



Q13. Do you consider a commercial bank 'creator of money' in the economy'?

Ans: Commercial banks play the important role of 'money creator' in the economy. They have the capacity to generate credit through demand deposits. These demand deposits make credit more than the initial deposits.

The process of money creation can be explained by taking an example of a bank XYZ. A depositor deposits Rs. 10,000 in his savings account, which will become the demand deposit of the bank. Based on the assumption that not all customers will turn up at the same day to withdraw their deposits, bank maintains a minimum cash reserve of 10 % of the demand deposits, i.e. Rs.1000. It lends the remaining amount of Rs.9000 in the form of credit to other customers. This further creates deposits for the bank XYZ. With the cash reserve of Rs.1000, the credit creation is worth Rs. 10,000. So, the credit multiplier is given by:

Credit multiplier =  $1/\text{CRR} = 1/10\% = 10$

The money supply in the economy will increase by the amount (times) of credit multiplier.

Q14. What role of RBI is known as 'lender of last resort'?

Ans: When a commercial bank faces a financial crisis and fails to obtain funds from other sources, then the central bank plays the vital role of 'lender of last resort' and provides them with the financial assistance in the form of credit. This role of the central bank saves the commercial bank from bankruptcy. Thus, the central bank plays the role of guarantor for the commercial banks and maintains a sound and healthy banking system in the economy.

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