Money and Banking

Standard difficulty · 20 questions · 40 marks · Time: 38 minutes

Name: _____ Date: _____ Score: ____ / 40

Write full answers in Sections B and C. Answers are on the last page — try every question first!

Section A — Choose the correct answer — 8 × 1 = 8 marks

1. A system where goods are exchanged directly for goods is:
   (a) credit **(b)** fiat money **(c)** banking **(d)** barter

2. Which function of money is shown by comparing the values of a cow and a cart in rupees?
   (a) unit of account **(b)** credit creation
   (c) collateral **(d)** legal reserve

3. If banks must keep 10% of deposits as reserves, what is the money multiplier?
   (a) 90 **(b)** 0.1 **(c)** 11 **(d)** 10

4. A new deposit of ₹2,900 is made in the banking system. With a reserve ratio of 5%, what can total deposits finally become?
   (a) ₹58,000 **(b)** ₹55,100 **(c)** ₹14,500 **(d)** ₹116,000

5. Suppose currency with the public is ₹2,070 crore, net demand deposits ₹3,030 crore, net time deposits of banks ₹5,570 crore and savings deposits with post office savings banks ₹320 crore. What is M2?
   (a) ₹5,100 crore **(b)** ₹5,420 crore **(c)** ₹10,670 crore **(d)** ₹2,390 crore

6. What happens when the RBI lowers the bank rate?
   (a) the money multiplier becomes zero **(b)** money supply falls
   (c) money supply rises **(d)** money supply is unchanged

7. A bank starts with a deposit of ₹2,800 and a reserve ratio of 10%. After its first loan comes back as a deposit, how much must it hold as required reserves on its round-2 deposits?
   (a) ₹532 **(b)** ₹2,268 **(c)** ₹280 **(d)** ₹5,320

8. Bank reserves are ₹300. If the reserve ratio changes from 40% to 50%, total deposits the system can support:
   (a) fall by ₹750 **(b)** rise by ₹600 **(c)** rise by ₹150 **(d)** fall by ₹150

Section B — Short answer — 8 × 2 = 16 marks

9. What is a double coincidence of wants?

10. Legal tender or not legal tender? (a) a credit card payment (b) a ₹100 note

11. Explain each term: (a) bank rate (b) open market operations

12. A deposit of ₹3,400 enters a banking system with a reserve ratio of 40%. Find the money multiplier, total deposits created and total loans.

13. Suppose currency held by the public is ₹1,120 crore, net demand deposits are ₹3,940 crore and net time deposits are ₹5,290 crore. Find M1 and M3. Which is more liquid?

14. A bank receives a deposit of ₹2,700; the reserve ratio is 20%. Fill rounds 1 and 2: deposits, required reserves and loans (the loan comes back as a deposit).

15. Reserves in a banking system are ₹200. Find total deposits at a reserve ratio of 50% and at 10%. What happens to money supply when the ratio falls?

16. What happens to the money supply when the RBI (a) raises the repo rate (b) buys government bonds in the open market? Give a reason.

Section C — Longer answers — 4 × 4 = 16 marks

17. Explain how commercial banks create money (credit).

18. Match each with its meaning: (a) open market operations (b) high powered money (c) bank rate. Choose from: central bank buying or selling government bonds; currency with the public plus bank reserves; rate at which the RBI lends to commercial banks.

19. A bank is the only bank in an economy. It receives a cash deposit of ₹2,600; the reserve ratio is 40%. (a) Find its final deposits, reserves and loans (its balance sheet). (b) Find the money multiplier. (c) If the ratio rises to 50%, what happens to loans?

20. Suppose currency with the public is ₹3,210 crore, net demand deposits ₹2,030 crore, savings deposits with post office savings banks ₹270 crore, net time deposits of banks ₹6,010 crore, and total post office deposits (excluding NSC) ₹610 crore. (a) Find M1, M2, M3 and M4. (b) Which are narrow and which broad money? (c) Which is most liquid?

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Answer key

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Q	Answer	Working
1	**(d) barter**	—
2	**(a) unit of account**	—
3	**(d) 10**	1 ÷ 0.1
4	**(a) ₹58,000**	2,900 × 1/0.05
5	**(b) ₹5,420 crore**	2,070 + 3,030 + 320
6	**(c) money supply rises**	—
7	**(a) ₹532**	10% of 5,320
8	**(d) fall by ₹150**	300 ÷ 0.4 = 750; 300 ÷ 0.5 = 600
9	**In barter, each person must want exactly what the other offers, which is hard to find.**	—
10	**(a) not legal tender (b) legal tender**	—
11	**(a) rate at which the RBI lends to commercial banks (b) central bank buying or selling government bonds**	—
12	**multiplier 2.5; deposits ₹8,500; loans ₹5,100**	1 ÷ 0.4; 3,400 × 2.5; 8,500 − 3,400
13	**M1 ₹5,060 crore, M3 ₹10,350 crore; M1 is more liquid**	1,120 + 3,940; + 5,290
14	**Round 1: ₹2,700, ₹540, ₹2,160. Round 2: ₹4,860, ₹972, ₹1,728**	round-2 loan = cash 2,700 − reserves 972
15	**₹400 and ₹2,000; money supply rises**	200 × 1/0.5; × 1/0.1
16	**(a) money supply falls (b) money supply rises**	—
17	**A deposit lets a bank keep a fraction as reserves and lend the rest; the loan is spent and redeposited, so deposits grow by a multiple of the first deposit.**	—
18	**(a) central bank buying or selling government bonds (b) currency with the public plus bank reserves (c) rate at which the RBI lends to commercial banks**	—
19	**(a) deposits ₹6,500; assets: reserves ₹2,600 + loans ₹3,900 (b) 2.5 (c) loans fall to ₹2,600, so money supply falls**	2,600 × 2.5; 2,600 × 2 − 2,600
20	**(a) M1 ₹5,240 crore, M2 ₹5,510 crore, M3 ₹11,250 crore, M4 ₹11,860 crore (b)**	M2 = M1 + PO savings; M3 = M1 + net time deposits; M4 = M3 + total PO deposits

Q	Answer	Working
	M1, M2 narrow; M3, M4 broad (c) M1	