Homework #8: Chapter 10
The Monetary System

Suppose the Federal Research purchases a U.S. Government Bond from you for $10,000.

1. What is the name of the Fed’s action?

2. Suppose you deposit the $10,000 in First Student Bank. Show this transaction on First Student Bank’s T-account.

First Student Bank

<table>
<thead>
<tr>
<th></th>
<th>assets</th>
<th>liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

3. Suppose the reserve requirement is 20%. Show First Student Bank’s T-account if they loan out as much as they can.

First Student Bank

<table>
<thead>
<tr>
<th></th>
<th>assets</th>
<th>liabilities</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

4. At this point, how much money has been created from the Fed’s policy action?

5. What is the value of the money multiplier? (what is the formula?)

6. After infinite rounds of depositing and lending, how much money could be created from the Fed’s policy action?

7. If during the rounds of depositing and lending some people keep extra currency or fail to deposit all of their receipts, will there be more or less money created from the Fed’s policy action than you found in part (f)?
Multiple Choice Questions

8. Which of the following is not a function of money?
   a. unit of account
   b. store of value
   c. hedge against inflation
   d. medium of exchange

9. Which of the following statements is true?
   a. The FOMC meets once per year to discuss monetary policy.
   b. The Federal Reserve was created in 1871 in response to the Civil War.
   c. When the Fed sells government bonds, the money supply decreases.
   d. The primary tool of monetary policy is the reserve requirement.

10. Required reserves of banks are a fixed percentage of their
    a. loans.
    b. assets.
    c. deposits.
    d. government bonds.

11. Which of the following policy actions by the Fed is likely to increase the money supply?
    a. reducing reserve requirements
    b. selling government bonds
    c. increasing the discount rate
    d. All of these will increase the money supply.

12. Suppose Joe changes his $1000 demand deposit from Bank A to Bank B. If the reserve requirement is 10%, what is the potential change in demand deposits as a result of Joe’s action?
    a. $1000
    b. $9000
    c. $10000
    d. zero

13. A decrease in the reserve requirement causes
    a. excess reserves to rise.
    b. excess reserves to fall.
    c. the money multiplier to rise.
    d. the money multiplier to fall.
    e. none of the above.

14. Which of the following policy combinations would consistently work to increase the money supply?
    a. sell government bonds, decrease reserve requirements, decrease the discount rate.
    b. sell government bonds, increase reserve requirements, increase the discount rate.
    c. buy government bonds, increase reserve requirements, decrease the discount rate.
    d. buy government bonds, decrease reserve requirements, decrease the discount rate.
    e. none of the above.
15. Suppose all banks maintain a 100% reserve ratio. If an individual deposits $1000 of currency in a bank
   a. the money supply will be unaffected.
   b. the money supply increases by more than $1000.
   c. the money supply increases by less than $1000.
   d. the money supply decreases by more than $1000.
   e. the money supply decreases by less than $1000.

16. If the Fed engages in an open market purchase and, at the same time, it raises reserve requirements,
   a. the money supply should rise.
   b. the money supply should fall.
   c. the money supply will remain the same.
   d. we cannot be certain what will happen to the money supply.

17. The three main tools of the monetary policy are
   a. government expenditures, taxation, and reserve requirements.
   b. the money supply, government purchases, and taxation.
   c. coin, currency, and demand deposits.
   d. open market operations, reserve requirements, and the discount rate.
   e. fiat, commodity, and deposit money.

18. Suppose the Fed purchases a government bond from a person who deposits the entire amount from the sale in her bank. If the bank holds some of the deposit as excess reserves, the money supply will
   a. rise less than the money multiplier would suggest.
   b. rise more than the money multiplier would suggest.
   c. fall less than the money multiplier would suggest.
   d. fall more than the money multiplier would suggest.