A. Direct Questions

Chapter 11 questions (“Money and Banking”):

1. What are the components that are included in “M1” money, and in what proportions?
2. Discuss the origins of banking and the fractional reserve banking system.
3. What are “reserves”, and what is the relationship between reserves, required reserves, and excess reserves?
4. Using “T-Accounts”, explain the money expansion process. Assume that the initial shock is the result of a discovery of gold in someone’s back yard.
5. How do we calculate the maximum amount of money creation (following a shock to the monetary system), and what are the requirements for the maximum money creation to be met?

Chapter 12 questions (“The Federal Reserve System”):

6. Explain briefly the structure and major functions of the Federal Reserve System.
7. Using “T-Accounts”, explain the role of the Federal Reserve System in the check clearing process. That is, what is the process and what are the entries whereby a check written on a bank in one city gets deposited in an account in another city?
8. What are the three tools that the Fed uses to control the money supply? How do they work?
9. Explain in detail the process whereby Open Market Operations affect the money supply.
10. Government securities are an important item on Open Market Operations. Why/How is it that government securities are initially owned by the private sector (banks, insurance companies, and pension/mutual fund portfolios)?

Chapter 13 questions (“Money and the Economy”):

11. What is the relationship between the equation of exchange and the quantity theory of money?
12. What would monetarists suggest as the role for monetary policy if the economy is in a recessionary gap or an inflationary gap? Be sure to consider the role of the self-regulating economy in your response.
13. Explain the inverse relationship between bond prices and interest rates.
14. How do interest rates affect consumption, investment, government spending and net exports?
15. What are “real interest rates”, and why are real interest rates important?

Chapter 14 questions (“Monetary Policy”):

16. What is the “liquidity trap”?
17. If bond prices fall, will individuals want to hold more or less money (cash)?
18. Discuss some alternative fixed monetary rules. Is a fixed monetary rule a good policy?
19. Under what conditions can an activist monetary policy eliminate or reduce a recessionary gap?