Unit IV FRQ Prep

Assume that the Fed has se t the Reserve Ratio at 15%. Complete the chart based on the information that follows.

**Assets**

**(all figures in thousands) Liabilities**

(1) (2) (1) (2)

Reserves $50 \_\_\_\_\_ \_\_\_\_\_ Deposits $200 \_\_\_\_\_ \_\_\_\_\_

Securities 80 \_\_\_\_\_ \_\_\_\_\_

Loans 70 \_\_\_\_\_ \_\_\_\_\_

1. Households deposit $20,000 into their accounts. Show what happens in column 1. Be sure to balance the bank sheet.
   1. Is there a change to the money supply?
   2. If so, what it is?
2. Now let’s assume that the bank is going to loan out all of its reserves. Show what happens in column 2.
   1. Is there a change to the money supply?
   2. If so, what it is?

Create a money market graph that shows Dm and Sm – be sure to label the axis correctly and show the equilibrium interest rate.

What happens to the money market if the interest rates increase? Decrease?

What tool would the Fed use if interest rates increase? Decrease?

What tools would the Fed use if the nation were experiencing inflation? Recession? Show the chain reaction.

**Example: Fed Buys OMO Sm inc.**

**Draw a Loanable Funds Graph – be sure to label it correctly and show the equilibrium real interest rate.**

**List the Determinants of Demand for LF List the Determinant of Supply for LF**

Now, graph a money market that shows the Fed’s response to inflation.

Next, graph a loanable funds market that shows this response.

Finally show how these changes would reflect on the AD/AS model. (show both)

Which has a greater impact – expanionsary or contractionary fiscal policy or expansionary or contractionary monetary policy? Why?