

Assignment #5: Chapters 14, 15 & 18: In-class Review Questions

1. Suzi deposited \$100 in currency in her checking account.
 - a. How will that deposit affect the values of M1 and M2?
 - b. Would your answer change if Suzi had deposited the money in her savings account
2. People on the street sometimes use the word “money” in ways that are inconsistent with the definition given in this course. Are each of the following statements consistent with our definition of money? Explain briefly
 - a. “He had a lot of money in his wallet.”
 - b. “She made a lot of money last year.”
 - c. “I use my Visa credit card for money.”
 - d. “She has most of her money in a checking account at a bank”

Use this balance sheet of the B-money Bank to answer the questions below. Assume the required reserve ratio is 10 percent.

B-Money Bank			
Assets		Liabilities and net worth	
Reserves	\$50,000	Deposits	\$200,000
Loans	\$120,000	Net worth	\$20,000
Treasury securities	\$50,000		

1. What are the required reserves of B-Money Bank?
2. What is the maximum new loan that B-Money bank can extend?
3. Rewrite B-Money bank's new balance sheet, after new loan is made?
4. When B-money bank extended the loan, by how much did the money supply increase?

5. If the Federal Reserve bought all of B-Money Bank's Treasury securities, how large in new loans could B-Money Bank now extend?
6. Looking at the *banking system as a whole*, what would be the maximum impact on the money supply from this Fed action?
7. What is the effect of this increase in the money supply on the interest rate?

1.
 - a. List and explain one advantage of holding money compared to holding bonds?
 - b. What is the opportunity of holding money?
2. How does each of the following affect the money demand curve? Is this a shift of or a movement along the money demand curve?
 - - a. Increased income
 - - b. Increased price level
 - - c. Increased interest rates

1. Draw a graph of the *money market* and show the effect of an increase in the price level on interest rates

2. a. What are the major strengths of monetary policy?

b. What do economists mean when they say that monetary policy can exhibit cyclical asymmetry?

1. a. The economy is experiencing a sharp and prolonged inflationary trend. What changes would you recommend in each of the following areas:

- i)* the reserve ratio,
- ii)* the discount rate, and
- iii)* open market operations

2. Show how an increase in interest rates affect aggregate demand?

1. Suppose the exchange rate between the U.S. dollar and the British pound is 0.635 British pounds per U.S. dollar (indirect quotation)

- Alternatively, we can express the same result as _____ U.S. dollars per British pound (direct quotation).

2. What are the three main sets of factors that cause the supply and demand curves in the foreign exchange market to shift:

i)

ii)

iii)

1. For each of the following events draw a **diagram** of the foreign exchange market for dollars and show the effect on the supply of dollars, and/or the demand for dollars ? Does the dollar rise or fall in value ?

i) Economic expansion in Japan, a major U.S. trading partner, leads to increases in incomes of Japanese households.

ii) Interest rates in the United States rise.

iii) Speculators become convinced that the future value of the Japanese yen will be higher relative to the dollar than it is today.

1. Suppose that you are in charge of purchasing for a U.S. corporation that is planning to acquire a large number of new computers.

- The company's computer specialist has identified two models, one Japanese-made and one U.S.-made, that meet the necessary specifications. Since the two models are essentially equivalent, the company will buy the one with the lower price.
- Suppose the U.S.-made computer costs \$2,400, and a similar Japanese-made computer costs 242,000 yen. If the nominal exchange rate is 110 yen per dollar, which computer is a better buy?
(Hint: calculate the real exchange rate for computers)