

B.Com 2nd year

Money and Banking

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Central Bank and Its Functions

Introduction

The central bank is an apex body which aims at controlling and managing the banking system operations along with regulating the money supply for the economic stability of a country.

Bank of International Settlement, “A *Central Bank is the bank in any country to which has been entrusted the duty of regulating the volume of currency and credit in that country.*”

According to Kent, “*Central Bank may be defined as an institution which is charged with the responsibility of managing the expansion and contraction of the volume of money in the interest of the general public welfare.*”

Features of Central Bank



- **Monopoly:** The central bank is only one in every country, enjoying the monopolistic rights and authorities.
- **Apex Body:** It is the supreme body of the country's banking system regulating the other banks and supporting the whole banking structure of the nation.
- **Government-Owned:** The central bank is strictly owned by the government and thus belong to the public sector.
- **Legal Entity:** It is a legal entity established under the provisions of a particular act of the government, holding a special significance and rights.
- **Banker of Other Banks and Government:** The central bank provides the banking services such as deposits and withdrawals to the various commercial banks and government.

- **Monetary Authority:** It keeps complete control over the flow of money within a country through the formulation of various monetary policies, rules and regulations.
- **Note Printing Authority:** The central bank is the only bank of the country which has the authority of printing new notes except coins and Re. 1 note.
- **Nation's Gold and Foreign Exchange Reserve:** This bank is also considered to be the custodian of the country's foreign exchange as well as gold reserve keeping these assets under its supervision.
- **The backbone of Banking System:** Being an apex body, the central bank acts as the backbone of a country's banking system, performing all the crucial financial functions. Such as framing the banking rules and regulations, circulation of currency in the market and advising the government on economic issues.
- **Clearing House:** The central bank can be seen as a clearinghouse since it initiates the settlement of bills, cheques and other financial instruments among the two or more banks to ensure smooth functioning of the banking system in a country.

Functions of Central Bank

The central bank holds many responsibilities and authorities which defines its services. These are as follows:

Functions of Central Bank

Controller of Money Supply and Credit

Printing Currency

Custodian of Cash Reserve

Custodian of Foreign Exchange Reserve

Clearing House

Lender of the Last Resort

Banking Services to Banks and Government

Issuing Government Bonds

Formulates Banking Rules and Regulations

Financial Agent and Advisor to the Government

The controller of Money Supply and Credit: The primary function of the central bank is to control the supply of money and the flow of credit in the market. It is facilitated through quantitative instruments (bank rates, cash reserve ratio, statutory liquidity ratio and open market operations) and qualitative instruments, i.e. fluctuating the rate of interest for loans.

Printing Currency: The central bank has the authority of printing the notes of all denominations except for Re.1 notes and the coins.

Custodian of Cash Reserve: All the banks have accounts with the central bank where they can maintain some cash reserve for future needs.

Custodian of Foreign Exchange Reserve: This bank is responsible for managing, controlling and exchange of the foreign currency and gold in a country, by maintaining the foreign exchange reserve to keep the exchange rates stable.

Clearing House: The central bank acts as a mediator between two or more commercial banks and settle their accounts at the time of loss and manage the transactions between the two commercial banks.

Lender of the Last Resort: One of the essential functions of the central bank is to provide loans to commercial banks at the time of emergency, loss and insolvency.

Banking Services to Banks and Government: This bank provides all the general banking services like accepting deposits and sanctioning loans to the other banks and the government.

Issuing Government Bonds: The central bank issues various government bonds to generate funds, encourage public deposits and investments in the country.

Formulates Banking Rules and Regulations: This bank performs various regulatory functions like licensing banks, framing banking norms and policies, preparing a judicial mechanism for debt recovery by banks, monitoring the banking operations, etc. The central bank even practices moral suasion for making the commercial banks to abide by the policies so framed.

Financial Agent and Advisor to the Government: The central bank acts as a financial advisor to the government by providing an expert opinion at the time economic crisis, fiscal deficit, and advancing loans to other countries. At the same time, it also acts as an agent by representing the country and the government in international conferences and meetings, along with issuing the government bonds and securities on behalf of the government.