

Introductory Economics

Introdução à Economia

Problems

2021/2022

3rd Quarter (P3)

4. Banks, money and the credit market; financial crises and globalization

4. Bancos, dinheiro e mercado de crédito; crises financeiras e globalização

4.1 Classify the following sentences as True or False. Justify.

- a. Wealth does not depend on material possessions, it only depends on the difference between the gross income and depreciation.
- b. The depreciation of an asset is not time-dependent.
- c. The net income is the maximum number of resources that one can consume without using its wealth.
- d. In Economics, investment means saving in financial assets such as stocks and bonds.

4.2 Julia intends to buy a new house. She does not have all the necessary money today, but she will have it in 5 years' time. The real estate market is unstable, so she does not know whether to buy the house today or in 5 years' time.

- a. Describe this trade-off.
- b. How can Julia buy the house today?
- c. If Julia only wants to buy the house in the future, how can she capitalize her money?

4.3 Classify the following sentences as True or False. Justify. (Adapted from CORE, The Economy)

- a. Liquidity transformation occurs when the banks transform illiquid deposits into liquid loans.
- b. Base money is broad money minus bank money.
- c. Money is the cash (coins and notes) used as the medium of exchange to purchase goods and services.
- d. Bank money is the total money in the savers' deposit accounts at the bank.

4.4 What is commodity money? What is fiat money? Which kind do we use? (Adapted from Mankiw, Principles of Economics)

4.5 Throughout history, several banking crises have affected the world. Describe situations that may originate a banking crisis.

4.6 Classify the following sentences as True or False. Justify.

- a. The supply of base money is only defined by the demand of the banks.
- b. The bank lending rate is defined by the commercial banks.
- c. The central bank's policy rate affects the level of spending in the economy because households and firms borrow to spend.
- d. The default risk is not considered in the expected return of the banks' investments.

4.7 Regarding the principal-agent problem, classify the following sentences as True or False. Justify. (Adapted from CORE, The Economy)

- a. The principal-agent problem leads to credit rationing in the loans market.
- b. A principal-agent problem exists in loans due to a positive possibility of the principal not being repaid.
- c. One solution for the principal-agent problem in loans is for the borrower to provide equity.
- d. The principal-agent problem can be resolved by writing a binding contract for the borrower to exert full effort.

4.8 Many countries have policies that limit how much interest a moneylender can charge on a loan. (Adapted from CORE, The Economy)

- a. Who benefits from the laws and who loses?
- b. What are likely to be the long-term effects of such laws?

4.9 Why don't banks hold 100 percent reserves? (Adapted from Mankiw, Principles of Economics)

4.10 The 2008 financial crisis was mostly provoked by the subprime housing crisis. (Adapted from CORE, The Economy)

- a. Explain the housing boom (on both sides: price increase and price decrease).
- b. How did it impact the financial sector?

4.11 Globalization may result in an unbalanced distribution of the mutual gains from exchange (poorer vs richer economies). What can Governments do to protect their local economies? (Adapted from CORE, The Economy)

4.12 International trade creates gains mostly because of specialization. Explain why. (Adapted from CORE, The Economy)