

I think the questions below are interesting, but some may be difficult. Try your best.

Workshop 8

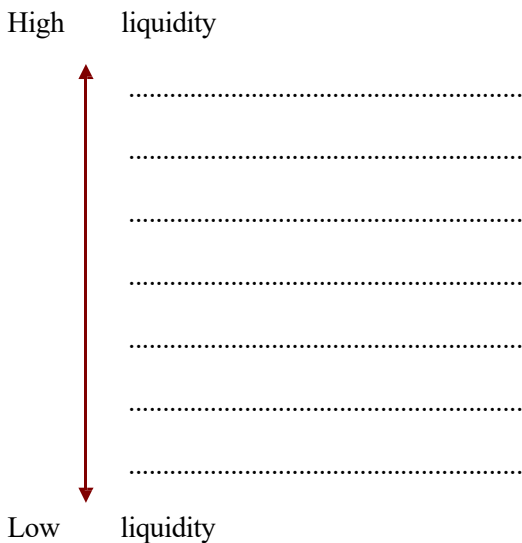
Money and Interest Rates

1. Which of the following are wholesale and which are retail?

- (a) Large-scale deposits made by firms at negotiated rates of interest.*retail / wholesale*
- (b) Loans made by high street banks at published rates of interest.*retail / wholesale*
- (c) Deposits in savings accounts in high street banks.*retail / wholesale*
- (d) Deposits in savings accounts in building societies*retail / wholesale*
- (e) Large-scale loans to industry syndicated through several banks.*retail / wholesale*

2. Rank the following assets of a commercial banks in order of decreasing liquidity.

- (a) Money at call and short notice
- (b) Operational balances with the Federal Reserve Bank System
- (c) Cash
- (d) Personal loans
- (e) Sale and repurchase agreements (repos)
- (f) Mortgages
- (g) Government bonds (of from one to five years to maturity)



3. Assuming that banks choose to maintain a liquidity ratio of 20 percent and assuming that new cash deposits of \$100m are made in the banking system:

(a) Complete the following table which shows how credit is created.

	<i>\$m</i>		<i>\$m</i>
Banks receive	100	Hold	20
		Lend	80
Second round deposits rise by	_____	Hold	-
		Lend	-
Third round deposits rise by		Hold	-
		Lend	-
Fourth round deposits rise by	_____	Hold	-
		Lend	-
Fifth round deposits rise by		Hold	-
		Lend	-
Total deposits after five rounds			

- (b) How much credit will have been created after five rounds?
- (c) To what level will total deposits eventually increase?
- (d) Define the bank multiplier.....
- (e) What is the bank multiplier in this case?
- (f) How is it related to the liquidity ratio?.....

4. An increase in the money supply will affect the level of economic activity in the country through a sequence of events. In each of the following, delete the wrong words.
1. The rise in the money supply will lead to a *rise / fall* in the rate of interest.
 2. (a) The *rise / fall* in the rate of interest will lead to a *rise / fall* in investment and other forms of borrowing.
(b) The *rise / fall* in the rate of interest will lead to a *rise / fall* in the rate of exchange..
 3. The *rise / fall* in the exchange rate will lead to a *rise / fall* in exports and a *rise / fall* in imports.
 4. The *rise / fall* in investment and the *rise / fall* in exports and *rise / fall* in imports will lead to a multiplied *rise / fall* in national income and a possible *rise / fall* in prices.
7. In the equation $MV = PY$, describe what is meant by each of the four terms:
- M
- V
- P
- Y
8. In an economy whose national income at current prices is \$24 billion and the money supply is \$8 billion:
- (a) What will be the velocity of circulation?.....
 - (b) If national income at base-year prices is \$12 billion, what is the price index?
.....
 - (c) Suppose the velocity of circulation stays constant and the government decides to increase the money supply to \$10 billion, what will happen to the price index if real national income remains the same?
.....
9. If money supply rises, will the price level rise by the same percentage? It all depends on what happens to V and Y . The effects will tend to differ in the short run from the long run. Delete the wrong words in the following statements:
- (a) In the short run, V *can change substantially / is unlikely to change much at all* when money supply changes.
 - (b) In the short run, a rise in MV (i.e. a rise in aggregate demand) *will lead to a rise in the price level / may or may not lead to a rise in the price level depending on the degree of slack in the economy*.