David Axelrod Due 3-22-17

Homework 3

Chapter 9

4. The regional banks governors sit on the Federal Open Markets Committee which gives them sway in policy decisions. The Individual banks also handle discount lending to financial institutions.

5. The discount rate and reserve requirements are controlled by the Board of Governors whereas open market operations are controlled by the FOMC

12. If the Fed was subject to more governmental oversight, politicians would likely attempt to game the fed to boost economic output while in power and thus giving them a higher likelihood of reelection. This short term thinking would create larger economic downturns when the bubbles collapse.

Chapter 10

2. The dual mandate is often a source of conflict for the fed. Increasing economic activity and reducing unemployment has a tendency to raise inflation. On the other hand if the fed wants to combat rising inflation with an interest rate hike, there could be negative economic consequences.

6. An increase in reserve demand will shift the demand curve to the right. The fed tries to bring the curve back in order to maintain interest rate stability by buying bonds on the open market to increase reserve supply. This will cause the money supply to increase overall.

1. 12% reserve requirement. $10 million in deposits, currently holds 400,000 in excess reserves. So the reserve requirement on new capital is 8% given excess. 8% \* 50000 = $4,000 required to keep in reserve.

3. Banking

Reserves Deposits

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1 million - - 1 million

- -

Fed

Securities Reserves

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

1 million - - 1 million

- -

3. Banking

Reserves Loans

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

500k - - $500k

- -

Fed

Loans Reserves

\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

- 500k - 500k

- -

Chapter 11

7. Businesses use money markets to meet short term capital needs. They also invest their excess cash in short term notes in order to earn interest.

11. Competitive bidding is the process of bidding on treasuries in an auction whereas non-competitive bidding is when the buyers take the yield dictated by the auction after the fact.

14. Large firms are the primary issuers of commercial paper. These short term debt instruments allow corporations to self-finance their own products (cars and trucks for example).

15. Banks are often seen as more trustworthy institutions especially overseas. When dealing with a foreign firm, a company might request payment in the form of a bank acceptance rather than cash from the foreign firm in order to ensure payment.

Part 2 Essay Question

1. Long term interest rates will have increased demand with the $400 billion in purchases by the fed. As the demand curve for longer term securities shifts to the right, the interest rate on these securities will have to fall. Short term rates will be sold off so the interest rates will have to rise as a result

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While the expected vs actual change in yield curves was nominal, the change itself was less significant than expected. In the long end of the curve, I underestimated the actual interest rate which shows how even $400 billion in capital maturity shift has a very small impact on the yield curve. Also the short end of the curve barely moves with changes in yield measuring in 1 or 2 basis points.

APPENDIX