

EE212 Principles of Macroeconomics, 2/2016 (Sec. 046401)

Problem Sets 2 :

Chapter 5. Monetary Policy

Please submit at the BE office, 5th floor department of Economics building.

Deadline of submission : March 31, 2016, before 15.00 hrs.

Late submission will not be accepted.

- 1. What is money supply? State whether Money supply is stock or flow variable and explain why.

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- 2. Define Narrow Money (M1).

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- 3. Assume that Hometown Bank has demand deposits of \$3,000,000, a reserve requirement of 10 percent and actual reserves of \$800,000. Determine the bank's required reserves and excess reserves.

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- 4. A person makes a deposit of \$4, 000 and the required reserve ratio is 2%. According to the simple money creation model, what is the final total change in deposits?

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- 5. Suppose that Lloyd Bank has reserves totaling \$100,000 on \$1,000,000 of deposits. Lloyd Bank lends out \$900,000. The reserve requirement is 10 percent. Can this bank make any new loans? Explain.

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6. Suppose Stefan deposits \$20,000 into Lloyd Bank. Suppose banks lends out all of its excess reserve. The reserve requirement is 5 percent. By how much will the banking system can increase total loans? What is the final total deposits in the banking system? How much money creation that the banking system can create? Show your work.

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7. Suppose that Stefan, fearing an impending financial crisis, withdraws \$20,000 from his account at Lloyd Bank and buries the cash in his backyard. The reserve requirement is 10 percent. Suppose the bank lends out all of its excess reserve. By how much will the bank have to reduce its loans? Calculate the maximum amount the money supply may contract as a result. Show your work.

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8. Suppose there is 2,000 million baht in the hand of the public.

(a) People want to hold only cash. They do not want to deposit money in a bank. What is the money supply of the economy?

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(b) Suppose people decide to deposit 1,500 million Baht in to the banking system. Required reserve ratio = 0.1. Assuming that the banking system has the potential to create deposits to the maximum. Calculate the total deposits in the banking system, money multiplier, and the deposits created by banks. What is the money supply of the economy?

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9. Why is the potential money multiplier (the maximum money multiplier =  $\frac{1}{\text{legal reserve ratio}}$  ) probably larger than the actual money multiplier?

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10. Suppose the central bank of China recently announced the reduction of required reserve ratio from 20% to 10%.

(a) How does money creation that the banking system in China would change? (Hint: calculate money multiplier)

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(b) How does this policy affect the money market? Explain adjustment from the original equilibrium to the new equilibrium. Graphically Illustrate.

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