

MID-TERM EXAM (90 mn.)

A- Solve the Following Problems (30 pts)

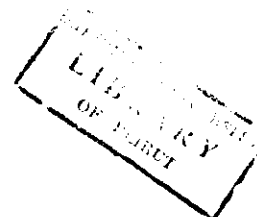
1- (20 pts) The following assumptions are made: the required reserve ratio on checkable deposits is 10%, banks do not hold on to excess reserves, and the public's holdings of currency do not change.

a- Using T-accounts, show what happens to checkable deposits in the banking system when the Central Bank lends an additional \$1 million to the First National Bank.

b- Using T-accounts, show what happens to checkable deposits in the banking system when the Central Bank sells \$2 million of bonds to the First National Bank.

c- Suppose that the Central Bank buys \$1 million of bonds from the First National Bank. If the First National Bank and all other banks use the resulting increase in reserves to purchase securities only and not to make loans, what will happen to checkable deposits?

d- If the Central Bank buys \$1 million of bonds from the First National Bank, but an additional 10% of any deposit is held as excess reserves, what is the total increase in checkable deposits?



- 2- (10 pts) You are offered two bonds, a one-year U.S. Treasury bond with a yield to maturity of 9% and a one-year U.S. Treasury bill with a yield on a discount basis of 8.9%. Which would you rather own?

B- Answer the Following Questions (40 pts)

- 1- (10 pts) "Because corporations do not actually raise any funds in secondary markets, they are less important to the economy than primary markets". Comment.

- 2- (10 pts) Using both the loan able funds and liquidity preference frameworks, show what the effect is on interest rates when the riskiness of bonds rises. Are the result the same in the two frameworks?

- 3- (10 pts) Central Bank have been discussing the possibility of paying interest on excess reserves. If this occurred, what would happen to the level of {ER/D }?

- 4- (10 pts) "If the demand for money did not fluctuate, the Central Bank could pursue both a money supply target and an interest-rate target at the same time". Is this statement true, false, or uncertain? Explain your answer.

C- Attached is a Multiple Choice Questions sheet, Circle the Correct Answer (30 pts)

N.B. An extra question is given as a bonus.

*Good Luck*