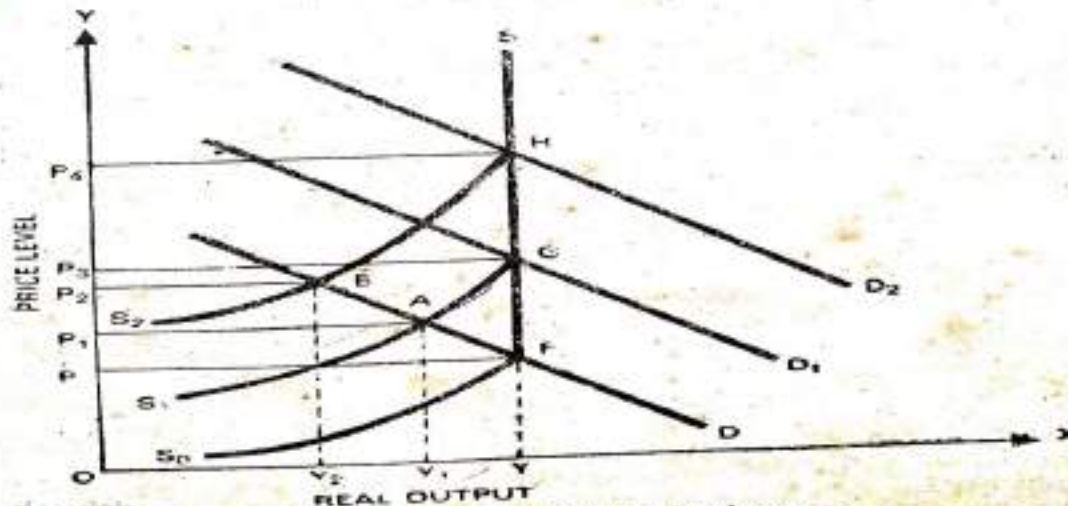


Fig. 5. Cost-push Inflation.

initiate a cost-push inflation. Basically, however, it is wage-push pressures which tend to accelerate the rising price spiral.

The phenomenon of cost-push inflation is graphically illustrated in Fig. 5. In the figure, the D curves represent the aggregate demand function, and the S curves, the aggregate supply function. The full-employment level of income is OY , which can be maintained only at rising price levels, P, P_1, P_2, P_3, \dots

Now, if we begin with price level P , F is the point of intersection of the aggregate supply curve; D and SS_0 . Let us assume that the aggregate supply function shifts upward as S_1 , which becomes a vertical straight line at point A , and merges with the SF line (the previous supply curve at full-employment level). The upward shift in the supply curve may be attributed to either an (increase in money wages due to trade unions' successful collective bargaining, or to the profit-motivated monopolists or oligopolists,) who might have raised the prices of goods. Anyway, as the aggregate supply curve shifts to S_1 , the new equilibrium point A is determined at OY_1 level of real output, which is less than full-employment level, at P_1 level of prices. This means that with a rise in the price level, unemployment increases. It is regarded as the cost of holding the price level close to P . Similarly, a further shift in the aggregate supply curve to S_2 on account of a further wage-push, implies a new equilibrium point, B . This causes the income level to fall further to Y_2 , and prices to rise to P_2 . If, however, the government or monetary authority is committed to maintain full employment, there will be more public spending or more credit expansion, causing the price level to rise much more—such as from P to P_3 and P_4 . In this case, the sequence of equilibrium points become $A-B-G-H$.)



Types of Inflation

- I. **Creeping, Walking, Running and Galloping Inflation.**
 - **Creeping** – In this case, the price level increases very slowly over an extended period of time. If the price rise within a range of **10% over a decade or around 1% per annum**
 - **Walking** : When prices rise by more than 10% and within a range of 30% to 40% over a decade or by 3 to 4 percent a year.
 - **Running** : Running inflation record more than 100% rise in prices over a decade or 10% per annum. It is dangerous for an economy.
 - **Galloping Inflation** : Otherwise know as hyperinflation, price rise in every moments, and there is no limit to the height to which prices might rise. If within a year / the price rise by 100%.

Types of Inflation

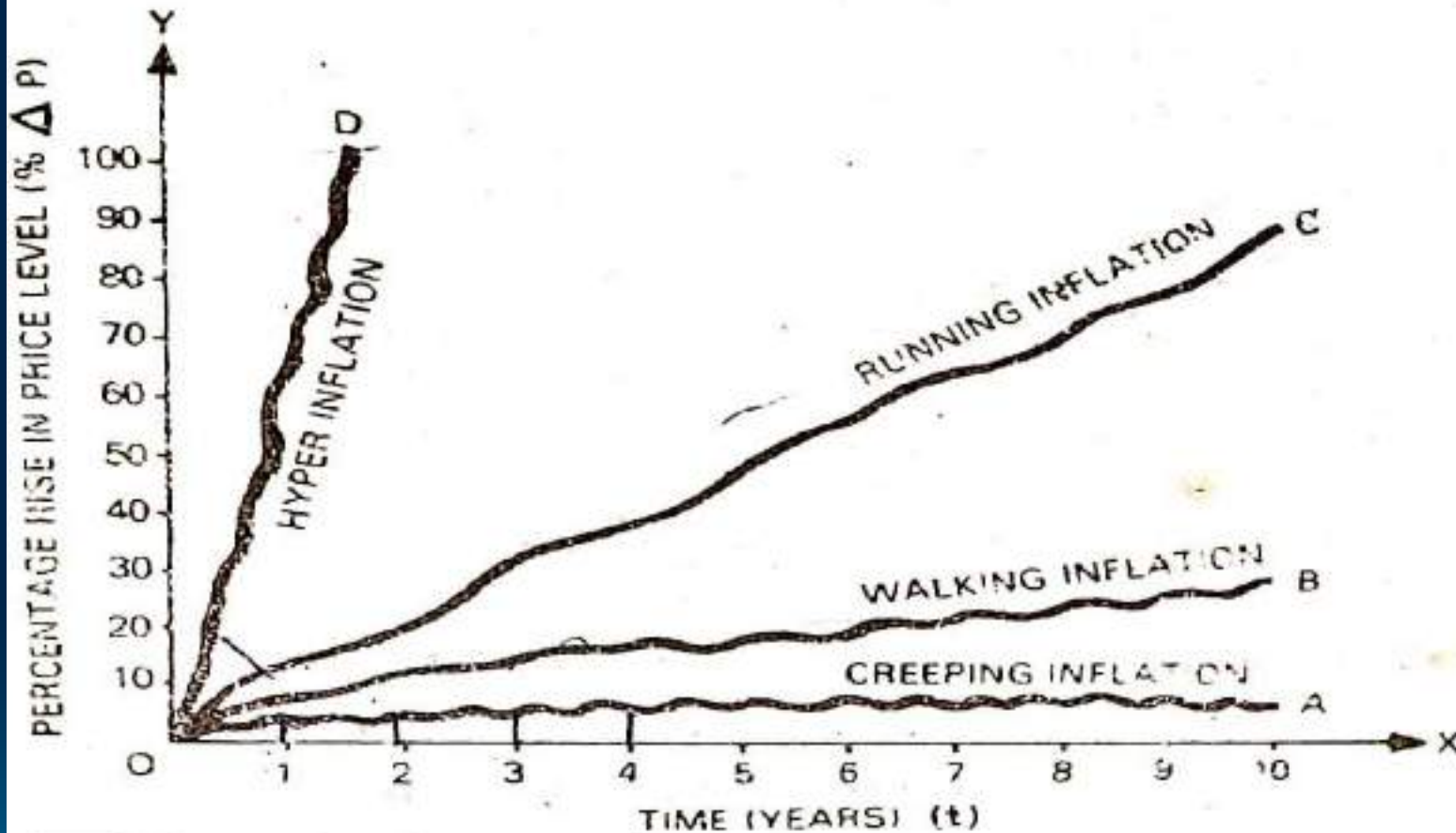


Fig. 7. Speed Categories of Inflation.

Types of Inflation

II. Excessive, Cost Deficit and Flight Inflation :

- When there is an excess of money supply in relation to the availability of real goods and services (**Excessive Inflation**).
- When inflation emerges on account of a rise in factor cost, it is called cost inflation. (Ex. Increase in wage rate, increase in cost of living – increase in wage rate – increase in prices of the goods)
- **Deficit inflation** : when the government budget contain heavy deficit financing through printing of new money, the purchasing power in the community increases and price rise.
- **Flight Inflation** : Relationship between money supply and goods, where there is a flight from the currency, reflecting increased velocity of spending. This occurs due to recurring budget deficits, and the creation of new money under deficit financing.

Types of Inflation

- III. **War, Post-war and Peace-time Inflation.**

- War-time Inflation:**

- It is the outcome of certain exigencies of war on account of increased government expenditure which is of unproductive nature.
 - By such public expenditure and government apportions a substantial production of goods and services out of total availability for war which causes a downward shift in the supply as a result an inflationary gap may develop.

- Post-war Inflation:**

- It is a legacy of war. In the immediate post-war period it is usually experienced.
 - This may happen when the disposable income of the community increases when war-time taxation is withdrawn or public debt is repaid in the post-war period.

Types of Inflation

III. War, Post-war and Peace-time Inflation.

▪ **Peace-time Inflation:**

- By this is meant the rise in prices during the normal period of peace.
- Peace-time inflation is often a result of increased government outlays on capital projects having a long gestation period so a gap between money income and real wage goods develops.

IV. Comprehensive Inflation & Sporadic Inflation :

▪ **Comprehensive Inflation :**

- When prices of every commodity throughout the economy rise it is called economy-wide or comprehensive inflation.
- It is a normal inflationary phenomenon and refers to the rising prices of the general price level.

Types of Inflation

IV. Comprehensive Inflation & Sporadic Inflation :

▪ **Sporadic Inflation :**

- This is a kind of sectional inflation.
- It consists of cases in which the averages of a group of prices rise because of increases in individual prices due to abnormal shortage of specific goods.

V. Open and Repressed Inflation :

Inflation is open or repressed according to **government's reaction** to the prevalence of inflationary forces in the economy.

▪ **Open Inflation:**

- When the government does not attempt to prevent price rise inflation is said to be open.
- Thus inflation is open when prices rise without any interruption of government

Types of Inflation

- **Open Inflation:**

- In open inflation free market mechanism is permitted to fulfill its historic function of rationing the short supply of goods and distribute them according to consumer's ability to pay.

- **Repressed Inflation:**

- When the government interrupts a price rise there is repressed or suppressed inflation.
- Thus suppressed inflation refers to those conditions in which price increases are prevented at the present time through adoption of certain measures like price controls and rationing by the government.

How is Inflation measured?

- In India, inflation is primarily measured by two main indices — WPI (Wholesale Price Index) and CPI (Consumer Price Index), which measure wholesale and retail-level price changes, respectively. The CPI calculates the difference in the price of commodities and services such as food, medical care, education, electronics etc, which Indian consumers buy for use.
- On the other hand, the goods or services sold by businesses to smaller businesses for selling further is captured by the WPI. In India, both WPI (Wholesale Price Index) and CPI (Consumer Price Index) are used to measure inflation.

How Inflation rate is calculated ?

- **CONSUMER PRICE INDEX (CPI)** NUMBERS ON BASE **2012=100** FOR RURAL, URBAN AND COMBINED FOR THE MONTH OF MARCH 2020


CPI	Base Year 2012 = 100	Mar. 19 Index (Final)	Mar. 20 Index (Prov.)	% Change (Inflation Rate) All India March 2020)
Combined	100	140.4	148.7	5.91
Rural	100	141.2	149.8	6.09
Urban	100	147.4	139.5	5.66

$$\text{Inflation rate (\%)} = \frac{\text{Current year index} - \text{previous year index}}{\text{previous year index}} \times 100$$

$$\text{Inflation rate (\%)} = \frac{148.7 - 140.4}{140.4} \times 100 = \mathbf{5.91}$$

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

- Since inflation is a phenomenon where money income or purchasing power is rising faster than the real goods and services the measures to check inflation should either be of a check on the increase in money incomes or making available more of real goods and services.
- The various anti-inflationary methods which can be taken to establish a better balance between aggregate supply and demand for money can be studied under the following three main heads.
 - I. **MONETARY MEASURES:** monetary measures aim at reducing money incomes. It includes,
 - i. **CREDIT CONTROL:**
 - One of the important monetary measures is monetary policy.  The central bank of the country adopts a number of methods to control the quantity and quality of credit.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

i. CREDIT CONTROL:

- One of the important monetary measures is monetary policy.
- The central bank of the country adopts a number of methods to control the quantity and quality of credit.
- Monetary policy may not be effective in controlling inflation, if inflation is due to cost-push factors.
- Monetary policy can only be helpful in controlling inflation created due to demand pull factors.

ii. DEMONETISATION OF CURRENCY:

- However one of the monetary measures is to demonetize currency of higher denominations.
- Such a measure is usually adopted when there is abundance of black money in the country.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

iii. ISSUE OF NEW CURRENCY:

- The most extreme monetary measure is the issue of new currency in place of the old currency in place of the old currency.
- Under this system one new note is exchanged for a number of notes of the old currency.
- It is a very effective measure. But is inequitable for it hurts the small depositors the most.

II. FISCAL MEASURES :

- Monetary policy alone is incapable of controlling inflation. It should therefore be supplemented by fiscal measures. The principal fiscal measures are the following
 - **REDUCTION IN UNNECESSARY EXPENDITURE:**
 - The government should reduce unnecessary expenditure on non-development activities in order to curb inflation.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

(i) **REDUCTION IN UNNECESSARY EXPENDITURE:**

- This will also put a check on private expenditure which is dependent upon government demand for goods and services.

(ii) **INCREASE IN TAXATION:**

- To cut personal consumption expenditure the rates of personal corporate and commodity taxes should be raised and even new taxes should be levied but the rates of taxes should not be as high as to discourage saving investment and production.

(iii) **INCREASE IN SAVINGS:**

- Another measure is to increase savings on the part of the people.
- This will tend to reduce disposable income with the people and hence personal consumption expenditure.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

(IV) SURPLUS BUDGETS:

- An important measure is to adopt anti-inflationary budgetary policy.
- For this purpose the government should give up deficit financing and instead have surplus budgets.
- It means collecting more in revenue and spending less.

(v) PUBLIC DEBT:

- At the same time it should repayment of public debt and postpone it to some future date till inflationary pressures are controlled within the economy.
- Instead the government should borrow more to reduce money supply with the public.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

(VI) CONTROL OVER INVESTMENT:

- Controlling investments is also considered necessary because due to the multiplier effect the initial investment leads to large increase in income and expenditure and the demand for both the consumer and capital goods goes up speedily.
 - (a) The projects selected should be such as result in utilization of ideal capacity or in making provision for procurement of scarce raw materials spares etc.
 - (b) These should have a short gestation period so that production of goods and services starts within the shortest possible time of those being undertaken.
 - (c) Speculation in goods should be restrained as it aggravates the inflationary tendencies.

ANTI-INFLATIONARY METHODS :

Measures to Control Inflation

3. OTHER MEASURES:

- A. INCREASING PRODUCTION:
- B. RATIONAL WAGE POLICY:
- C. PRICE CONTROL
- D. RATIONING

NATIONAL INCOME



National Income : Concepts & Measurement.

- National income, income of the nation during a period of time, provides a comprehensive measure of the economic well-being of the nation.
- The growth rate of an economy is also measured by the rate at which its national income is growing.
- Knowledge of the national income and its movement over time is of significance to a business organisation, as this provides a measure of the nation's ability to buy goods and services, and thus the business sales are dependable on its magnitude.

NATIONAL INCOME – DEFINITIONS

- ❖ National Income is defined as the **total market value** of all the **final goods and services** produced in an **economy** in a given **period of time**. Thus, it measures the **monetary value of the flow of output of final goods and services** produced in an economy over a period of time.
- ❖ National income is a monetary measure of:
 - ❖ The net or final value of all products and services
 - ❖ In an economy during a time period (usually a year)
 - ❖ Counted without duplication
 - ❖ Both in the public and private sector of products and services
 - ❖ In consumption and capital goods sector
 - ❖ The net gains from international transactions.

NATIONAL INCOME

❖ *NI can be estimated at **current** or **constant** prices.*

❖ If NI is estimated on the basis of the **prevailing prices** it is called **NI at current/Nominal price** (i.e. not adjusted for inflation). If NI is measured on the basis of some **fixed price**, that is price prevailing at a point of time or in some **base year** it is known as **NI at constant or real price (adjusted for inflation)**.

❖ *NI can also be estimated at **factor cost** or **market prices***

❖ NI at factor cost is estimated as the sum of net value added by the different producing units and the consumption of fixed capital. The contribution of each producing unit to the current flow of goods and services is known as the **net value added**.

Gross National Product (GNP)

- **Gross National Product (GNP) :**
 - Monetary Value of goods and services that are
 - A. Currently produced
 - B. Sold through market
 - C. Not resold or used in further production
 - D. Produced by national owned resources (factors of production)
 - E. Valuated at market prices.
- GNP is expressed **in terms of money (₹)** because goods and services are non-additive in physical quantities due to differences in units of measurement.
- Income is a **flow concept**. So, GNP includes only those items which are

Gross National Product (GNP) Contd..

- produced during that period of time for which GNP stands.
- Ex : GNP of 2019 includes the production of all goods and services during January 1, 2019 through December 31, 2019 only.
- GNP accounts for only those goods which are traded through the market.
 - ✓ Ex. **'do it yourself'** like housewives work in home, imparting education to your own children, white wash of your own house etc. are excluded
 - ✓ While paid servants, private tuitions, wages paid to the labourers for service rendered etc. are included
 - ✓ Unreported production are excluded

self-consumption of production by producers is valued and is included in GNP.

rent on owner-lived houses is computed and included in GNP.

Gross National Product (GNP) Contd..

- **Intermediate goods** are not included in GNP for avoiding double counting of production.
- GNP measures the production or income. It excludes non-productive transactions like purely financial transactions and second hand sales.
 - public transfer payment (not included)
 - Private transfer payments (not included)
 - Buying and selling of securities (not included)
 - Retirement and pension benefits (not included)
 - Buying and selling of stocks and bonds (not included)
 - Fathers gift to son (not included)
 - Sale of an old car to other person (not included)

Gross National Product (GNP) Contd..

- Ex. If an Indian resident professor takes up one year visiting professorship in Harvard University, his income in USA is a part of India's GNP and similarly the income that a foreign owned firm (say City Bank) makes in India is not a part of India's GNP.
- **GNP at Market Prices (GNP_M)**
 - is inclusive of indirect taxes (T_i), net of subsidies (S).
- **GNP at Factor Cost (GNP_F) = $GNP_M - T_i + S \dots \dots \dots (1)$**

GROSS DOMESTIC PRODUCT

- **Gross Domestic Product (GDP) Market at Prices :**

- Value of goods and services produced within the geographical boundaries of the country, irrespective of the ownership of the resources.

- **$GDP_F = GNP_F - NIA$ (2)**

- NIA is Net Factor Income Earned from Abroad

- (*incomes* earned (by of wages, interest and dividends) by the resident factors abroad minus the incomes earned by the non-resident factors in the home country)

Facts & Figures

- **GDP at Constant (2011-12) Prices in Q2 of 2019-20 is estimated at `35.99 lakh crore, as against `34.43 lakh crore in Q2 of 2018-19, showing a growth rate of 4.5 percent**
- GDP at Current Prices in Q2 of 2019-20 is estimated at `49.64 lakh crore, as against `46.79 lakh crore in Q2 of 2018-19, showing a growth rate of 6.1 percent.
- **Real GDP or Gross Domestic Product (GDP) at Constant (2011-12) Prices in the year 2019- 20 is estimated to attain a level of ₹ 146.84 lakh crore, as against the First Revised Estimate of GDP for the year 2018-19 of ₹ 139.81 lakh crore, released on 31st January 2020. The growth in GDP during 2019-20 is estimated at 5.0 percent as compared to 6.1 percent in 2018-19.**
- GDP at Current Prices in the year 2019-20 is estimated to attain a level of ₹ 203.85 lakh crore, as against ₹ 189.71 lakh crore in 2018-19, showing a growth rate of 7.5 percent.

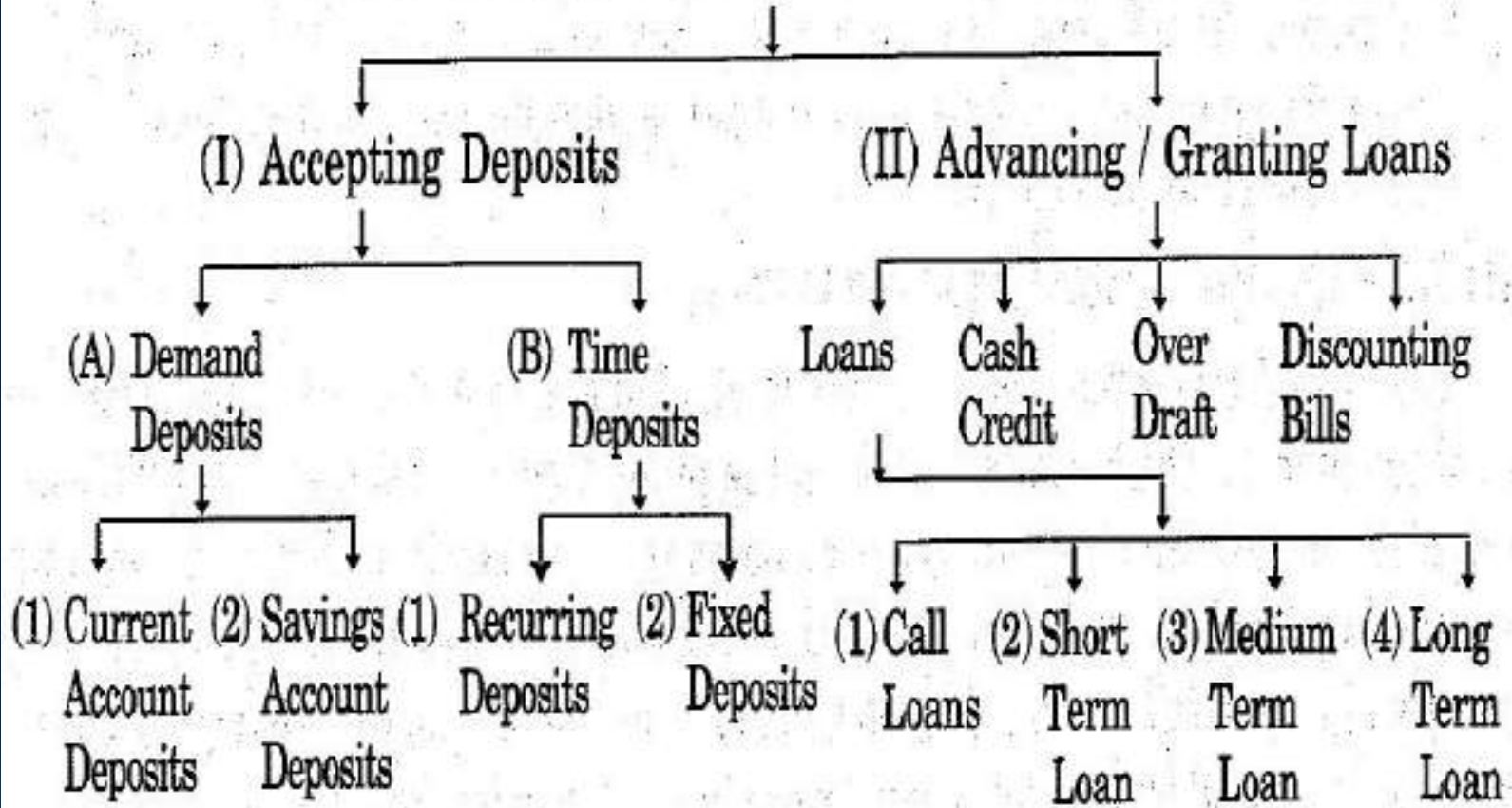
What is a Bank?

- Banking occupies one of the most important positions in the modern economic world. It is a basic necessity for trade and industry. Hence it is one of the great agencies of commerce.
- A Bank is a financial institution which is licensed to receive the **deposits** and **lend loans to the needy**. The banks also perform other functions in the form of currency exchange, wealth management, financial service, safe deposit boxes and so on.
- In India, the banking sector is categorized into two broad categories namely scheduled and non-scheduled banks.
- The scheduled banks come under the second schedule of the Reserve Bank of India Act of 1934.

What is a Bank?

- The list of **scheduled banks** in India are further categorized into
 - Nationalized Banks
 - Foreign Banks: (American Express Bank, Hong Kong and Shanghai Banking Corporation (HSBC), Standard & Chartered Bank, and Citibank)
 - Regional Rural Banks
 - State Bank of India and its associates and
 - Other Private Sector Banks : Dena Bank
- The Central Bank of India - RBI, in its official website has listed the 19 banks as nationalized banks. (Refer RBI website for list).
- The major nationalized banks in India are State Bank of India (SBI), Punjab National Bank (PNB), Bank of Baroda (BOB), Canara Bank, Union Bank of India and so on.

PRIMARY FUNCTIONS / BANKING FUNCTIONS



Commercial Bank

- A commercial bank is a profit-seeking business firm, dealing in money and credit. It is a financial institution dealing in money in the sense that it accepts deposits of money from the public to keep them in its custody for safety.
- **Functions of Commercial Bank :**
 1. **Acceptance of Deposits from Public** : Bank maintains three types of deposits
 - **Current Deposits Account / Demand Deposits Account** : Non – interest bearing account / withdrawable by cheques
 - **Fixed Deposits Account** : Withdrawable only after a specified period. Carries high rate of interest
 - **Savings Bank Account Deposit** : Bank imposes certain restrictions on deposits and withdrawals.
 - **Recurring Deposits Account** : To encourage regular savings

Functions of Commercial Bank

2. Advancing of Loans :

- **Overdraft** : The bank provides overdraft facility to certain customers through which they are allowed to withdraw more than their deposits. Interest is charged from the customers on the overdrawn amount.
- **Discounting of Bills of Exchange** : Another instrument through the bank lends money to the holder of the bill of exchange.
 - A bill of exchange is generally drawn by the creditor upon his debtor. It has to be accepted by the drawee (debtor) or someone on his behalf. It is just a draft till its acceptance is made.
 - Drawer / Payee is the maker of the bill of exchange. A seller/creditor who is entitled to receive money from the debtor can draw a bill of exchange upon the buyer/debtor. The drawer after writing the bill of exchange has to sign it as maker of the bill of exchange.

Functions of Commercial Bank

- Drawee is the person upon whom the bill of exchange is drawn. Drawee is the purchaser or debtor of the goods upon whom the bill of exchange is drawn.
- Ex : **Amit (creditor)** sold goods to **Rohit (Debtor)** on credit for ` 10,000 for three months. To ensure payment on due date Amit draws a bill of exchange upon Rohit for ` 10,000 payable after three months. Before it is accepted by Rohit it will be called a draft. It will become a bill of exchange only when Rohit writes the word **“accepted”** on it and **append his signature** thereto communicate his acceptance.
- Meanwhile Amit (Creditor) needs money before due date i.e. maturity of 3 months, in that case Amit can approach to a commercial bank to get it discounted. The bank pays the value of the bill after discounting to Amit. The bank gets its payment from the party which had accepted the bill i.e. Rohit (Drawee / Debtor).

Functions of Commercial Bank

- **Cash Credit** : The borrower is granted a loan against his current assets such as shares, bonds, stocks etc. The bank opens an account in the name of the borrowers and allows him to withdraw money from time to time. Interest is charged from the customers on the amount actually withdrawn from the account.
- **Money at call**: **Inter-bank loans** provided by commercial banks for a period of 7 to 15 are known as call loans.
- **Term Loans** :
 - Short Term Loans (Not more than 2 years)
 - Medium Term Loans (Two to Five Years)
 - Long Term Loans (Five Years to 20 years)

Functions of Commercial Bank

3. Credit Creation :

Credit creation is a major function of a commercial bank. When a banks create a credit or advances loan, there tends to be a multiple expansion of credit in the banking system.

Banks are not merely purveyors of money but, in an important sense manufacturers of money (Prof. Sayers).

Example. Let us assume that 20% (Cash-reserve ratio). Suppose a person deposit ₹ 1000 at SBI. The balance sheet of SBI will be as follows

Liabilities		Assets	
Demand Deposits	₹ 1000	Cash received	₹ 1000
		Cash reserves	₹ 200
		Excess Reserves	₹ 800

Excess reserves can be used for granting credit.

Functions of Commercial Bank

Changed Balance sheet of SBI

Liabilities		Assets	
Demand Deposits (Primary Deposit)	₹ 1000	Cash received	₹ 1000
Demand Deposits (Derivative Deposit)	₹ 800	Loans	₹ 800

Suppose the borrower, Mr. X pays a cheque of ₹ 800 to Mr. Y who has an account in Bank of Borada. Then the Bank of Borada receives ₹ 800 as primary deposit, which increase the liabilities of the bank by ₹ 800.

Balance sheet of Bank of Borada

Liabilities		Assets	
Demand Deposits (Primary Deposit)	₹ 800	Cash received	₹ 800
		Cash reserves	₹ 160
		Excess Reserves	₹ 640

Functions of Commercial Bank

Changed Balance sheet of Bank of Borada

Liabilities		Assets	
Demand Deposits (Primary Deposit)	₹ 800	Cash received	₹ 800
Demand Deposits (Derivative Deposit)	₹ 640	Loans	₹ 640

Suppose the borrower, Mr. Z pays a cheque of ₹ 640 to Mr. L who has an account in Canara Bank. Then the Canara Bank receives ₹ 640 as primary deposit, which increase the liabilities of the bank by ₹ 640.

Balance sheet of Canara Bank

Liabilities		Assets	
Demand Deposits (Primary Deposit)	₹ 640	Cash received	₹ 640
		Cash reserves	₹ 128
		Excess Reserves	₹ 512

TABLE 2

The Multiple Expansion of Credit/Demand Deposits in the Banking System

Assets		Liabilities			
Reserves Total	Required (RR)	+ Excess (ER)	Loans & Investment or Derivative Demand Deposits $\Delta(DD)$	Total Demand Deposits $\Delta(TD)$	
	(20%)	(80%)			
Initial Reserves Provided	1000	200	800	—	1000
Expansion Stage 1	1000	360	640	800	1800(1000+800)
2	1000	488	512	1440	2440(1800+640)
3	1000	590.4	409.6	1952	2952(2440+512)
4	1000	672.3	327.7	2361.6	3361.6(2952+409.6)
5	1000	737.9	262.1	2699.3	3699.3(3361.6+327.7)
...
...
Stage 20	1000	990	10	3980	4980 (Approximation)
...
...
Final Stage	1000	1000	0	4000	5000

In the above example, the credit expansion (DD) is five times the initial excess reserves (ER) of Rs. 800. Thus, the propagated magnitude of credit is Rs. 4,000. Here, cash reserve requirement

(RR) is 20 per cent or $\frac{1}{20}$. . .

Higher the cash-reserve ratio lower the credit multiplier and vice versa.
For example,

Example

Cash Deposit in Bank (1)	Cash-reserve (%) (2)	Initial Excess reserve (3)	Multiple Expansion Credit (4) = (3) X 1/cash-reserve ratio
1000	20	800	$800 \times (5) = 4000$
1000	10	900	$900 \times (10) = 9000$
1000	30	700	$700 \times (3.34) = 2333$
1000	40	600	$600 \times (2.5) = 1500$
1000	50	500	$500 \times (2) = 1000$
1000	60	400	$400 \times (1.7) = 680$
1000	70	300	$300 \times (1.42) = 429$

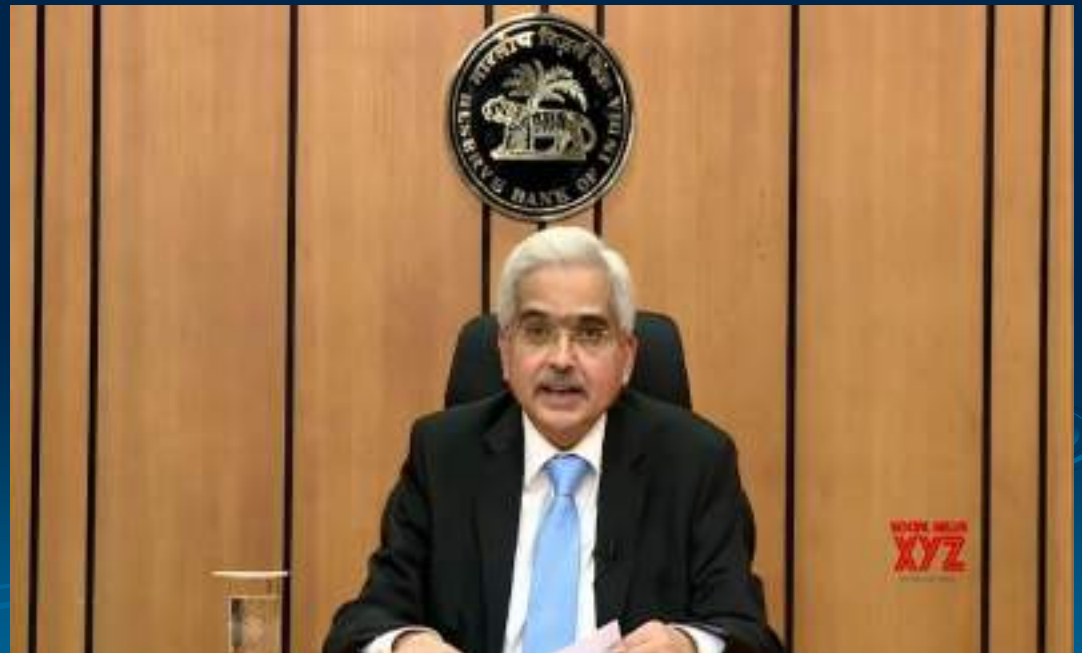
Students are advised not to write this example while answering the functions of commercial bank unless the specific question is asked for. This example is from understanding point of view.

Agency Services

- Remittance of funds
- Collection and Payment of Credit Instruments
- Execution of standing orders
- Purchase and sale of securities
- Income Tax Consultancy
- Collection of Dividend on shares
- Acting as Trustee and Executor
- To work as correspondents, agents of their clients

General Utility Functions

- Letters of Credit : given by the banks to their customers to enable them to go abroad.
- Provide safety locker facility to customers.
- To provide money transfer facility. (Ex. Bank Draft, Traveler's Cheque, Gift Cheque)
- To act as referees : (Business reputation)
- To accept various bills for payment e.g. phone bills, gas bills, water bills, etc.
- To provide various cards such as credit cards, debit cards, Smart cards, etc.
- Deal with foreign exchange
- Banks also compile statistics and business planning.



Dr. L.P.Panda, GCEK

Central Bank – Reserve Bank of India

- Reserve Bank of India (RBI) is the Central Bank of India. RBI was established on 1 April 1935 by the RBI Act 1934.
- RBI is a statutory body. It is responsible for the printing of currency notes and managing the supply of money in the Indian economy. RBI was nationalized on January 1, 1949.
- **Functions of Reserve Bank of India :**
 - Bank of Note Issue :
 - Banker, Agent and Advisor to the Government
 - Banker's Bank
 - Lender of Last Resort
 - Clearing Agent
 - Custodian of Foreign Exchange Reserves.
 - Controller of Credit
 - Developmental Role

Functions of Reserve Bank of India

1. Bank of Note Issue :

- The Reserve Bank has a monopoly for printing the currency notes in the country. It has the sole right to issue currency notes of various denominations **except one rupee note** (which is issued by the Ministry of Finance).

2. Banker, Agent and Advisor to the Government

- Maintain accounts of central and state governments.
- Receives deposits from government / lend short term advances
- Lends money to all the commercial banks of the country
- Collects taxes and other payments on behalf of government
- Advice to the government on matters related to economic and monetary policy.

Functions of Reserve Bank of India

3. **Bankers Bank:**

- Custodians of the cash reserves
- As the lender of the last resort
- As clearing agent

4. **Lender of the Last resort :**

- As a Banker to Banks, the Reserve Bank also acts as the 'lender of the last resort'. It can come to the rescue of a bank that is solvent but faces temporary liquidity problems by supplying it with much needed liquidity when no one else is willing to extend credit to that bank. The Reserve Bank extends this facility to protect the interest of the depositors of the bank and to prevent possible failure of the bank, which in turn may also affect other banks and institutions and can have an adverse impact on financial stability and thus on the economy. Ex. YES Bank

Functions of Reserve Bank of India

5. Custodian of Foreign Exchange Reserves:

- The Reserve Bank of India, is the custodian of the country's foreign exchange reserves and is vested with the responsibility of managing their investment.
- Reserve Bank to invest the reserves in the following types of instruments:
 - *Deposits with Bank for International Settlements and other central banks*
 - *Deposits with foreign commercial banks*
 - *Debt instruments representing sovereign or sovereign- guaranteed liability of not more than 10 years of residual maturity*
 - *Other instruments and institutions as approved by the Central Board of the Reserve Bank in accordance with the provisions of the Act*

Functions of Reserve Bank of India

6. Clearing Agent :

- In India the Reserve Bank of India acts as the clearinghouse for scheduled banks, which have statutory accounts with it. Through this function the Reserve Bank of India enables the banks to settle their transactions among various banks easily and economically.
- The Reserve Bank of India has its clearinghouse offices in 14 places in India. Some of the cities where it has its own clearinghouses are Mumbai, Bangalore, Kolkata, Chennai, Nagpur, Hyderabad, New Delhi, Patna and Kanpur. In other places, the clearinghouse function is carried out in the premises of SBI and its Associate Banks. At present 578 centers are run by SBI and its associate bankers.

Functions of Reserve Bank of India

7. Controller of Credit :

- The RBI undertakes the responsibility of controlling credit created by commercial banks. RBI uses two methods to control the extra flow of money in the economy.
- These methods are quantitative and qualitative techniques to control and regulate the credit flow in the country.
- When RBI observes that the economy has sufficient money supply and it may cause an inflationary situation in the country then it squeezes the money supply through its tight monetary policy and vice versa.

Functions of Reserve Bank of India

8. Other Functions :

- The Reserve Bank performs a number of other developmental works. These works include the function of clearinghouse arranging credit for agriculture (which has been transferred to NABARD) collecting and publishing the economic data, buying and selling of Government securities (gilt edge, treasury bills etc.) and trade bills, giving loans to the Government buying and selling of valuable commodities etc. It also acts as *the representative of the Government in the International Monetary Fund (I.M.F.) and represents the membership of India.*

Important Information- on 30th April 2020

Policy Repo Rate : 4.40%
Reverse Repo Rate : 3.75%
Marginal Standing Facility Rate : 4.65%
Bank Rate : 4.65%

CRR : 3%
SLR : 18.00%

Base Rate : 8.15% - 9.40%
MCLR (Overnight) : 7.10% - 7.75%
Savings Deposit Rate : 3.00% - 3.50%
Term Deposit Rate > 1 Year : 5.70% - 6.00%

Money Market

Call Rates : 2.30% - 4.50% *

Government Securities Market

6.45% GS 2029 : 6.1244% #
7.27% GS 2026 : 5.8235% #
7.32% GS 2024 : 5.1140% #
6.18% GS 2024 : 5.1914% #
6.17% GS 2021 : 4.0904% #
91 day T-bills : 3.6427%*
182 day T-bills : 3.6553%*
364 day T-bills : 3.7016%*

Capital Market

S&P BSE Sensex : 32720.16 *
Nifty 50 : 9553.35 *