Money Multiplier

Bank loans to the customers

↓

usually in the form of demand deposits.

↓

Change in NDTL

↓

Change in reserves

Suppose, a bank gives a loan of Rs 100 to a person, say, for example A.

↓

Loan A/c - A

Loan sanctioned — ₹100

(credit Entry)

↓

Δ NDTL = ₹100

$\Delta NDTL \longrightarrow ₹100$

Case - I : Only CRR is working

$\downarrow$

CRR is 10 %.

So, this bank needs to increase reserves with the RBI by ₹ 10

$\downarrow$

Thus, multiplier is 10 in the above case.

We can say that -

Multiplier is - $\dfrac{1}{CRR}$

$$\frac{1}{10\%} = \frac{1}{0.10} = 10$$

If CRR is 5 %, then, multiplier is

$$\frac{1}{5\%} = \frac{1}{0.05} = 20$$

Case II : Both CRR & SLR are working

Assumption – CRR is 10%
&
SLR is also 10%

↓

Value of multiplier →

$$\frac{1}{CRR + SLR} = \frac{1}{10\% + 10\%} = \frac{1}{20\%} = 5$$

Bank habit of the people
&
money multiplier

↓

we need to introduce a new ratio called CDR.

↓

Currency-Deposit Ratio

↓

a proportion of NDTL which people want to maintain as cash.

Case III : CRR, SLR & CDR are working

Formulae for multiplier in case of CRR, SLR & CDR –

$$\frac{1}{CRR + SLR + CDR}$$

Assuming that CDR is also 10 %, then, multiplier will be –

$$\frac{1}{10\% + 10\% + 10\%} = \frac{1}{30\%}$$

We can say →

(i) If bank habit is good,

↓

CDR will be lower

↓

Multiplier will be higher

(ii) If bank habit is not good,

↓

CDR will be higher

↓

Multiplier will be lower.

all linked with NDTL

(i) only CRR — $\dfrac{1}{CRR}$

(ii) CRR & SLR — $\dfrac{1}{CRR+SLR}$

(iii) CRR, SLR & CDR — $\dfrac{1}{CRR+SLR+CDR}$

Financial Market

Intro.

A Market in which money & various financial instruments are exchanged is called financial market.

The economic development of a country is critically dependent on the level of development of the financial market.

Structure of Financial Market (India)

- Money Market
  - Short-term
    - Funds are exchanged for a period not more than one year.
- Capital Market
  - Long term
    - Funds are exchanged for a time period more than one year.

Structure of Money Market (India)

- Organised
  - Call Money Market
  - Notice Money Market
  - Inter-Bank Term Money Market
  - CBLO
  - CPs
  - CDs
  - Bills
    - Comm. Bills
    - Treasury Bills
    - Cash Management Bills
- Unorganised
  - Hundis
  - Money-lenders
  - Friends
  - Relatives etc.

Notes :

(i) Hundis used to be the instruments of money transfer or the instruments of exchanging goods during Medieval India.

(ii) In the call money market

↓

Banks exchange funds

↓

for overnight.

(iii) Notice Money Market

↓

Banks exchange money

↓

for up to 14 days

(iv) Inter-Bank Term Money Market

↓

Banks

↓

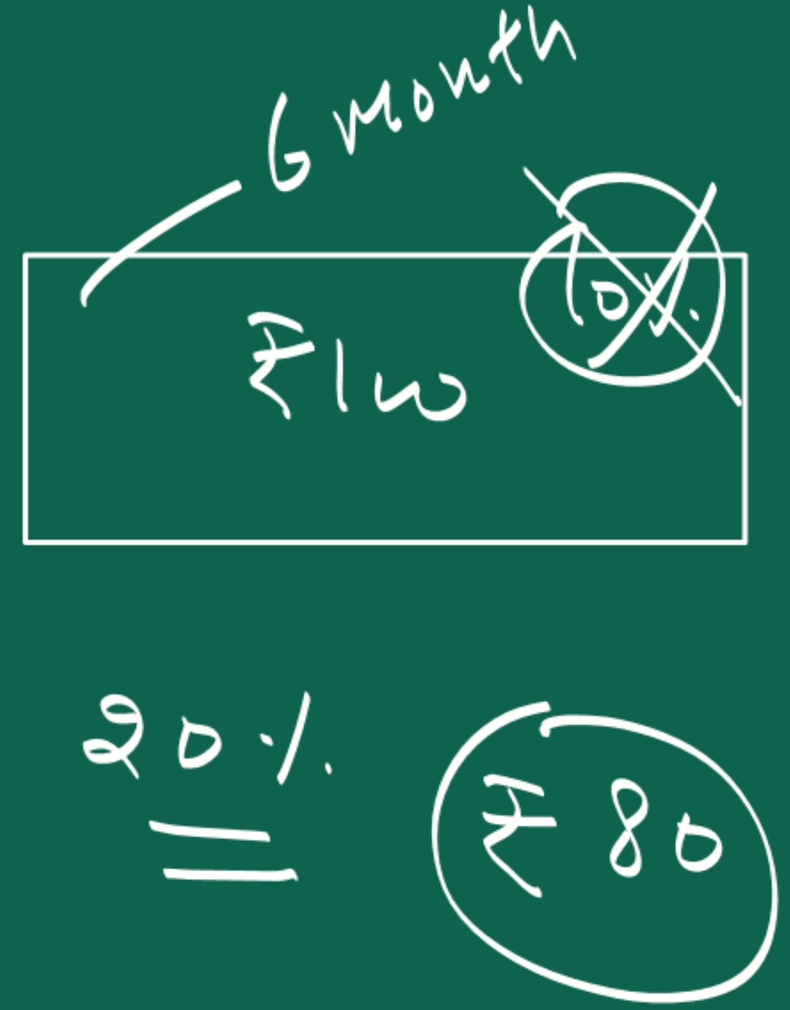
up to one year

(v) CBLOs = Collarteralised Borrowing & Lending Obligations

a financial tool to be used by banks for borrowings

from one day to one year

(vi) CP_s = Commercial Papers



unsecured financial tool for borrowings by Companies, All India Financial Inst. & Primary Dealers.

Time — 7 days to One year

<u>Note</u> - Are issued on discount.

(vii) CDs = Certificates of Deposit

↓

- unsecured
- are issued on discount
- Time-period → 7 days to One year
- To be issued by – Banks & AIFIs

(viii) Comm. Bills

↓

- Issued by traders
- Time period – usually 3 months
- Not popular in India.

(ix) Treasury Bills

- To be issued – RBI for GoI
- To be issued at <u>discount</u>.
- fully secured
- Time period
  - 91-days
  - 182-days
  - 364-days

<u>Note</u> – State govt. → not allowed.

(x) CMBs = Cash Management Bills

↓

- To be issued by — RBI for GoI
- Similar to TBs but the following two differences –
  - (i) Time-period → less than 91 days
  - (ii) Time format is not fixed.

(xi) The Money Market regulation in India.

↓

by RBI

CRR - 10%

RBI

↓

₹10

₹5 + ₹5

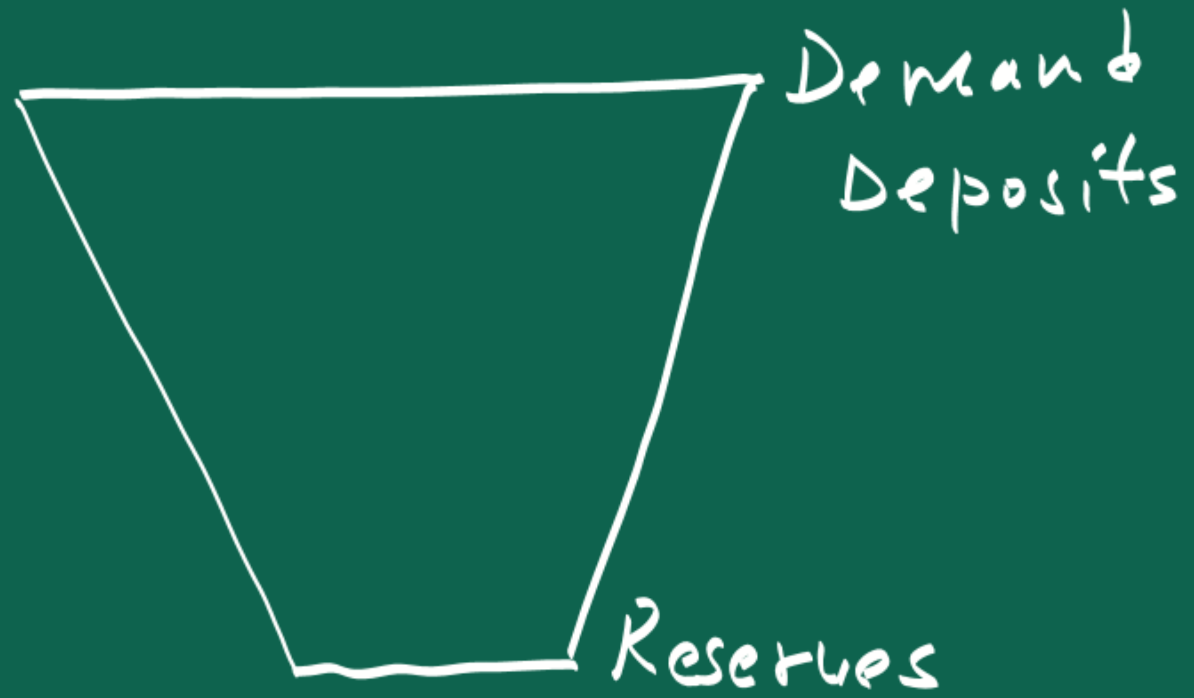
↓

₹100 + ₹100 = ₹200

ΔNDTL

↓

₹100


Demand
Deposits
Reserves