EC370 **Name:** ____________________
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Chapter 9 - Practice - PART II **UO ID:** ____________________

QUESTION 1

Excess reserves act as insurance against deposit outflows. Suppose that on a yearly basis Malcom Bank holds \$12 million in excess reserves and \$88 million in required reserves. Suppose that Malcom Bank can earn 3.5% on its loans and that the interest paid on (total) reserves is 0.2%. What would be the cost of this insurance policy?

QUESTION 2

The bank you own has the following balance sheet. If the bank suffers a deposit outflow of \$50 million with a required reserve ratio on deposits of 10%, what actions should you take?

Assets	Liabilities+Capital
Reserves: \$75	Deposits: \$500
Securities: \$0	Borrowings: \$0
Loans: \$525	Capital: \$100

QUESTION 3

Duck Bank is a commercial bank in Oregon. Below is its initial balance sheet (unit: million USD).

Assets	Liabilities+Capital
Reserves: \$124	Deposits: \$300
Securities: \$176	Borrowings: \$200
Loans: \$300	Capital: \$100

(1) Given the required reserve ratio is 20%, calculating the required reserves amount.

(2) What is the largest deposit outflow that Duck Bank can sustain without making changes to other components in its balance sheet?

(3) Fill in the new balance sheet after a customer withdraws \$100 million.

Assets	Liabilities+Capital
Reserves:	Deposits:
Securities:	Borrowings:
Loans:	Capital:

(4) You will see that the bank fails to meet the reserve requirement because of this deposit outflow. How much more reserves that this bank needs to meet the requirement?

(5) Duck bank chooses to **selling securities** to make up for this shortfall in reserves. Complete the final balance sheet after this securities sale is completed.

Assets	Liabilities+Capital
Reserves:	Deposits:
Securities:	Borrowings:
Loans:	Capital:

(6) What is cost of this option? Note that this cost is not reflected in the balance sheet.

(7) Give one more option to make up for this shortfall in reserves.