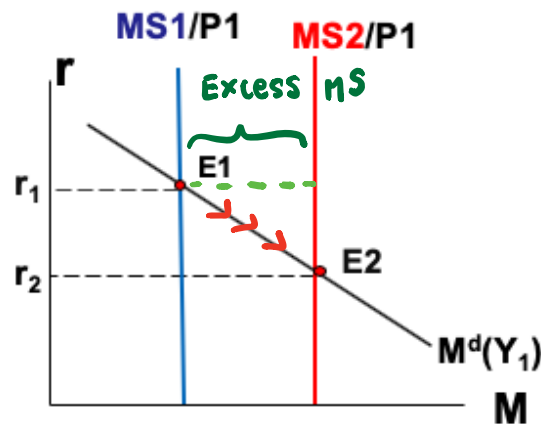


EE212 (2/2018 Section 046402): Quiz 2

1. (20 marks) Suppose there is 6,000 million Baht in form of currency in circulation and 4,000 in form of million Baht demand deposit. What is the money supply of the economy? [Hint: please give the definition of money supply, the definition of narrow definition of money (M1) and show how to calculate the money supply]

- Money Supply is total amount of “money” in the hand of public at a specific time.
- Narrow definition of money (M1) = currency in circulation + demand deposits
- Therefore, from the informaion given, M1 = currency in circulation + demand deposits = 6,000 + 4,000 = 10,000

2. (80 marks) Suppose originally the economy is at equilibrium. If the central bank buys government bonds from the public. How does equilibrium interest rate in the money market change? Provide money market graph to support your explanation. Explain the adjustment toward the new equilibrium. [Hint: Please make the graph clear; i.e. indicate the initial equilibrium, the new equilibrium. Make your explanation clear and complete. Marks depend on the quality of explanation.]



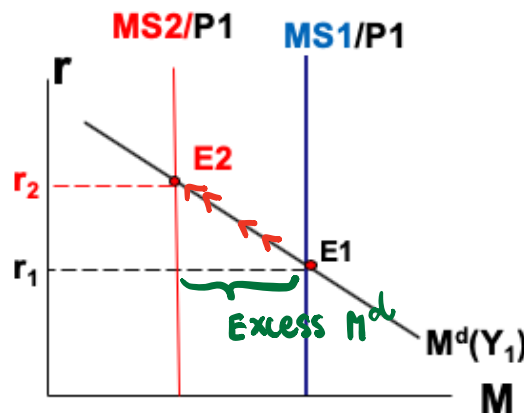
- Initially the economy is at equilibrium where real money supply $= \frac{MS_1}{P_1}$ is equal to real money demand. Equilibrium interest rate is at r_1 .
- When the central bank buys government bonds from the public, money supply (MS) increases from MS_1 to MS_2 . This is expansionary monetary policy.
- As money supply increases, real money supply increases from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
- Real money supply shifts to the right from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
- Equilibrium interest rate decreases from r_1 to r_2 .
- Explain the adjustment toward the new equilibrium.
 - Real money supply shifts to the right from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
 - The initial interest rate r_1 cannot be equilibrium interest rate.
 - At r_1 , there is excess money supply. People will buy more bonds. Bond price will increase and interest rate will decrease.
 - As interest rate decreases, money demand increases (move along money demand curve).
 - Until interest rate drops to r_2 , Real money demand is equal to Real money supply again.

EE212 (2/2018 Section 046402): Quiz 2

1. (20 marks) Suppose there is 6,000 million Baht in form of currency in circulation and 4,000 in form of million Baht demand deposit. What is the money supply of the economy? [Hint: please give the definition of money supply, the definition of narrow definition of money (M1) and show how to calculate the money supply]

- Money Supply is total amount of “money” in the hand of public at a specific time.
- Narrow definition of money (M1) = currency in circulation + demand deposits
- Therefore, from the informaion given, M1 = currency in circulation + demand deposits = 6,000 + 4,000 = 10,000

2. (80 marks) Suppose originally the economy is at equilibrium. If the central bank sells government bonds to the public. How does equilibrium interest rate in the money market change? Provide money market graph to support your explanation. Explain the adjustment toward the new equilibrium. [Hint: Please make the graph clear; i.e. indicate the initial equilibrium, the new equilibrium. Make your explanation clear and complete. Marks depend on the quality of explanation.]



- Initially the economy is at equilibrium where real money supply = $\frac{MS_1}{P_1}$ is equal to real money demand. Equilibrium interest rate is at r_1 .
- When the central bank sells government bonds from the public, money supply decreases from MS_1 to MS_2 . This is constraconomy monetary policy.
- As money supply decreases, real money supply decreases from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
- Real money supply shifts to the left from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
- Equilibrium interest rate increases from r_1 to r_2 .
- Explain the adjustment toward the new equilibrium.
 - Real money supply shifts to the left from $\frac{MS_1}{P_1}$ to $\frac{MS_2}{P_1}$.
 - Initial interest rate r_1 cannot be equilibrium.
 - At r_1 , there is excess money demand. People will sell more bonds. Bond price will decrease and interest rate will increase.
 - As interest rate increases, money demand decreases (move along money demand curve).
 - Until interest rate rises to r_2 , Real money demand is equal to Real money supply again.