**EE 431/ EE438 Economics of Financial Markets and Institution**
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**Assignment 4 Solutions**

1. **ME Chapter 17 Questions: 1**
   The rank from most to least liquid is (c) Reserves, (b) Securities, (a) Commercial Loans, (d) Physical Capital.

   **ME Chapter 17 Questions: 2**
   Possibly no, because the bank president is not managing the bank well. The fact that the bank has never incurred costs as a result of a deposit outflow means that the bank is holding a lot of reserves that do not earn any interest. Thus the bank's profits are low, and stock in the bank is not a good investment.

   **ME Chapter 17 Questions: 3**
   No. When you turn a customer down, you may lose that customer's business forever, which is extremely costly. Instead, you might go out and borrow from other banks, corporations, or the Fed to obtain funds so that you can make the customer's loan. Alternatively, you might sell some of your securities to acquire the necessary funds.

   **ME Chapter 17 Questions: 5**
   You should want to make short-term loans. Do not lock your interest rate. Then, when these loans mature, you will be able to make loans at higher interest rates, which will generate more income for the bank.

2. **ME Chapter 17 Quantitative Problems: 1**
   1.33 M − 0.84 M + 0.22 M + 1.48 M = $2.19 M

   **ME Chapter 17 Quantitative Problems: 6**
   The highest that demand deposits will reach, with 99% confidence, is $100 M + 3 × $5 million, or $115 million ("3" comes from the standard normal table). To maintain 8% as reserves against this possibility, they must maintain $115 M × 0.08 = $9.2 million.
   A better approach would be to increase/decrease reserves as deposits are received/withdrawn, rather than maintain $9.2 million against the possibility of $115 M in deposits.

   **ME Chapter 17 Quantitative Problems: 7**

| Assets | Liabilities |
|---|---|
| Required Reserves $ 8 million | Checkable Deposits $100 million |
| Excess Reserves $48 million | Bank Capital $ 6 million |
| Loans $50 million | |