

Week #12 Exercisess**Chapter 14: Money, Banks, and the Federal Reserve**

1. **Money:** assets that people accept in exchange for goods, services, and debt payments
 - Functions of money
 - i. Medium of exchange
 - ii. Unit of account
 - iii. Store of value
 - iv. Standard of deferred payment
 - Commodity money: A good used as money that has some intrinsic value independent of its use as money (ex: gold)

Q1. The major shortcoming of a barter economy is

- A) Requirement of double coincidence of wants
- B) Requirement of specialization and exchange
- C) That goods and services are not traded
- D) That money loses value from inflation

Q2. Consider the following traders who meet.

Bob has an apple wants an orange

Ted has an orange wants a peach

Mary has a pear wants an apple

Alice has a peach wants an orange

Which, if any, pairs of traders has a double coincidence of wants?

- A) Bob with Alice
- B) Ted with Alice
- C) Bob with Mary, Ted with Bob, and Ted with Alice
- D) None of the pairs above has a double coincidence of wants.

Q3. In an economy with barter, there are _____ prices than in an economy with money

- A) More
- B) Less
- C) Equal
- D) Can't say

Q4. Which of the following lists ranks types of assets from most liquid to least liquid?

- A) currency, demand deposits, money market mutual funds
- B) currency, money market mutual funds, demand deposits
- C) money market mutual funds, demand deposits, currency
- D) demand deposits, money market mutual funds, currency

Week #12 Exercises

2. Measurement of money (the money supply)

- **M1:** The narrowest (most liquid) definition of money
 - currency in circulation (not held by banks or government)
 - checking account deposits (demand deposits)
 - holdings of traveler's checks
- **M2:**
 - M1
 - savings account balances
 - small denomination time deposits
 - balances in money market deposit accounts in banks
 - non institutional money market fund shares

Q5. Which of the following is included in M2 and in M1?

- | | |
|--------------------|-------------------------------------|
| A) demand deposits | C) small denomination time deposits |
| B) corporate bonds | D) money market mutual funds |

Use the following table to answer Q6 and Q7:

Currency	\$1000
Checking Account Balances	\$2000
Savings Account Balances	\$5000
Small Denomination Time Deposits	\$6000
Non institutional Money Market Fund Shares	\$7000

Q6. M1 = _____

- A) 1000 B) 2000 C) 3000 D) 8000

Q7. M2 = _____

- A) 3000 B) 8000 C) 14000 D) 21000

Q8. You earn \$5000 a month and currently have \$200 in currency, \$100 in your checking account, \$2000 in your savings account, \$3000 worth of illiquid assets and \$1000 in debt. Then: Money (M1) = _____, Wealth = _____.

- A) 2300,5000 B) 300,4300 C) 200,4300 D) 300,5000

Q9. If I withdraw \$500 from my savings account and put it in my checking account, M1 will _____ and M2 will _____.

- | | |
|---------------------------|-------------------------|
| A) Increase, decrease | C) Not change, increase |
| B) Not change, not change | D) Increase, not change |

Q10. If a person withdraws \$500 from their checking account and holds it in currency, M1 will _____ and M2 will _____.

- | | |
|-------------------------|---------------------------|
| A) Increase, decrease | C) Not change, not change |
| B) Not change, increase | D) Decrease, increase |

Week #12 Exercises

3. Banks

• Bank balance sheets

ASSETS

Reserves
Loans
Securities
Buildings and Equipment
Other Assets

LIABILITIES

Deposits
Short-term Borrowing
Long-term Debt
Other Liabilities

- **Reserves:** Deposits that a bank keeps as cash in its vault or on deposit with the Federal Reserve
- **Required reserves:** Reserves that a bank is legally required to hold, based on its checking account deposits
- **Required reserves ratio (RR):** The minimum fraction of deposits banks are required by law to keep as reserves
- **Excess reserves:** Reserves that banks hold above the legal requirement
- How banks create money
 - Simple deposit multiplier: the ratio of the amount of deposits created by banks to the amount of new reserves
 - Deposit multiplier = $\frac{1}{RR}$
 - Change in checking account deposits = Change in bank reserves $\times \frac{1}{RR}$

Q11. A bank will consider a car loan to a customer as a _____ and a customer's checking account as a _____.

- A) Liability, asset C) Liability, liability E) Asset, net worth
B) Asset, liability D) Asset, asset

Table 1. The First Bank of Johnson City

Assets		Liabilities	
Reserves	\$2,000	Deposits	\$10,000
Loans	\$8,000		

Q12. Refer to Table 1. The reserve ratio for this bank is

- A) 0 percent. B) 20 percent. C) 80 percent. D) 100 percent.

Imagine that John deposits \$10,000 of currency into his checking account deposit at Bank A and that the required reserve ratio is 20%.

Q13. Bank A's reserves immediately increase by

- A) 2000 B) 8000 C) 10000 D) 50000

Q14. Bank A's required reserves increase by

- A) 2000 B) 8000 C) 10000 D) 50000

Week #12 Exercises

- Q15. Of the new reserves, Bank A can loan out a maximum of
A) 2000 B) 8000 C) 10000 D) 50000
- Q16. Checking Account deposits could eventually increase to a maximum of
A) 8000 B) 10000 C) 50000 D) 100000
- Q17. Suppose you deposit \$2000 in currency into your checking account. The reserve ratio is 10%. Assuming that banks do not hold any excess reserves, what is the maximum increase in checking account deposits that can result from your \$2000 initial deposit? What is the maximum increase in the money supply?

Use the following information to answer questions Q18 through Q20.

The Monetary Policy of Tazi is controlled by the country's central bank known as the Bank of Tazi. The local unit of currency is the Taz. Aggregate banking statistics show that collectively the banks of Tazi hold 300 million Tazes of required reserves, 75 million Tazes of excess reserves, have issued 7,500 million Tazes of deposits, and hold 225 million Tazes of Tazian Treasury bonds. Tazians prefer to use only demand deposits (checking accounts) and hold no currency in their wallets.

- Q18. Assume that banks desire to continue holding the same ratio of excess reserves to deposits. What is the reserve ratio for Tazian Banks?
A) 8 percent B) 4 percent C) 5 percent
D) None of the above is correct.
- Q19. Assuming the only other thing Tazian banks have on their balance sheets is loans, what is the value of existing loans made by Tazianbanks?
A) 6,900 million Tazes B) 7,125 million Tazes C) 7,350 million Tazes
D) None of the above is correct
- Q20. Suppose the Bank of Tazi loaned the banks of Tazi 10 million Tazes. Suppose also that both the reserve requirement and the percentage of deposits held as excess reserves stay the same. By how much would the money supply change?
A) 250 million Tazes
B) 200 million Tazes
C) 125 million Tazes
D) None of the above is correct