Question 1.a

Beleaguered State Bank T – account.

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| Beleaguered State Bank | |
| **Assets** | **Liabilities** |
| Reserves $25 Million | Deposits $250 Million |
| Loans $225 Million |  |

Question 1.b

When the largest depositor withdraws $10 million, it would reduce Beleaguered State Bank’s Deposits by $10 million. This has an effect on the reserve as it would be adjusted for the reserves ratio, hence, the new reserves would be 10% of $240 million. This brings the reserves amount to be $24 Million, thus, the amount which Beleaguered State Bank can give out as loans would be ($240 Million - $24 Million) $216 Million.

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| Beleaguered State Bank | |
| **Assets** | **Liabilities** |
| Reserves $24 Million | Bank Deposits $240 Million |
| Loans $216 Million |  |

Question 1.c

Because BSB is cutting back on its loans, other banks will find themselves short of reserves and they may also cut back on their loans as well.

As BSB (Beleaguered State Bank) has decreased the amount of loans it can give out, the other banks would have more request for loans. This may lead the other banks finding themselves low on reserves, thus, they to shall reduce their loans.

Question 1.d

BSB may find it difficult to cut back on its loans immediately, because it cannot force people to pay off loans. Instead, it can stop making new loans. But for a time, it might find itself with more loans than it wants. It could try to attract additional deposits to get additional reserves, or borrow from another bank or from the Fed.

Question 2.

From the first part of this question, we come to find out that both scenarios increase the money supply. However, scenario 1 would cause a greater increase and this is why.

Both scenarios appear to cause a $40 000 increase in the money supply (given that the reserve requirement was 5%).

This is so because in scenario 1 we have $2000 worth of bonds being bought by the Central Bank. This means that the Central Bank is injecting money into the economy. Given that the reserve requirement is 5%, the money multiplier figure is 20, thus, the Feds purchases of bonds increases money supply by $40 000 ($2000 x 20).

In scenario 2, it appears as though money supply would also been increased by $40 000 but is not the entire case. As the $2000 in the cookie jar was always part of the money supply, by depositing the $2000 at the bank, money supply increased by $40 000 (due to the multiplier) but it also decreased by $2000. Hence, the net increase in scenario 2 is $38 000 and not $40 000.