

Experiential Activity

Subject	ECONOMICS
Class	XII
Topic	MONEY AND BANKING
Sub topic	Credit Creation by Commercial bank
Time	40 mts
Nature of Activity	Group activity

What will I learnt (L.O) –

Develop the understanding of money creation by commercial banks.

How does banks create credit more than the deposit?

What I have to do?

Find out primary functions of commercial bank and understand the process of credit creation.

What do I require?

Reading material, Text book of NCERT, Internet connection, paper and pen.

What do I need to know?

- The entire commercial banking system is one unit and is termed as bank.
- All receipts and payments are routed through the banks.
- Role of CRR and SLR, primary deposit, MPC(meaning)

Teacher's Activity:

- Ask students to do this activity in a group.
- Explain the process of credit creation by commercial bank.

Student's Activity:

1. Class room will be converted as one huge banking system.
2. Two students will demonstrate themselves as one bank and there will be five banks. Other students will act as depositors and borrowers.
3. Primary deposit be assumed as Rs 1000 and CRR as 10
4. In the first round one student Suresh will deposit a cheque of Rs 1000/ in bank and the bank will open account on the name of the first depositor.
5. Now the bank is free to give loan of Rs. 800/ to a borrower Sudheer after keeping a reserve of Rs. 200/
6. Sudheer withdraws the whole amount , bank gives a cheque of Rs 800/ and he makes payments to Sunil.
7. Sunil deposit the whole amount in second bank. Now this bank is free to give loan of Rs. 640 after keeping a reserve of Rs 160/.
8. With new deposit of Rs 640/ bank will give loan to Geeta after keeping 20% of deposit.
9. Students will keep on taking loan and depositing the money in the form of cheques.
10. There will be five rounds of depositing and withdrawing money and to find final credit creation formula will used.
11. Deposit creation will come to an end when all banks have cash reserves equal to initial deposit i.e Rs 1000/.

12. All transactions will be recorded as-

	DEPOSIT	LOAN	CASH RESERVE
Initial deposit	1000	800	200
1 Round	800	640	160
2 Round	640	512	128
3 Round	512	460.8	51.2
4 Round			
TOTAL	5000	4000	1000

What have I observed?

S. NO.	Statement	feedback
1.	The formula of money multiplier(MM)	
2.	Effect of higher value of LRR on MM	
3.	Effect of lower value of LRR on MM	
4.	The relationship between MM and credit creation	
5.	The determinants of credit creation	
6	Difference between primary and secondary deposit	

What have I learnt?

Primary deposits are those which people deposit in cash with banks.

Secondary deposits are those deposits which are created by banks during the process of credit creation.

What am I curious to learn?

The other secondary functions of commercial banks.

Let me evaluate myself.

Do the following—

Q1. What is the name of ratio of total deposits that a commercial has to keep with RBI ?

Q2. Why financial units like UTI are, not considered banks?

Q3. Name the types of deposits accepted by commercial banks.

Q4. If LRR is 20%. What will be the value of money multiplier?

Q5.If the total deposits created by commercial banks are Rs 10,000 crore and LRR is 10% then calculate the amount of initial deposit with the bank.
