

Functions of Central Bank

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Central Bank: Definition

“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”-Bank of International Settlement.

- ▶ A central bank plays an important role in monetary and banking system of a country.
- ▶ It is responsible for maintaining financial sovereignty and economic stability of a country, especially in underdeveloped countries.

Functions of Central Bank

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graph TD; A[Functions of Central Bank] --> B[Traditional Functions]; A --> C[Developmental Functions]
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Traditional
Functions

Developmental
Functions

Traditional Functions

- ▶ **Bank of issue:** Possesses an exclusive right to issue notes (currency) in every country of the world.
- ▶ **Government's banker, agent, and advisor:** Implies that a central bank performs different functions for the government. As a banker, the central bank performs banking functions for the government as commercial banks performs for the public by accepting the government deposits and granting loans to the government. As an agent, the central bank manages the public debt, undertakes the payment of interest on this debt, and provides all other services related to the debt. As an advisor, the central bank gives advice to the government regarding economic policy matters, money market, capital market, and government loans.
- ▶ **Custodian of cash reserves of commercial banks:** Implies that the central bank takes care of the cash reserves of commercial banks. Commercial banks are required to keep certain amount of public deposits as cash reserve, with the central bank, and other part is kept with commercial banks themselves.

Traditional Functions

- ▶ **Custodian of international currency:** Implies that the central bank maintains a minimum reserve of international currency. The main aim of this reserve is to meet emergency requirements of foreign exchange and overcome adverse requirements of deficit in balance of payments.
- ▶ **Bank of rediscount:** Serve the cash requirements of individuals and businesses by rediscounting the bills of exchange through commercial banks. This is an indirect way of lending money to commercial banks by the central bank. Discounting a bill of exchange implies acquiring the bill by purchasing it for the sum less than its face value.

Traditional Functions

- ▶ **Lender of last resort:** Refer to the most crucial function of the central bank. The central bank also lends money to commercial banks. Instead of rediscounting of bills, the central bank provides loans against treasury bills, government securities, and bills of exchange.
- ▶ **Bank of central clearance, settlement, and transfer:** Implies that the central bank helps in settling mutual indebtedness between commercial banks. Depositors of banks give checks and demand drafts drawn on other banks. In such a case, it is not possible for banks to approach each other for clearance, settlement, or transfer of deposits.

Traditional Functions

- ▶ **Controller of Credit:** Implies that the central bank has power to regulate the credit creation by commercial banks. The credit creation depends upon the amount of deposits, cash reserves, and rate of interest given by commercial banks. All these are directly or indirectly controlled by the central bank. For instance, the central bank can influence the deposits of commercial banks by performing open market operations and making changes in CRR to control various economic conditions.

Developmental Functions:

Developmental Function refer to the functions that are related to the promotion of banking system and economic development of the country. These are not compulsory functions of the central bank.

- ▶ **Developing specialized financial institutions:** Refer to the primary functions of the central bank for the economic development of a country. The central bank establishes institutions that serve credit requirements of the agriculture sector and other rural businesses.
- ▶ **Influencing money market and capital market:** Implies that central bank helps in controlling the financial markets Money market deals in short term credit and capital market deals in long term credit. The central bank maintains the country's economic growth by controlling the activities of these markets.

Developmental Functions

- ▶ **Collecting statistical data:** Gathers and analyzes data related to banking, currency, and foreign exchange position of a country. The data is quite helpful for researchers, policymakers, and economists. For instance, the Reserve Bank of India publishes a magazine called Reserve Bank of India Bulletin, whose data is useful for formulating different policies and making macro-level decisions.

Thanks!!!