22
MONEY SUPPLY AND ITS REGULATION

22.1 INTRODUCTION

Money has always been the most sought commodity. We want money because by this we can buy goods and services. Each one of us keeps some amount of money in our pockets, money-drawers, safes and in banks. How much do we keep depends on our needs in terms of day to day spending, possibility of some emergency expenditure or merely for the feeling of economic security. The reasons may differ but all individuals, firms and institutions hold some amount of readily available money. By adding up all such holdings we can have some idea of the total stock of money in a country. The concept of money supply is derived from certain selected holdings of money in a country. This lesson explains this concept as well as how money supply can be increased or decreased.

22.2 OBJECTIVES

After going through this lesson you will be able to :

- explain the need for money and its various forms;
- explain how we make money payments;
- state that who issues currency notes and coins in a country;
- explain the lending activity of commercial banks;
- explain who regulates the lending activity of commercial banks;
- explain the components of the nation's stock of money and money supply;
- explain the need for keeping a check on money supply;
- explain how central bank regulates money supply.

22.3 WHY IS MONEY WANTED?

Is money wanted for its own sake? The answer is 'no'. Money has no direct use. It is not consumed. Money is also not of any direct use in production. Money cannot be used as a material or as a machine in the actual production process. But we can use money to buy goods and services either for consumption or for use in production.

The fact of life is that money is not wanted for its own sake. It is wanted because it gives us the power to obtain goods and services. The more money a person has greater is his power to obtain goods and services. This is why most of us run after money. This is how an individual looks at money.

If we cannot directly consume money or directly produce goods and services from it, of what use is money to the society as a whole. The society cannot be rich if it has more current notes or coins. It can be rich only when it has more goods and services. In fact the invention of money initially was to facilitate transactions in buying and selling and in borrowing and lending. This function of money is called medium of exchange function. In the primitive societies price of a good was expressed in quantity of other goods. It was a highly inconvenient mode of exchanging one good for another. Money was invented to remove this inconvenience. With the introduction of money the price of every good or service can be expressed in money units. So for the society money is required to facilitate transactions.

22.4 WHERE DO WE KEEP OUR MONEY?

Individuals keep their money holdings in their pockets, in money drawers, in safes and in banks. Institutions, including business establishments, keep their money in money drawers at counters, in safes and in banks. This is our 'ready to use' money, or simply ready money. We can use this money to buy something or can lend it. The money lying in pockets, money drawers and safes is in the form of currency notes and coins. The money kept in banks is in the form of bank deposits.

To keep money in a bank we open an account in our name. It is called bank account. The bank gives the facility to withdraw it any time during banking hours. The bank issues a cheque book containing many cheque leaves. We can use a cheque to withdraw money ourselves personally or issue a cheque to somebody who can get collected money on our behalf. What bank needs is our signature and our instructions to pay the 'bearer' of the cheque a certain specified amount of money. The bank has no objection in making payment so long as the required amount of money is lying in our account. It is our money and we can withdraw it any time we like. Whether the whole of the money deposited by us in the bank is kept by the bank in the form of notes and coins or in some other form is not our concern. So long as the bank makes us the payment whenever we demand it is ready money for us.

There are many types of accounts we can open in a bank. The instant withdrawal facility is not available in all types of accounts. One such account is called fixed deposit account. The term fixed here refers to the fixed time period, say a month, a year, two years and so on. The money deposited in a fixed deposit account can be withdrawn only after a fixed time period mutually agreed upon by the depositor and the bank. Thus if a deposit is made for one year, we cannot, as a rule, withdraw money before one year. As such money deposited in this account cannot be treated as ready to use money. More appropriately it is a loan to the bank for a fixed period.

The deposits in banks with instant withdrawal facility are called **demand deposits** because money from these deposits can be withdrawn on demand. The deposits without instant withdrawal facility are called **time deposits** because money from these accounts can be withdrawn only after the mutually agreed upon time period expires. Only money deposited in demand deposits is ready money. The money in time deposits is investment.

To conclude we keep our ready to use money in pockets, money drawers, safes and in the form of demand deposits in banks. The total of such money held by all individuals and institutions in a country is country's stock of money. This point is further elaborated in the section 22.9.

22.5 HOW DO WE MAKE MONEY PAYMENTS?

You go to a bookseller and buy a book. The price of the book is expressed in money. Suppose the price of the book is Rs.100. You take out currency notes worth Rs.100 and make payment to the bookseller. This is one way of making a payment. Why does the bookseller accept these currency notes? He accepts it because he is sure that if he uses these currency notes to make payment to the publisher of the book he will gladly accept the same. From where does the bookseller derive this confidence? In fact this confidence is given to everyone in the country by the law of the country. According to law no one can refuse to accept payment for any good or service in the form of currency notes. Any money backed by such legal assurance is called **legal tender money.** All currency notes and coins are legal tender money, but within the legal boundary of the country. For example, In India Rupee currency notes are legal tender money. If currency of some other country is offered for payment one is within his legal right to refuse to accept this currency. British pounds, U.S. dollars, Pakistan rupee, etc. are not the legal tender in India. British pound is legal tender in Britain. Pakistan rupee is legal tender in Pakistan and so on.

How else you can make the payment? Suppose you don't have enough currency notes to make the payment of Rs.100. But you have enough money in your bank account with instant withdrawal facility. One way is that you go to bank, withdraw the money and make the payment. This consumes lot of your time. Also suppose that the bank is closed on that day or during the hours when you thought of buying the book. What is the alternative before you? You postpone the purchase of the book and wait for the bank to open. Is this the only alternative? Not necessarily if the bookseller knows you. You can issue a cheque for Rs.100 in the name of the bookseller and tell him to collect the money from the bank. Is the bookseller legally bound to accept the cheque? He may decline to accept payment by cheque. Thus **bank deposits are not legal tender money.** If the bookseller knows you and is satisfied that you are likely to have sufficient money in your bank account he may accept the cheque from you. We have made two points here. First, bank deposits are money but not legal tender money. Second, if the cheque is accepted, payment by cheque and payment by currency notes and coins are part of money stock of the nation. Both are ready to use money.

When the bookseller accepts the cheque is it not inconvenient for him to go to so many banks where his customers have accounts. The banking system has a solution for this problem. What actually the bookseller has to do is to hand over all cheques of the different banks to the bank in which he has an account. His bank does the job of collecting money from all the banks on his behalf and deposit the same in his account. All this merely involves bank to bank entries. No currency is actually withdrawn or deposited. Only the entries of withdrawals and deposits are made by different banks. The payments are made without really involving actual transfer of currency notes. This is why bigger payments are generally made through cheques to avoid the inconveniences of counting, handling, transporting large amount of currency.

To conclude demand deposits are much more convenient mode of payment than currency notes. Generally, payments involving small amounts are preferred to be made in cash i.e. in currency notes and coins; and payments involving large amounts are generally made by cheques.

POINTS TO REMEMBER

- Money is not wanted for its own sake. Individual wants money because it gives him power to buy goods and services. The society needs money to facilitate transactions involving payments.
- Money deposited in the demand deposits in the bank can be withdrawn on demand by writing a cheque.
- We make money payments in two ways : (a) by currency notes and coins and (b) by writing a cheque.

INTEXT QUESTIONS 22.1

Fill in the blanks with appropriate words out of those given in the brackets:

(i) Money is ______________ (wanted, not wanted) for its own sake.

(ii) Cash can be withdrawn by writing a cheque from ______________ (time, demand) deposits.

(iii) Payment by notes and coins is ______________ (the only, not the only) mode of money payment.

(iv) Demand deposits ______________ (are, are not) legal tender money.

22.6 WHO ISSUES CURRENCY NOTES AND COINS?

Take out a currency note of Rs.2 or of higher denomination from your pocket. Suppose it is a 10 rupee note. On the top of the note is printed Reserve Bank of India. At the bottom it is signed by the Governor of the Reserve Bank of India.

The above 10 rupee note is issued by the Reserve Bank of India. All currency notes of Rs.

2, Rs. 5, Rs. 10, Rs. 20, Rs.50, Rs. 100 and Rs. 500 denominations in India are issued by the Reserve Bank of India (RBI).

In banking language, RBI is the central bank of the country. It is the apex bank. It is called 'central' because it is central to the banking system as a whole and the highest authority to regulate the functioning of the entire banking institutions of the country. It frames rules and regulations about their day to day working and keeps a watch over their functioning. RBI is a government owned institution and regulates the entire banking system of the country in accordance with the policies of the government. It doesn't deal directly with public. You cannot open an account with RBI. It deals only with the government and maintains government's account.

Now take out a one rupee note. On its top is printed 'Government of India'. At the bottom it is signed by the Secretary, Ministry of Finance (Government of India).

The one rupee note is issued by the Government of India. Coins of all denominations are also issued by the Government of India.

To the general public it does not make any difference whether currency notes and coins are issued by the RBI and the Government of India so long as they are acceptable in settlement of payments. Both are legal tender. Both constitute stock of money with a person or an institution.

We have pointed out above that the RBI, being a central bank, besides issuing most currency notes also regulates the functioning of all banking institutions. All banks other than RBI are called **commercial banks**. They are called 'commercial' because they undertake banking activities on commercial basis with the intention of earning profit. They accept deposits, borrow and lend to earn income. Out of these the lending activity of the commercial banks is of special importance.

22.7 LENDING ACTIVITY OF COMMERCIAL BANKS

What is special about lendings by commercial banks in the context of stock of money in a country? For this let us first understand the lending activity of commercial banks. From where do the commercial banks get funds for lending? The most important source is the deposits made by people and institutions. Another source is borrowings from people, institutions and the central bank. In India people make deposits in saving account. Firms and institutions deposit in current account. The bank gives some token interest on deposits in saving account. No interest is paid on deposits in current account. The bank provides instant cash withdrawal facility to both type of account holders. In addition to this bank provides the facility of collection and transfer of funds of account holders from one bank to another. The bank issues a statement of account periodically on demand to the depositors. In common usage these are called pass books. For providing these services a bank normally does not charge any fee. So bank pays some token interest and alongwith provides many services free of charge. The bank has to incur expenditure on all this. In addition bank promises instant withdrawal facility.

Now, to meet its expenditure on interest and free services to depositors bank must earn income. Bank can do so only by lending depositors, funds and earn 'interest' income. This leads us to a dilemma. The bank promises instant withdrawal facility to its depositors. It means that the bank must be ready to pay the money to the depositors on demand. The dilemma is that if bank lends the funds of depositors how will it meet its promise of instant payment on demand. On the other hand, if the bank doesn't lend any money and keeps all the deposit money as cash-in-hand bank will not be able to earn any income. Then from where will the bank meet its expenditure on interest payment and free services to depositors. How can a bank lend depositors, money and at the same time be ready to pay back to the depositors their money on demand?

The dilemma is resolved by a practical assumption about the banking habits of the depositors. The assumption is that not all depositors will turn up at the same time to withdraw money. Only few depositors will turn up at any one point of time. Furthermore, those who turn up to withdraw will not withdraw the whole of their deposits. They will withdraw only a part of their deposit. Deposits by the account holders continuously flow in. So there is a continuous inflow into and outflow of cash from the bank. All these assumptions, which so far have been found to be very practical, reduce the requirement of a bank to keep the deposits as cash-in-hand to meet the withdrawal requirements of the people. A bank from experience learns that how much ready money should it keep to meet the withdrawal demand of depositors. Suppose bank finds that it should keep 20 percent of deposits in the form of ready money and lend the remaining to earn interest. Suppose the bank becomes greedy and keeps only 10% as cash reserve and lends 90% of the depositors' money so that it can earn more interest. It may create problems both for the depositors and the bank. The bank may not be able to keep its promise of instant withdrawal facility and the depositors may be unhappy on this account and they may lose confidence in bank.

To stop the banks from being greedy the RBI (i.e. the central bank) enters into the picture. It exercises its legal power to control the functioning of commercial banks. It makes it legally obligatory for the commercial banks to keep a minimum percentage of deposits as reserves. It is called **legal reserve.** The legal reserve of a commercial bank is held at two places i.e. with itself and with the central bank, i.e. RBI. The required minimum percentage of deposits to be held with itself is called Statutory Liquidity Ratio (SLR) and that held with RBI is called Cash Reserve Ratio (CRR). (The term liquidity broadly refers to cash or assets that can conveniently be converted into cash without loss of time). The amount left with commercial banks for lending now equals total deposits **minus** legal reserves. The legal reserve limits the lending capacity of a commercial bank.

22.8 WHY REGULATE THE LENDING ?

The bank uses 'legal reserve' requirement to limit the lending capacity of commercial banks. Why is there such a need? Producers need money for investment. If banks lend to them what is the harm. In fact unregulated lending by commercial banks may do two harms. First, it may harm the interests of the depositors. The bank may not have enough cash to pay to depositors when they need it. Second, it may unduly increase the total amount of demand deposits in the country. Demand deposits are a part of money stock of the nation. Thus the unlimited lending may lead to the unlimited increase in the money stock of the nation. It may lead to rise in price.

How does lending by commercial bank increases deposits? When bank lends it opens an account in the name of the borrower. The borrower spends the amount on making payments to the suppliers, creditors, etc. He issues cheques in the names of these suppliers, creditors, etc. They deposit these cheques with their respective banks who collect the money from the bank of the borrower and deposit the same in the respective accounts of suppliers, creditors etc. This raises the total amount of deposits in the bank and raises the money stock of the nation. The story doesn't end here. When banks receive these fresh deposits they keep a part of it as legal reserve and are in a position to lend the remaining amount. If they lend, deposits increase further and so also the money stock of the country. This is why commercial banks are sometimes described as manufacturers of money.

If banks do not lend even a rupee out of a fresh deposit made, there will be no more new deposits. If they lend a part of deposit new deposits equal to the amount of lending are created provided the entire sum lent comes back to the banks. If some people do not have banking habits and keep money paid to them in their safes the deposit creation process is restricted.

The lending power or the deposit creating or money creating power of the commercial banks depends on legal reserve requirement. Higher the legal reserve ratio lower the lending, or the money creating, power of the commercial banks. The legal reserve ratio is determined by our central bank (RBI). If RBI raises this ratio, the lending capacity of banks decreases. If it reduces the ratio, the capacity increases. In this way legal reserve ratio becomes a tool in the hands of the central bank to regulate the stock of money in the country.

22.9 WHAT IS NATION'S STOCK OF MONEY?

The total stock of money in an economic system has four components :

(1) Notes and coins with public (other than banks)
(2) Notes and coins with commercial banks
(3) Deposits of the commercial banks with the central bank
(4) Demand deposits with commercial banks.

Of the above the sum of first three is total stock of cash in the country. It is also referred to as **paper money**. The sum of second and third components is total cash with commercial banks. This must not be less than the legal reserve requirement imposed on commercial banks by the central bank. The first component is simply currency with public. The fourth component is money in the form of demand deposits used for payment by cheques. It is also referrerd to as **bank money**.

22.10 WHAT IS NATION'S SUPPLY OF MONEY?

There is no unique definition of money supply. The general definition of money supply is that it consists of those items that are actually used for transactions, to buy and sell things and make other payments. It includes two of the four components given above :

(1) Notes and coins with public (i.e. other than banks)
(2) Demand deposits with commercial banks.

Cash reserves of commercial bank (i.e. second and third components of stock of money as listed in section 22.9) is not a part of money supply as generally understood. The items included in money can be called **transactions money**.

There are many concepts of money supply used in practice. The above concept of money supply is the one generally used and designated as M_1 by RBI. It is also referred to as **'narrow'** concept of money supply. It means that other concepts of money supply are broader than M_1 and include more items. But all these concepts exclude cash reserves of commercial banks.

22.11 IS THERE NEED TO KEEP A CHECK ON MONEY SUPPLY?

Money supply includes notes and coins outside banks and demand deposits with banks. Notes, coins and demand deposits must at each moment be in the possession of particular persons, firms, etc. Money represents command over goods and services. More the money more the command. By holding money, and not spending it, one denies himself the satisfaction he could have derived by spending it on goods and services. As such an individual or the firm will not like to hold all the money it gets. Normally each individual would like to hold a particular amount of money at one time. How much money to hold will vary from individual to individual depending on his income, daily transactions etc. Those who have higher income or make many sale and purchase daily will keep larger amounts. As such each one of us gets into the habit of holding certain amount of money with us or as demand deposits.

Now what one does when his money holding becomes more than what he would like to keep. He will consider spending the excess on goods and services. It is because by holding more money than he needs for daily transactions etc., he is denying himself the satisfaction which he can derive by spending money. He spends it either on consumption or invests the same. So if money supply in the country is increased and people have excess balances they will like to spend on consumption and investment. This raises demand for goods and services and pushes the general price level in the economy.

If money holding becomes less than average because money supply is decreased people refrain from spending the money they receive to raise their money holding back to the average level. This reduces demand for goods and services and in turn leads to fall in prices. So reducing money supply leads to fall in prices.

Large fluctuations in prices, continuous rise or continuous fall, are not good for an economy. Changes in money supply affect prices. So by keeping a watch on money supply with the people we can check large scale fluctuations in prices.

22.12 WHO CAN KEEP A CHECK ON MONEY SUPPLY?

This amounts to asking that who should regulate money supply in the country and how. Money supply has three components : notes, coins and demand deposits. Notes are issued by our central bank i.e. the Reserve Bank of India. Coins are issued by our government i.e. the Government of India. Demand deposits are created by commercial banks by lending money.

By adding or withdrawing currency notes from circulation Reserve Bank of India can increase or reduce money supply. By adding or withdrawing coins from circulation the Government can increase or reduce money supply. By lending more or less the commercial banks can increase or decrease money supply. Out of the three components the coins, issued by government, form a very insignificant portion of money supply. Out of the remaining of the two demand deposits are more significant than the currency notes in total money supply.

Demand deposits are created by commercial banks by lending money. It gives them interest income. Will commercial banks be really interested in reducing their lendings? They are interested in more and more lending to earn more and more of income. But what about the interest of the depositors. Banks use depositors' funds for lending. Depositors to commercial banks are like customers to businessmen. Guided by self-interest commercial banks may care less for depositors and may not be really interested in restricting their lendings.

22.13 CONSTRAINTS ON LENDING

How much can banks really lend all depends upon two factors. One is the amount of deposits it receives. If less money is deposited initially less lending is possible. The second is the legal reserve requirement imposed by the central bank.

(a) Legal Reserve Ratio

Higher the legal reserve requirement lower the lending capacity of banks. Legal reserve requirement is a direct tool in the hand of the central bank. If it is desired to reduce money supply in the country the central bank can raise legal reserve ratio. It will limit the lending capacity and consequently the deposit creating capacity of banks.

(b) Open Market Operations

Lending capacity, or the deposit creating capacity, of the banks can also be checked through the depositors' route. The depositors themselves may not show interest in depositing less in banks. But the central bank can create conditions which may induce depositors to reduce their deposits in banks. The central bank sells securities (loans instruments) to the public. To buy these securities, the public withdraws money from their deposits either in cash or by issuing a cheque in favour of the central bank. In this way total deposits are reduced and the currency flows into the central bank and goes out of circulation. Reduction in deposits curtails the lending power of banks. Reduction in deposits by one rupee curtails lending and deposit creation by banks by several rupees. This we have already explained in section 22.8. Similarly if the central bank desires to increase money supply it buys securities from the public and makes them payment by writing cheques in favour of the buyers. The public deposit this amount in banks. Deposits in banks increase and so there is multiple increase in lending and deposit creating power of commercial banks. This technique of controlling money supply by the central bank is, in technical language, called **open market operations.** 'Open market' here refers to the act of buying and selling of securities by the central bank in the open market.

(c) Bank Rate

So far we have learnt about two techniques by which the central bank can regulate money supply, Legal Reserve Requirement and Open Market Operations. There is one more technique called the 'Bank Rate'.

When firms need money they borrow from the commercial banks. When commercial banks need money they borrow from the central bank. The central bank charges interest on this. The interest rate so charged in technical language of banking is called **bank rate.** So the Bank Rate is essentially the Central Bank's Rate of Interest on lending to commercial banks. Now if the central bank lends to commercial banks and the commercial banks lend to public the rate of interest charged by the commercial bank must be higher than the 'bank rate' charged by the central bank. If the central bank wants that commercial banks should lend less it raises its own lending rate, i.e. bank rate, charged from commercial banks. (Remember the central bank does not lend to the public). This forces commercial banks to increase their lending rate. The borrowers now have to pay higher rate of interest. It increases their cost of borrowing and they borrow less. This reduces lending by commercial banks. This in turn reduces money supply. Similarly, if the central bank lowers Bank Rate, commercial banks also lower their lending rate. Lending increases and so is money supply.

To conclude, it is the central bank which can regulate money supply through the techniques of (a) Legal reserve requirements, (b) Open market operations and (c) Bank rate.

POINTS TO REMEMBER

- People make demand deposits in banks. The bank promises to pay money from these deposits on demand. At the same time bank lends a substantial part of the deposits to earn interest. The bank is able to do this because all depositors do not turn up at the same time to withdraw cash. They also do not withdraw cash. Some deposit cash. To protect the interest of depositors and to check the lending of commercial banks the central bank makes it obligatory for the banks to keep a certain percent of deposits as legal reserves.
- The nation's stock of money includes : (1) Notes and coins with public, (2) Notes and coins with banks, (3) Deposits of commercial banks with the Central Bank and (4) Demand deposits with the commercial banks.
- The nation's supply of money comprises of : (1) Notes and coins with the public and (2) Demand deposits with the commercial banks.
- There is need to keep a check on money supply because more money supply may lead to rise in prices and less money supply may lead to fall in prices.
- The central bank keeps a check on money supply through the techniques of (1) legal reserve requirements, (2) open market operations and (3) bank rate.

INTEXT QUESTIONS 23.2

Choose the correct alternative :

(i) Currency notes are issued by :
   A. the Commercial banks
   B. the Central bank
   C. the Government
   D. All of the above.

(ii) Coins are issued by :
   A. the Commercial banks
   B. the Central bank
   C. the Government
   D. All of the above.

(iii) The nation's stock of money includes :
   A. Notes and coins with public and banks
   B. Demand deposits with commercial banks
   C. Deposits of commercial banks with central bank
   D. All of the above.

(iv) The nation's money supply includes :
   A. Notes and coins with public only
   B. Demand deposits with commercial banks only
   C. Both (a) and (b)
   D. Neither (a) nor (b).

(v) The minimum percentage of deposits which commercial banks are required to keep in the form of reserve are :
  A. Legal reserve ratio
  B. Cash reserve ratio
  C. Statutory liquidity ratio
  D. Lending ratio.

WHAT YOU HAVE LEARNT

- Money is wanted because (a) it gives power to buy goods and services and (b) facilitates transactions. People keep money in the form of currency notes and coins and demand deposits. Currency notes are issued by the Central Bank and coins by Government. Demand deposits are held in commercial banks. Currency notes and coins both are legal tender.
- The commercial bank promises cash withdrawal facility on demand and at the same time lends depositors' money. The bank is able to do it because all depositors do not turn up at the same time to withdraw cash and not the whole of cash. Some turn up to deposit cash. To safeguard the interests of depositors and to keep a check on lendings by commercial banks the central bank makes it obligatory for the banks to keep a certain percentage of deposits as legal reserves.
- The nation's stock of money includes : (1) Notes and coins with public, (2) Notes and coins with banks, (3) Deposits of commercial banks with central bank and (4) Demand deposits with commercial banks.
- Out of the above the nation's money supply includes (1) Notes and coins with public and (2) Demand deposits with commercial banks.
- There is a need to keep a check on money supply because it affects price level in the country. The central bank keeps this check through the technique of (1) legal reserve requirements, (2) open market operations and (3) bank rate.

TERMINAL EXERCISE

1. What is the need of money?
2. Distinguish between demand deposits and time deposits of commercial bank. Which of the two is money and why?
3. Describe the ways in which we can make monetary payments.
4. State who issues currency notes and coins in the country.
5. Explain briefly the conflict between lending activity of commercial bank and depositors' interest.
6. Explain how the 'legal reserve requirement' keeps a check on lending by commercial banks.
7. State the components of nation's stock of money.
8. State the components of nation's supply of money.
9. Explain the need for keeping a check on supply of money.
10. How do 'Open Market Operations' keep a check on money supply?
11. What is bank rate? How is it used to keep a check on money supply?

ANSWERS

Intext Questions 22.1

(i) not wanted (ii) demand (iii) not the only (iv) are not

Intext Questions 22.2

(i) B (ii) C (iii) D (iv) C (v) A

Terminal Exercise (Hints)

1. (i) It gives us power of buying goods and services.
   (ii) It facilitates transactions involving payment. (Read section 22.3)
2. Demand deposits are deposits from which cash can be withdrawn on demand. Time deposits are deposits from which cash can be withdrawn after a particular period of time. (Read section 22.4)
3. (i) By currency notes and coins.
   (ii) By issuing cheque on banks. (Read section 22.5)
4. Currency notes are issued by the central bank. Coins are issued by the Government. (Read section 22.6)
5. Banks promise instant withdrawal of cash to deposit holders. At the same time they lend depositors' money. So there is a possibility that the bank may not be able to keep up its promise (Read section 22.7).
6. Legal reserve is that minimum percent of depositors' money which banks are legally required to keep. The remaining they can lend. Higher the legal reserve ratio lower the lending capacity of banks. (Read section 22.8)
7. (i) Notes and coins with public
   (ii) Notes and coins with commercial banks
   (iii) Deposits of commercial banks with central bank.
   (iv) Demand deposits with commercial banks (Read section 22.9)
8. (i) Notes and coins with public
   (ii) Demand deposits with commercial banks. (Read section 22.10)
9. Increase in money supply may raise prices. Decrease in money supply may reduce prices. To avoid fluctuations in money supply it is necessary to keep a check on money supply (Read section 22.11).
10. When the central bank sells securities money is withdrawn from deposits in commercial bank and paid to the central bank. As deposits are reduced the lending capacity of banks is also reduced. This in turn reduces deposits which are a part of money supply (Read section 22.13b).
11. Bank rate is the rate of interest charged by the central bank on lending to the commercial banks. When bank rate is raised the commercial banks also raise their lending rate. Borrowing becomes costly and people borrow less. This reduces the lending or deposit creating capacity of commercial banks (Read section 22.13c).