

Problem Set #6Due Friday 5/5/06 by 6 p.m. in the Econ 101 slot in the Economics Alcove

Use a stapler! Write legibly and use full and grammatically correct sentences in your answers. Draw graphs neatly and label axes and points clearly. Each part below is weighted equally in grading, as are subparts within a part.

- A. 1) Do Problem 1 on p. 585 in Chapter 27 Appendix.
- 2) a. Do Problem 2 on p. 585 in Chapter 27 Appendix.
- b. What would be the effect on this economy of an increase in  $G$  of 100 and an increase in the fixed component of  $T$  of 100, where these occur at the same time (so a balanced budget change)?
- B. 1) What would be the effect on money supply of each of the following?
- a. Declining public confidence in the banks.
- b. Increased use of credit cards.
- 2) a. Describe the tools of monetary policy available to the Federal Reserve.
- Indicate whether, and if so how, they might be used for the following purposes:
- b. To signal that the Fed favors a sharp curtailment of bank lending.
- c. To permit an expansion of bank credit with existing reserves.
- d. To supply banks and the public with a temporary increase of currency for holiday (December) shopping.

C. Assume a small country's banking system's balance sheet looks like this:

<u>Assets</u>		<u>Liabilities</u>	
Reserves	\$15,000	Deposits	\$75,000
Loans	\$75,000	Capital	\$15,000
	<u>\$90,000</u>		<u>\$90,000</u>

- 1) What is the reserve ratio of this system? What is the money multiplier?

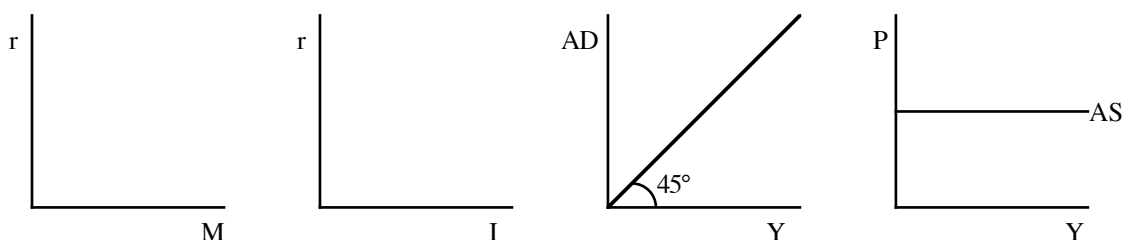
C. Show how the banking system balance sheet would look, always restarting from the one given on the flip side, after each of the following occurrences. Also state how much the money supply has changed, and whether or not the money multiplier has changed.

2) An immigrant deposits \$5000.

3) The reserve ratio is changed to 15%.

4) The central bank sells \$1000 worth of securities as an open market operation.

D. The effect of changes in the money market on national income can be traced through the following four graphs:



1) Finish drawing the four graphs started above. Then show how they are affected by a decrease in the money supply.

2) Draw a similar set of graphs to illustrate the consequences of all households' deciding to keep more cash on hand.

3) a. If the aggregate supply curve were upward-sloping, in which direction would the money demand curve shift under D.(1)? What causes this shift?

b. If the only reason people desired money was for transactions, what would the money demand curve look like?

4) a. Do Problem 1 on p. 662 in Chapter 31.

b. Do Problem 2 on p. 662 in Chapter 31.

c. Do Problem 5 on p. 662 in Chapter 31.

d. Do Problem 4 on p. 682 in Chapter 32.