1 Review Questions
   Based on ABE Ch. 14 RQ #2, 5

1. What is the effect on the monetary base of an open-market purchase of U.S. Treasury securities? What is the effect on the money supply?

2. Besides open-market operations, what other means does the Federal Reserve have for controlling the money supply? Explain how these alternative methods work.

2 Fractional Reserve Banking
   Based on ABE Ch. 14 NP #1

The monetary base is $1,000,000. The public always holds half its money as currency and half as deposits. Banks hold 20% of deposits in the form of reserves. Starting with the initial creation of the monetary base that accompanies the purchase by the central bank of $1,000,000 worth of securities from the public, show the consolidated balance sheet of the banks after they receive deposits, after a first round of loans and redeposits, and after a second round of loans and redeposits.

Show the balance sheets of the central bank, the banking system, and the public at the end of the process of multiple expansions of loans and deposits. What is the final value of the money supply?

3 Money Supply and Money Multipliers
   Based on ABE Ch. 14 NP #2

a) The money supply is $6,000,000, currency held by the public is $2,000,000, and the reserve-deposit ratio is 0.25. Find deposits, bank reserves, the monetary base, and the money multiplier.

b) In a different economy, vault cash is $1,000,000, deposits by depository institutions at the central bank are $4,000,000, the monetary base is $10,000,000, and the bank deposits are $20,000,000. Find bank reserves, the money supply, and the money multiplier.
4 Shocks in the IS-LR Framework
Based on ABE Ch. 14 AP #3

Use the $LR$ curve to show how each of the following shocks affects output, the real interest rate, and the price level in the short run and long run, following the Keynesian model. Draw a diagram to answer each question.

a) The expected inflation rate increases, and the Fed keeps its target for the nominal interest rate unchanged.

b) The expected inflation rate increases, and the Fed keeps its target for the real interest rate unchanged.

c) An increased investment tax credit designed to stimulate investment is put into place, and the Fed changes its target for the real interest rate to keep output from changing in the short run.