



Q9. What is High Powered Money?

Ans: High powered money is the total liability of the monetary authority of the country. This is also called the monetary base and is created by the RBI. High powered money includes currency (notes and coins), deposits with the government and reserves of commercial banks with RBI. So, to sum up, high powered money is

$$H = C + R$$

Where

H – High powered money

C – Currency

R – Cash Reserves of commercial banks

Q10. Explain the functions of a commercial bank.

Ans: Commercial banks perform various functions that are as follows:

a. Accepting deposits: The basic function of commercial banks is to accept deposits of the customers. These deposits are of the following types:

(i) Saving Accounts: Saving accounts cater to the needs of those individuals who wish to save a part of their income and earn interest on the amount saved. Account holders of saving accounts can deposit cheques, drafts, etc. However, there is a limit on withdrawal.

(ii) Fixed deposit accounts: As the name suggests, fixed deposit accounts imply deposits are kept for fixed periods of time; for example, Rs.500 per month for 5 years. The period has to be decided in advance, while opening the account. Holders of these accounts do not enjoy the cheque facility. Higher the time period, higher will be the interest rate, which is decided by RBI.

(iii) Current deposits accounts: Current deposit accounts are also called 'demand deposits' as the depositor can withdraw money at any time through cheques. Businessmen use this account to make many transactions in a single day; however, they do not earn interest on the deposits. Banks provide account statements to the current account holders at regular intervals.

b. Granting loans and advances: The second most important function of the commercial banks is to give loans and advances. The rate of interest charged by the banks on loans is higher than the rate of interest paid by the banks on demand deposits and saving deposits. Loans granted by commercial banks are generally for long term and are given against securities. Advances are given by a bank only for a short span of time.

c. Agency functions: The commercial banks perform various agency functions with the prime purpose of acceptance of deposits and granting of loans. Their functions include:

(i) Transfer of funds- The banks provide easy flow of funds from place to place via mail transfers, demand drafts, etc.

(ii) Collection of funds- The banks also collect funds on behalf of its customers through bills, cheques, etc.

(iii) Banks collect insurance premiums, dividends, interest on debentures, etc.

(v) Banks assist in the process of tax payment by the account holders.

(vi) Banks also play the role of trustees or executors.

d. Discounting bills of exchange: Commercial Banks provide financial assistance to the business community by discounting bills

of exchange. The banks purchase these bills, produced by customers, by deducting interest from the face value of the bill, thus providing easy finances to the business community when required.

e. Credit creation: Commercial banks create credit in the economy through demand deposits. Credit creation paves the path for the growth of the economy.

f. Other functions:

- (i) Providing locker facility
- (ii) Purchase and sale of foreign exchange
- (iii) Issue of gift cheques
- (iv) Underwriting of shares and debentures
- (v) Providing information and statistical data useful to customers

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