CHAPTER THREE

CENTRAL BANKING

Definitions of Central Bank:

The bank which governs banking system and money market is Central Bank. The primary function of a central bank is to assist Government in formulating economic policy, in controlling and conducting money-market and also controlling bank‟ credit. Some specialized Bankers, Economists and thinkers have given different definitions:

"**A central bank** is a bank whose essential duty is to maintain stability of the monetary standard."

In the words of Decock, "The central bank is a banking system in which a single bank has either a complete or a residuary monopoly of note issue."

Professor Hatley says, "Central Bank is the lender of the last resort."

Functions of central banks

Functions of Central Bank: The functions of central bank are different from other banks. The following functions of central bank are stated below:

A. Monetary policy mandate

All central banks are responsible for conducting monetary policy. The monetary policy objective, however, is not the same for all central banks. While the maintenance of price stability is an important objective across the board, some central banks are also supposed to pursue additional goals, which have the same priority as the maintenance of price stability.

The monetary policy mandate of the European Central Bank (ECB), for example, consists primarily of maintaining price stability: "Without prejudice to the objective of price stability, the ECB shall support the general economic policies in the Union with a view to contributing to the achievement of the objectives of the Union…" (European Central Bank 2015b).

B. Traditional or general functions:

1**. Issue of notes and coins:**

The first and foremost function of central bank is to issue notes and coins as per needs of the public and requirement of business and commerce. As per rules, notes are issued against gold, silver and foreign currency. Bangladesh Bank (Central Bank) keeps foreign currency reserves as security against issuance of notes. Bangladesh Bank unilaterally reserves the right to issue notes. The arguments in its favour are as follows:

(a) To maintain equilibrium in quality between notes and currency issue
(b) To maintain equilibrium in size, types and values of notes and currency
(c) To maintain stability in rates of exchange both inland and foreign
(d) To create confidence on the people
(e) To control money market.

2. Government Bank:

Central Bank acts as banker and economic adviser of the Government. The central bank conducts and maintains Government accounts for all Government receipts and payments.

3. Banker's Bank:

Central Bank acts as banker‟s bank. As a rule, all scheduled and commercial banks have to maintain Statutory Liquidity Reserve (SLR) 18% with Bangladesh Bank (CRR: 5% and Bonds & Securities 13%).

4. Lender of the last Resort:

In case of financial crisis of the commercial banks, central bank acts as a lender of the last resort through lending against first class securities, bill of exchange etc.

5. Reservoir of foreign currency:

Central Bank maintains Foreign Currency Reserve. For the purpose of control of foreign currency, the following factors are responsible:

(a) For issuance of notes
(b) For payments of liabilities
(c) For payments of debts.

6. Clearing House:

Central Bank acts as a Clearing House for settlement of interbank transactions.

1. **Credit Control**: Credit Control is one of the major functions of central bank. The following are the ways of controlling credit:

(a) Change in bank rates

(b) Open market operation

(c) Change (increase or decrease) in reserve- ratio

(d) Selective credit

(e) Direct influence

(f) Moral suasion

(g) Propaganda.

C. Purposeful functions:

(a) Control Currency Market:

Central Bank acts as a controller and guardian of the currency market. For the purpose of formation, control and maintenance of currency market and for its overall development, central bank is the pioneer.

(b) Stabilize Exchange Rate:

Central Bank maintains stability of the foreign currency exchange rates by means of controlling credit. Stable exchange rates position helps create favourable balance of trade and acceptability of stable currency gets momentum in the international market.

(c) Maintain Gold Standard:

Central Bank is responsible for maintenance and control of gold reserve.

(d) Stabilize Price-Level:

Fluctuations and frequent changes of price-level affect economic growth. With a view to making good of the economic imbalances and crisis situations, central bank takes necessary measures for stabilizing price-level.

(e) Stabilize business activities:

Central Bank formulates credit policy and with this spirit, central bank takes necessary steps to protect economic depression for stabilizing business activities.

(f) Employment opportunities:

Central Bank takes initiatives for creating employment opportunities by means of credit-control mechanism.

D. Expansion and Development Functions:

(a) Development of Agriculture Sector: Central Bank formulates policy for expansion of Agri-sector for the purpose of economic upliftments in the country.

(b) Development of Industry Sector:

(c) Development of natural resources: Central Bank plays vital role for tapping natural resources which may lead to economic growth.

E. Other Functions:

(a) Adviser and Representative of Government:

Central Bank advises Government on economic issues and sometimes acts as a representative of the Government.

(b) Economic Research:

Central Bank conducts various economic research works and formulates policies for economic development. Central Bank conducts survey on different economic issues for the knowledge of the general public of the country.