

## **Role and Functions of a Central Bank**

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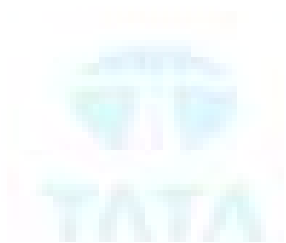
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## **Sub Topic – Role and Functions of a Central Bank**

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### **Introduction**

This topic introduces the associate to the concept of “Central banking” with an example of the Indian scenario of central banking.

### **Learning Objective**

After reading this chapter, you will be able to understand:

- Role and Functions of a Central Bank
- Understand in detail through the example of RBI and its core functions

## Central Banking System

Every country has a central bank. For example, In India, it is the Reserve Bank of India (RBI), in the US it is the Federal Reserve, in the UK it is the Bank of England and for Europe it is the European Central Bank etc.

The primary function of a central bank is to manage the nation's money supply, through active duties such as managing interest rates, setting the reserve requirements, and acting as a lender of last resort to the banking sector during times of bank insolvency for financial crisis.

The central bank has been described as “**The lender of last resort**“, which means that it is responsible for providing its economy with funds when commercial banks cannot cover a supply shortage. In other words, the central bank prevents the country's banking system from failing. However, the primary goal of central bank is to provide the countries' currencies with price stability by controlling inflation.

A central Bank also acts as the regulatory authority of a country's monetary policy and is the sole provider and printer of notes and coins in circulation.

Times has proved that the central bank can best function in these capacities by remaining independent from government fiscal policy and therefore uninfluenced by the political concerns of any regime.

The central bank should also be completely divested of any commercial banking interests.

### Indian Scenario – Case of RBI

Let us understand the above in much more detail with the example of RBI of India and its core functions:

#### Main Functions of RBI

##### Monetary Authority:

- Formulates, implements and monitors the monetary policy.
- Objective: maintaining price stability while keeping in mind the objective of growth.

##### Regulator and supervisor of the financial system:

- Prescribes broad parameters of banking operations within which the country's banking and financial system functions.
- Objective: maintain public confidence in the system, protect depositors' interest and provide cost-effective banking services to the public.

### **Manager of Foreign Exchange**

- Manages the Foreign Exchange Management Act, 1999.
- Objective: to facilitate external trade and payment and promote orderly development and maintenance of foreign exchange market in India.

### **Issuer of currency:**

- Issues and exchanges or destroys currency and coins not fit for circulation.
- Objective: to give the public adequate quantity of supplies of currency notes and coins and in good quality.

### **Developmental role**

- Performs a wide range of promotional functions to support national objectives.

### **Related Functions**

- Banker to the Government: performs merchant banking function for the central and the state governments; also acts as their banker.
- Banker to banks: maintains banking accounts of all scheduled banks.

(Source: rbi.org)

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