Text Questions

1. Money is a medium of exchange. A $20 bill is readily accepted as payment for purchases of goods, services, and resources. Money is a measure of value. A $20 bill will buy twice the goods, services, and resources that a $10 bill can buy. Money provides a method for storing wealth and delaying payments. A $20 bill can be saved, and used in the future to purchase a good, service, or resource or to pay a debt.

2. The basic components of M1 and M2 are listed in Table 7-2 and Table 7-4 respectively.
M1 and M2 differ in the types of accounts that are considered spendable funds. M2 includes a much broader range of spendable funds. M2 has become an increasingly important measure of the money supply to observe because it includes money market deposit accounts that allow limited checkable transactions, and savings and time deposits that can be easily converted to spendable funds.

3. The First National Bank of Anytown had $350,000 in its reserve account at the end of the day.

4. a. The dollar value of output equals $6.5 trillion ($1.3 trillion x 5).
   b. The dollar value of the output would increase to $6.75 trillion ($1.35 trillion x 5).
      The real value of the output would remain at $6.5 trillion because the economy is at full employment.
   c. Prices would not rise as quickly and the level of output would decrease.
   d. If the decrease in the money supply was exactly offset by the increase in velocity, then the dollar value of output would be unchanged.

5. Hometown Bank’s required reserves equal $4,500,000 ($30,000,000 x .15).
   Its excess reserves equal $700,000 ($5,200,000 - $4,500,000).
   The bank can make new loans totaling $700,000.

6. The money multiplier is the factor by which an initial increase or decrease in excess reserves will cause the money supply to expand or contract, respectively. The money multiplier is the reciprocal of the reserve requirement. The maximum amount the money supply can increase is $1500 million ($180 million x 8.333).

7. a. To counteract demand-pull inflation the Federal Reserve should decrease excess reserve.
    b. To bring about a decrease in excess reserves the Federal Reserve could sell securities on the open market, raise the reserve requirement, and raise the discount rate.
8. a. Uptown Bank’s excess reserves and its loan-making ability would decrease from $1,000,000 to $500,000.
   
   b. Required reserves would increase from $3,000,000 to $3,600,000. As a result, Uptown Bank’s excess reserves and its loan-making ability would decrease by $600,000, from $1,000,000 to $400,000.
   
   c. An increase in the discount rate has no direct effect on the excess reserves of Uptown Bank. Its loan-making ability would remain at $1,000,000.
   
   d. The decrease in the reserve requirement would increase Uptown Bank’s excess reserve by $600,000, from $1,000,000 to $1,600,000. When the Federal Reserve buys $1,000,000 in government securities from the bank, the bank’s excess reserves increase by $1,000,000. The combined increase in Uptown Bank’s excess reserves and its loan-making ability would be $1,600,000.