Money market

1) • medium of exchange / means of payment : what people generally accept in their transactions of goods & services

• store of value : an asset that can be used to transport purchasing power from one time peroid to another

• unit of account : a standard unit that allows people to compare value of things

2) $M1$ = currency in circulation + demand deposits $\Rightarrow M1 = 1000 + 1000 = 2000$

$M2$ = $M1$ + saving and time deposits $\Rightarrow M2 = 2000 + 1000 = 3000$

$\therefore$ the money supply in the economy is 3000 \$

3) FRS is a system in which only a fraction of bank deposits are backed by actual cash on hand and available for withdrawal.

4)

a) banks have to keep 20% of their deposits as reserves

b) $100 + 200 = 300$ \$

c) $1/0.2 = 5$

d) $200\,(1/0.2) = 1000$ \$

e) $20/100 \times 1000 = 200 \rightarrow 1000 - 200 = 800$ \$

f) $100 + 1000 = 1100$ \$

5) • performs several important functions for banks, such as clearing interbank payments and assisting banks that are in difficult financial positions

• facilitates the transfer of funds among banks and is responsible for many of the regulations governing banking practices and standards

• responsible for managing exchange rates and the nation's foreign exchange reserves

6) Liquidity refers to how easily assets can be converted into a mean of exchange. The most liquid asset is money, especially cash.

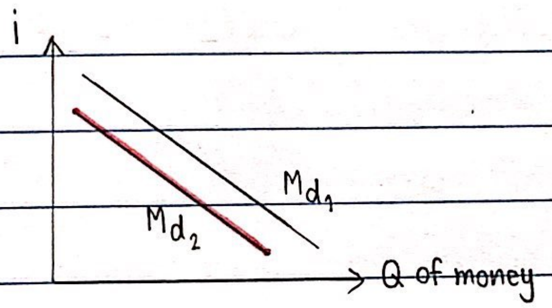
Demand for liquidity is determined by three motives:

- transaction demand (for daily use)
- precautionary demand (for unexpected use)
- speculative demand (for future investment)

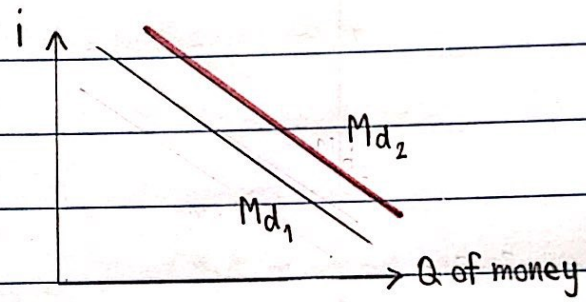
downward - sloping ⇒ speculative demand

7)

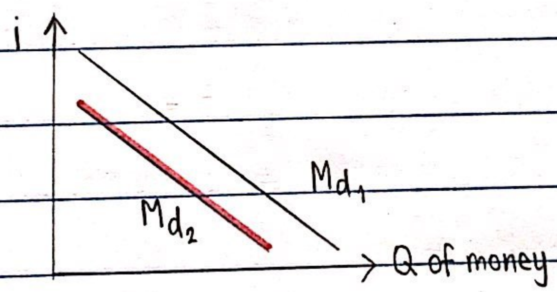
a) curve shifts to the left



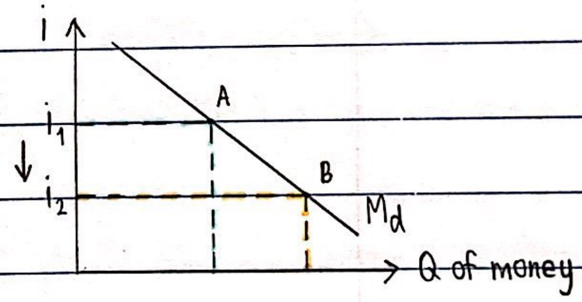
b) curve shifts to the right



c) curve shifts to the left

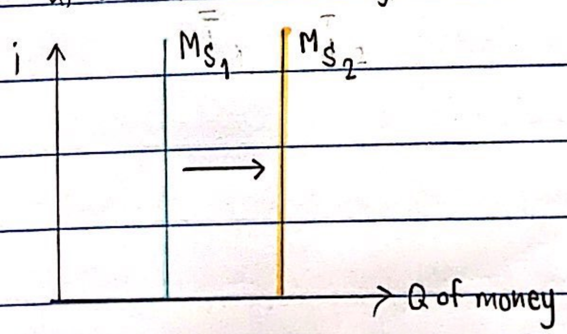


d) $Md \uparrow$ movement along the curve

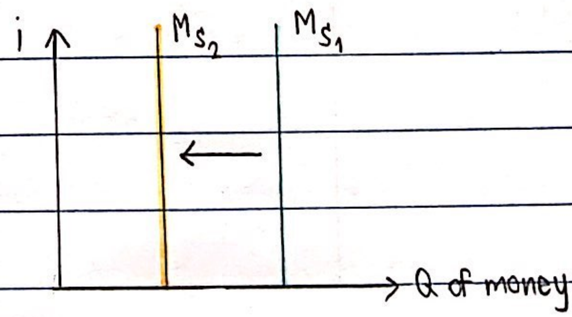


8) The Fed sets the amount of money available without consideration for the value of money.

a) line shifts to the right

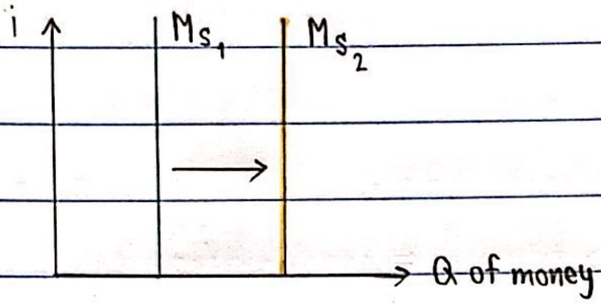


b) line shifts to the left

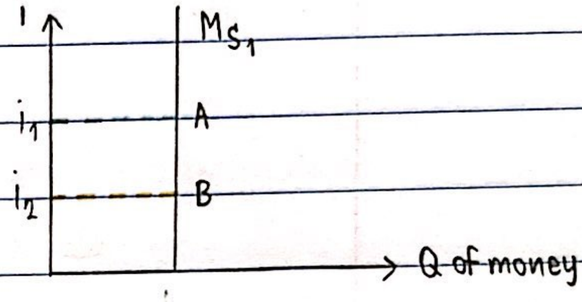


Money supply is determined by the CB, it doesn't depend on r

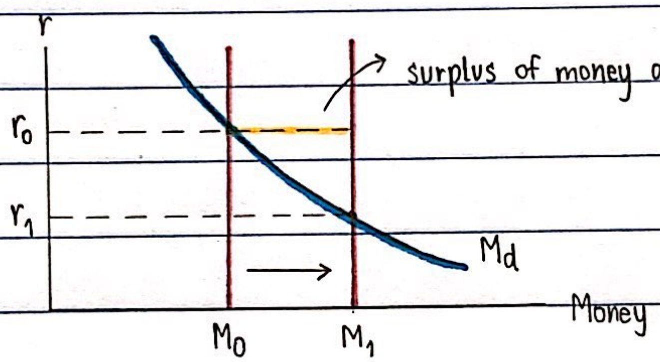
c) line shifts to the right



d) X change (not depends on i)



9)



surplus of money arises at r_0 when $M_s \uparrow$

Use Expansionary Monetary policy to increase money supply

($M_s \uparrow \rightarrow$ interest rate $\downarrow$)

10)
- excess supply of money
- so people convert cash into interest-bearing assets / buy bonds
- too much money offered to bond issuers who can't give high r to many savers
- bond issuers need to reduce i
- i falls i^*

11) $MV = PY \rightarrow$ real output (at the full-employment level)

An increase in money supply leads to an increase in price level

$\Rightarrow$ printing money creates inflation

12)

a) $200 - 1000i = 100$

$100 = 1000i$

$\therefore i^* = \frac{1}{10} = 10\%$

b) 400 refers to the transaction demand