HOMEWORK #2

EE 212 PRINCIPLES OF MACROECONOMICS

(SECTION 046401)

DUE DATE: APRIL 17TH, 2012 (IN CLASS)

CAUTIONS: Your assignment must be <u>your own original work</u>. Cheating or plagiarism is a violation of Thammasat University's academic policies and it <u>will result in giving zero credit to your work</u>.

Question #1

Assume that a quantity of money circulated in the economy consists of coins and paper money worth 2,000 million baht. The government buys back bonds from people valued 500 million baht. Those who sold bonds to the government deposited the money-sold in current account. Given the required reserve ratio is 5%. (20 points)

(i) How much is the quantity of money circulated in the economy? Classify the types of money in circulation.
(ii) How can the banking system create the maximum money deposit? How much can it create? What are the consequences of such creation towards the quantity of money supplied in circulation?
(iii) If there is a recession, should the Bank of Thailand increase the required reserve ratio? Why?
(iv) Regarding to the fact that commercial banks can create the money deposit, they can also destroy those deposit, how this is done? What is the maximum amount of money deposit can be destroyed by the commercial banks?

Question #2

In the following situations, explain the effects towards equilibriums in both financial market and goods market. (hint: please use both DAE and money market analysis to explain the short-run adjustment). (45 points)

(i) An increase in the amount of "checks" used by people
(ii) Central Bank sells bonds to public
(iii) Government conducts a budgetary deficit
(iv) Bank of Thailand decrease the required reserve ratio
(v) Balance of payment deficit
(vi) An increase in "credit cards" used by people
(vii) Commercial banks expand the credit lines
(viii) Foreign interest rate is higher than domestic interest rate
(ix) An increase in excess reserves held by every commercial banks

Question #3

In country A, it is found that the relationship of investment and interest rate $\left(\frac{\Delta I}{\Delta i}\right)$ is small, and that of money demand and interest rate $\left(\frac{\Delta Md}{\Delta i}\right)$ is large. Currently this country is experiencing recession. Should the government implement the fiscal expansion or monetary policy? Please explain by using DAE and money market analysis. (35 points)