(v) Government has no role in producing high powered money in an economy.

28.6 COMMERCIAL BANKS

Meaning: The commercial bank is a financial institution which is primarily concerned with accepting deposits from public and lending to the public besides others. These banks operate both under the public as well private sectors. Some public sector banks include the State Bank of India, Punjab National Bank and Bank of India among others. The private sector commercial banks may include the banks namely HDFC bank, ICICI bank and HSBC bank among others.

Functions of Commercial Banks: The commercial banks normally perform the following functions in an economy:

(i) **Acceptance of deposits:** Every commercial bank accepts deposits from different sections of society including the general public, business entities and other institutions. Commercial banks accept following types of deposit:

- **Current Account Deposits or Demand Deposits:** This type of account is generally maintained by the business entities and money under these deposits are payable on demand of the depositor. The depositors are free to deposit or withdraw money from their account any number of times without any restrictions.

- **Savings Account Deposits:** This type of account is generally maintained by the households or individuals. The depositor can deposit or withdraw money deposited under this account only for a limited number of times. This account also attracts a nominal rate of interest payable to the account holder.

- **Fixed Deposit or Time Deposit or Term Deposit:** Under this account money is deposited for a fixed period and the rate of interest is relatively higher than other accounts depending on the tenure of the fixed deposit.

(ii) **Extending Loans and Advances:** This is another important function of a commercial bank. This is also the main source of income of any commercial bank. Banks grant loans and advances out of the surplus money after keeping certain percentage of their total deposit called as reserves. Some important forms of loans and advances are *ordinary loans*, *overdraft facility* and *discounting of bills of exchange*.

(iii) **Creation of Credit:** This function is derived from the earlier two functions of the commercial banks. This unique function has direct impact on the supply of money in an economy.

(iv) Transfer of Funds: The banks provide the facility of fund transfer to its customers through the instruments of cheque, demand draft or electronic transfer from one place to another or one person to another.

(v) Agency Functions: Banks receive and collect different types of payments on behalf of their clients through the instruments of cheques, drafts, bills and promissory notes etc. Banks also buy and sell gold, silver and other securities on behalf of their customers.

(vi) Sale and Purchase of Foreign Exchange: This is another important function of a commercial bank which has increased tremendously with increasing volume of international trade particularly in the era of globalization.

(vii) General Utility Services: In modern days the banks also perform some very useful functions for the benefit of its customers and the economy like collection and publication of data, advisory functions, issue of lockers and underwriting of loans, shares and debentures issued by the government.

28.7 CREATION OF CREDIT BY COMMERCIAL BANKS

Credit creation is one of the most important functions of a commercial bank. Banks create credit out of the deposits that is mobilized by them. Credit creation is also called money creation or deposit creation. Therefore, commercial banks are also known as creator of money or credit.

The process of credit/money creation: Money is not created by commercial banks by actually printing of notes or minting of coins. The money is created by granting loans and advances to public and making relevant entries into the books of accounts of the lending banks.Loans are granted out of the deposits received by the banks. Normally, the amount of loan granted by a bank is greater than the amount of deposits received by it. This is mainly because of the fact that when money is deposited by the depositors in a bank, the bank by its experience knows that not all the money would be withdrawn by the depositors at once at any point of time. This peculiar habit of the depositors leaves the bank with huge amount of surplus fund which in turn is used to create loans by the banks. The banks keep certain proportion of its total deposits in form of cash to honour the demand of its customers. Further, every commercial bank is required to keep certain proportion of its total deposits with the R.B.I. which is known as *Cash Reserve Ratio* (CRR). Besides CRR, the bank is also required statutorily to maintain certain proportion of its total deposits as liquid assets in form of cash, gold, and certain government approved securities. This is known as *Statutory Liquidity Ratio* (SLR). The CRR and SLR together form the *Legal Reserve Ratio* (LRR) which is determined by the central bank of a country (R.B.I. in case of India). When LRR is increased by the central bank the capacity of the commercial banks to create deposit or credit decreases and when LRR is decreased the capacity to create more credit increases.