Chapter 10 Assignment

C 1. Credit cards are used as which of the following?
   a. a method of payment
   b. a part of the M2 money supply
   c. a method of deferring payment
   d. a unit of account

C 2. Actions of the Bank of Canada are likely to influence the rate of which of the following?
   a. unemployment in the long run but not in the short run
   b. inflation in the short run but not in the long run
   c. inflation in the long run but not in the short run
   d. inflation but not the rate of unemployment

B 3. Suppose a bank has a 5 percent reserve ratio, $10 000 in deposits, and it loans out all it can, given the reserve ratio. Which of the following is correct?
   a. It has $50 in reserves and $9950 in loans.
   b. It has $500 in reserves and $9500 in loans.
   c. It has $555 in reserves and $9445 in loans.
   d. It has $559 in reserves and $9445 in loans..

C 4. The Bank of Canada increases the money supply by using which of the following open market operations?
   a. selling Treasury securities and lowering the bank rate
   b. selling Treasury securities and raising the bank rate
   c. purchasing Treasury securities and lowering the bank rate
   d. purchasing Treasury securities and raising the bank rate

B 5. When the Bank of Canada conducts open market sales, what effect does it have on the money supply?
   a. It increases the money supply.
   b. It decreases the money supply.
   c. There is a gradual change to the money supply.
   d. There is no change to the money supply.

D 6. Other things being equal, when the Bank of Canada cuts its bank rate, which of the following is likely to occur?
   a. The money supply tends to fall.
   b. Bank reserves tend to fall.
   c. Bank lending tends to fall.
   d. The money supply tends to rise

C 7. When the Bank of Canada purchases government bonds in the open market, which of the following is likely to occur?
   a. The money supply will decrease.
   b. Interest rates will increase.
   c. The money supply will increase.
   d. Interest rates will be unaffected.

A 8. Suppose the Bank of Canada increases the percentage reserve requirement from 10 percent to 12 percent. Which of the following will occur?
   a. Bank reserves will increase.
   b. Bank lending will increase.
   c. Bank reserves will decrease.
   d. Interest rates will decrease.

D 9. A medium of exchange must be which of the following?
   a. legal tender
   b. issued by the government
   c. a commodity that is as valuable as a commodity as it is as money
   d. generally accepted by people for goods and services

A 10. Liquidity is best described as which of the following?
   a. the ease with which an asset can be converted into a medium of exchange
   b. a measure of the amount of income an asset earns
   c. positive net worth
   d. something that only legal tender can possess

A 11. Assume Bank A receives a deposit of $4000. If the required reserve ratio is 10 percent, how much can Bank A lend?
   a. $3600
   b. $4000
   c. $36 000
   d. $40 000

C 12. Which of the following items is a liability to a bank?

a. loans
b. reserves
c. deposits
d. an interest-bearing asset owned by the bank

B 13. Which of the following is true of fiat money?

a. It is not decreed by the government to be money.
b. It has no intrinsic value.
c. It is backed by a commodity such as gold.
d. It can be used as a medium of exchange only in a barter economy.

B 14. The ability of banks to create money has its source in which of the following?

a. the 100 percent reserve requirement
b. fractional-reserve banking
c. the ability of the government to mint as much currency as it wishes
d. the banks' ability to issue currency (bank notes) of their own

C 15. Giving up a dollar bill to purchase an ice-cream cone illustrates money's function as what?

a. a store of wealth
b. a unit of account
c. a medium of exchange
d. a standard of value

True or False?

F 16. Liquidity refers to the ease with which an asset flows through the bank.

T 17. Money is the set of assets in an economy that people regularly use to buy goods and services from other people.

T 18. Demand deposits are balances in the bank that depositors can access on demand by writing a cheque.

F 19. The money multiplier is the amount of reserves that the banking system generates with each dollar of money.

F 20. The bank rate is the rate of interest that the Bank of Canada gives to commercial banks on their deposits with the Bank of Canada.

21. What are the three functions of money?

1) medium of exchange: used by buyers to exchange w/ sellers for g&s

2) unit of account: used to post prices & record debts

3) store of value: used to transfer purchasing power from the present to the future

22. What are the four major functions of the Bank of Canada?

1) issue currency

2) act as banker to commercial banks

3) act as banker to the gov't

4) regulate money supply in the economy using monetary policy

23. What are the tools of monetary control as used by the Bank of Canada?

1) open mkt operation

2) foreign exchange mkt operation

3) change reserve requirement

4) change bank rate or overnight interest rate

24. Mike finds $10,000 cash buried in his back yard. He deposits all of it at his bank. Assume all banks are fractional reserve with a 5% reserve ratio. Calculate the loans made from the initial deposit.

Bank	Liabilities	Assets	
	Deposit	Reserves	Loans
Bank A	10,000	500	9500
Bank B	9500	475	9025
Bank C	9025	451.25	8573.75
Bank D	8573.75	428.69	8145.06
Bank E	8145.06	407.25	7737.81
Bank F	7737.81	386.89	7350.92

25. Suppose Jeremiah deposits in a bank an amount of $1000 that he had been holding at home in a jar for a long time.

   a. If the banking system is 100 percent reserve, how much does the money supply change?

   $\Delta M^S = \Delta C + \Delta D = \$1000$

   $\Delta C = 0$

   $\Delta D = 1000$

   b. If the reserve requirement is 10 percent and the bank holds no excess reserves, how does the money supply change?

   $\Delta C = 0$

   $\Delta D = 1000 \times 1/0.1 = \$10,000$

   $\Delta M^S = \Delta C + \Delta D = \$10,000$

   c. If the reserve requirement is 10 percent and the bank holds an excess reserve of 2 percent, how does the money supply change?

   $\Delta C = 0$

   $\Delta D = 1000 \times 1/0.12 = \$8333.33$

   $\Delta M^S = \Delta C + \Delta D = \$8333.33$

26. Suppose Heather receives a payment in cash of $400 and she deposits it in a bank.

   a. If the banking system is 100 percent reserve, how does the money supply change?

   $\Delta C = C_2 - C_1 = 0 - 400 = -\$400$

   $\Delta D = D_2 - D_1 = 400 - 0 = \$400$

   $\Delta M^S = \Delta C + \Delta D = -400 + 400 = 0$

   b. If the reserve requirement is 10 percent and the bank holds no excess reserve, how does the money supply change?

   $\Delta C = C_2 - C_1 = 0 - 400 = -\$400$

   $\Delta D = D_2 - D_1 = 400/0.1 - 0 = \$4000$

   $\Delta M^S = \Delta C + \Delta D = -400 + 4000 = \$3600$

   c. If the reserve requirement is 10 percent and the bank holds an excess reserve of 2 percent, how does the money supply change?

   $\Delta C = C_2 - C_1 = 0 - 400 = -\$400$

   $\Delta D = D_2 - D_1 = 400/0.12 - 0 = \cancel{\$8333.33}$ 3333.33

   $\Delta M^S = \Delta C + \Delta D = \cancel{8333.33} - 400 = \$\cancel{7933.33}$

   3333.33 2933.33