Week 9 Review Session Questions

Thursday, March 6th, 4 and 5pm, North Hall 1110

1. a. The Federal Reserve carries out an open market purchase of Treasury securities. Why does this increase the reserves and deposits at banks?

b. The Federal Reserve carries out an open market sale of Treasury securities. Why does this decrease reserves and deposits at banks?

2. A bond promises to pay its owner $5000 one year from now. For the following prices, find the corresponding interest payments and interest rates that the bond offers.

Price	Amount Paid in 1 Year	Interest Payments	Interest Rate
$4000	$5000		
$4500	$5000		
$4900	$5000		
$5000	$5000		

As the price of the bond rises, what happens to the bond's interest rate?

3. The Federal Reserve has a "dual mandate". What does this mean and how does it relate to the three overarching goals discussed earlier in the class?

4. When carrying out monetary policy, the market for money is examined. What does the demand for money represent? What is the advantage and disadvantage of holding money? Why does the quantity of money change when the interest rate changes?

5. Draw a demand and supply graph showing equilibrium in the money market. Suppose the Fed wants to lower the equilibrium interest rate. Show on the graph how the Fed would accomplish this objective.

6. What is the Federal Funds rate and what role does it play in monetary policy?

7. When the interest rate changes, how does the each component of aggregate expenditures change?

8. Suppose there is just one interest rate in the economy. In an attempt to prevent the economy from overheating, the Fed raises its interest rate target. Illustrate graphically using the money market and aggregate expenditure graphs to show how the money supply, interest rate and GDP change.

9. Suppose that the price level in the economy rises from CPI = 105 to CPI = 120. Show how this changes the demand for money and the interest rate. How does this change the equilibrium level of GDP in the economy?