Chapter 29

1. Suppose the Bank of England purchases a UK government bond from you for £10,000.

a. What is the name of the Bank's action?

b. Suppose you deposit the £10,000 in First Student Bank. Show this transaction on First Student Bank's T-account.

First Student Bank

Assets	Liabilities

c. Suppose the reserve requirement is 20 per cent. Show First Student Bank's T-account if they loan out as much as they can.

First Student Bank

Assets	Liabilities

d. At this point, how much money has been created from the Bank of England's policy action?

e. What is the value of the money multiplier?

f. After infinite rounds of depositing and lending, how much money could be created from the Bank of England's policy action?

g. If during the rounds of depositing and lending some people keep extra currency and fail to deposit all of their receipts, will there be more or less money created from the Bank of England's policy action than you found in part (f)? Why?

h. If during the rounds of depositing and lending, some banks fail to loan the maximum amount of reserves allowed but instead keep excess reserves, will there be more or less money created from the Bank of England's policy action than you found in part (f)? Why?

2. Suppose the entire economy contains €1,000 worth of one euro notes.

a. If people fail to deposit any of the euro notes but instead hold all €1,000 as currency, how large is the money supply? Explain.

b. If people deposit the entire €1,000 worth of euro notes in banks that are required to observe a 100 per cent reserve requirement, how large is the money supply? Explain.

c. If people deposit the entire €1,000 worth of euro notes in banks that are required to observe a 20 per cent reserve requirement, how large could the money supply become? Explain.

d. In part (c), what portion of the money supply was created due to the banks? (Hint: €1,000 of euro notes already existed).

e. If people deposit the entire €1,000 worth of euro notes in banks that are required to observe a 10 per cent reserve requirement, how large could the money supply become?

f. Compare your answer in part (e) to part (c). Explain why they are different.

g. If people deposit the entire €1,000 worth of bills in banks that are required to observe a 10 per cent reserve requirement, but they choose to hold another 10 per cent as excess reserves, how large could the money supply become?

h. Compare your answer in part (c) to part (g). Are these answers the same? Why?