

Finance 30220
Problem Set #6

- 1) Suppose that the cash to deposits ratio is 20% and the reserve to deposits ratio is 10%.
 - a) What would be the impact on M0 and M1 of a purchase of \$100 million dollars in securities by the Federal Reserve Bank?
 - b) How would your answer change if the cash to deposits ratio fell to 5%?

- 2) Explain how each of the following events (assuming that nothing else changed) would affect money demand, money supply, and interest rates (assume that the price level is fixed).
 - a) An increase in productivity.
 - b) The increased availability of credit cards.
 - c) An increase in expected inflation.
 - d) An open market sale of securities

- 3) It is believed that the widespread availability of ATMs have drastically reduced the transactions costs involved in holding money? How would this affect money demand? What should happen to interest rates (assume that the price level is fixed)?

- 4) Explain the impact on money demand, money supply, and the interest rate (assume the price level is fixed) of the following events (hint: think about inflation expectations)
 - a) A one-time increase of the money supply
 - b) An increase in the *growth rate* of the money supply.

- 5) Suppose that the economy experiences a temporary rise in productivity.
 - a) Explain the impact of this event in the capital market. What happens to the interest rate?
 - b) Explain the impact of this event on the money market. What happens to the interest rate?
 - c) Given your answers to (a) and (b), what happens to the price level?