

MOT1421
Economic Foundations
Week Eight

MACROECONOMICS: MONEY CREATION
SELF-TEST

The self-assessment consists of 10 Questions. Each Question has a weight of 1. Your maximum score therefore is 10. A score of 6 means that you have successfully passed the test.

Question 1

Consider the money multiplier model. Suppose the cash-reserve ratio is 7%. The central bank increases (cash) reserves by €20 billion. What will be the change in money supply according to the money multiplier model?

Question 2

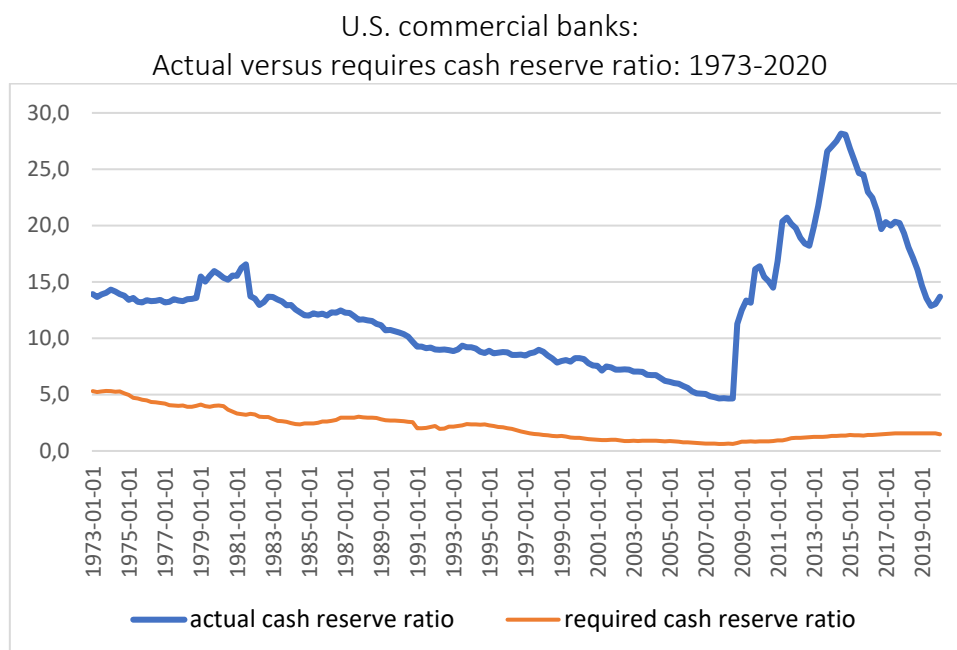
Explain what is meant by the expression 'banks are always fully loaned-up'.

Question 3

Explain why the assumption that banks are always fully loaned-up is problematic.

Question 4

Consider the following graph:



Source: Federal Reserve Bank of St Louis FRED Database
data-series CASACBW027SBOG, DPSACBW027SBOG & REQRESNS

<https://fred.stlouisfed.org/>

Explain why this graph shows that U.S. commercial banks have not been fully loaned-up.

Question 5

Consider the following balance sheet:

Balance sheet ABC-OMRA – June 2, 2020

assets = 'active'

liabilities = 'passive'

<p>cash reserves = €100 m</p> <p>loans = €1200 m</p> <p>govt. bonds = €200 m</p> <p>total = €1500 m</p>	<p>deposits = €1000 m</p> <p>inter – bank loans = €200 m</p> <p>equity = €300 m</p> <p>total = €1500 m</p>
---	--

What happens in this balance sheet when bank ABC-OMRA issues a new loan of €20 million to consulting company Fix-a-Fact? Explain what happens in a successive manner.

Question 6

Give two limitations on endogenous money creation by commercial banks.

Question 7

Consider the following balance sheet:

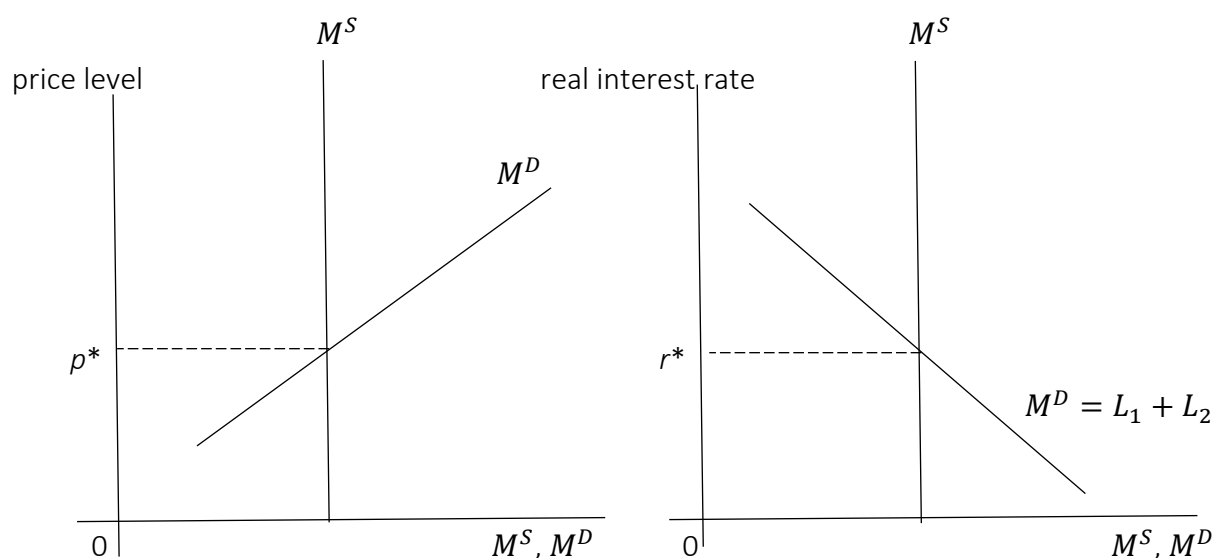
Balance sheet ABC-OMRA – June 2, 2020

assets = 'active'	liabilities = 'passive'
cash reserves = €110 m	deposits = €1100 m
loans = €1300 m	inter – bank loans = €210 m
govt. bonds = €200 m	equity = €300 m
total = €1610 m	total = €1610 m

What happens when Ms. Marple, a deposit-holder of bank ABC-OMRA withdraws €10 million to set up a private-detective agency.

Question 8

Consider the following Figure and explain what will happen to money demand and the price level (or the interest rate) if the central bank increases money supply.

**Question 9**

When is a commercial bank insolvent? Why is that a problem?

Question 10

Why is there a risk that a (short-run) liquidity problem of a commercial bank may turn into a solvency crisis?

End of self-test Week 8