

Unit Four Money Market Homework

1. Assume that the economy of Underhillia is in a long run equilibrium in 2017. Also assume that consumers in Underhillia (Underhillians) begin using credit cards more frequently and using less currency to purchase goods and services.
 - a. Draw a correctly labeled graph of the money market and show the effect of increased credit card use on the nominal interest rate.
 - b. Based on the indicated change in nominal interest rate what will happen to the following in the short run?
 - i. Prices of bonds issued in 2007
 - ii. General Price level
 - c. With a constant money supply, based on your previous answer, will the velocity of money increase, decrease or remain the same? Explain.
 - d. If the Underhillian Central bank wants to reverse the change in the interest rate that you've identified what open market operation should they pursue?

2. Rainbow Bank has the balance sheet below.

Assets		Liabilities	
Required Reserves	\$2000	Demand Deposits	\$10,000
Excess Reserves	\$0	Owner's Equity	\$10,000
Customer Loans	\$8000		
Government securities/bonds	\$7000		
Buildings and fixtures	\$3000		

- a. Based on Rainbow Bank's balance sheet, calculate the reserve ratio.
- b. Suppose that the Federal Reserve purchases \$5000 worth of bonds from Rainbow Bank. What will be the change in the dollar value of each of the following?
 - i. Excess reserves
 - ii. Demand Deposits
- c. Calculate the maximum change in the money supply as a result of the Federal Reserve's bond purchase from Rainbow Bank.
- d. When the Federal Reserve purchases bonds, what will happen to the price of bonds on the open market? Explain.
- e. Suppose that Sandra deposits \$5000 into her checking account (demand deposit). What is the immediate effect of the cash deposit on M1?

Unit Four Money Market Homework