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Eco-Fun-omics: How bad will the PNB scam hurt the economy?!

Howdy! As mentioned in my last article, that I would try to highlight the economic consequences of the Nirav Modi-PNB scam. If you have't read my last article – 'Everything One Needs to Know about Nirav Modi-PNB Scam' please do it now (check out the home page).

A gist from my last article ' on January 29th of 2018, Indian Government's Central Bureau of Investigation (CBI) launched an investigation into Modi. The CBI was acting on a complaint received from the Punjab National Bank (PNB), an Indian state commercial bank, that accused Modi and his partners of bank fraud of ₹280 Crore (USD 40 million). While ₹280 Crore was just the principal amount of the loan, the potential liability of loss to PNB goes well up to ₹11,400 crore (USD 1,759 million).'

So, how does the banking system affect our economy?

Commercial banks play a crucial role in the expansion and contraction of the money supply in our economy. Through their lending activities, banks increase or decrease the checking deposit component of the money supply (the total amount of money circulating in an economy). Basically, when you deposit your money in the bank you are basically reducing the economy money supply. On the other hand, when the banks are lending out your deposited money as loans, they are increasing the money supply of the economy.

Saving = Investment, this is the equation which any novice learns during his initial days. If our economy worked on this equation, we would had earned zero interest on our savings. God knows how many frauds and loss would the country see, risking all domestic savings. Fortunately that's not how it works in real world. Central bank steps in to protect the common men and their hard earned money. In India's case, it is Reserve Bank of India which acts like a super hero to save the economy. However, super hero also commit their bit of err.

Central banks have certain monetary policies which are framed to control situations of crisis. Monetary operations involve monetary techniques which control the magnitudes money supply, interest rates, price stability, stable exchange rate, inflation and so on.

Change in Money Supply = Change in reserves * (1/reserve ratio)

What is Cash Reserve Ratio (CRR)? Commercial banks are required to maintain a percentage of the deposits with RBI in the form of reserves or balances. Higher the CRR with the RBI lower will be the liquidity in the system and vice versa. As per records, the average reserve ratio is 5.53%. We would proceed with the calculations taking the reserve ratio to be 5.53%.

Therefore, Change in Money Supply = ₹240 crore * 1/5.53%

Change in Money Supply = ₹4,340 crore i.e. estimated loss of money supply to the Indian Economy. Wohhhh!!! that's a lot of monetary loss…