Name: ________________________

AP Macroeconomics Problem Set #4
Money, Banking and Monetary Policy

1. (____/60) **Money, Banking and Financial Markets**
   Define and give ***specific*** examples of each of the following:
   a. Definition of financial assets: money, stock and bonds (____/15)
   b. Time Value of Money (present and future value). (____/10)
   c. Measures of Money Supply. (____/5)
   d. How banks create money. (____/5)
   e. Money Demand. (____/5)
   f. Money Market – ***Make sure to include a graph!*** (____/10)
   g. Loanable Funds Market – ***Make sure to include a graph!*** (____/10)

2. (____/25) **Central Bank and Control of the Money Supply**
   Define and give ***specific*** examples of each of the following:
   a. Tools of Central Bank Policy ***Make sure to provide a complete response here!*** (____/15)
   b. Quantity Theory of Money (____/5)
   c. Real vs. Nominal Interest Rates (____/5)

3. (____/15 Points) **Practice Free Response Questions**
   Complete the attached FRQs. ***Make sure to provide complete answers and label all graphs completely.***
   FRQ #1: (____/7)
   FRQ #2: (____/8)

Monetary Policy Study Guide
<u>Key Concepts</u>

1. What are the three functions of money?

2. Explain why a small increase in bank deposits cause a larger increase in the money supply and identify the equation for the Money Multiplier?

3. EXPLAIN the three tools of monetary policy and identify how each increase or decreases the M_S.
   a. Reserve Requirement-

   b. The Discount Rate-

   c. Open Market Operations-

4. In three graphs, show the effect of an increase in Money Supply

Money Market Investment Market AD/AS

5. In three graphs, show the effect of a decrease in Money Supply

Money Market

Investment Market

AD/AS

	Fiscal Policy	Monetary Policy
What is it?		
Who does it?		
Specific Tools		
Problems with Policy		
Expansionary Policies	**Recessionary Gap** **Process=**	**Recessionary Gap** **Process=**
Contractionary Policies	**Inflationary Gap** ***Process=***	**Inflationary Gap** **Process=**

The Federal Reserve can influence the supply of money.

(a) Assume that the Federal Reserve targets a lower federal funds rate.

(i) What open market operation can the Federal Reserve use to achieve the lower target?

(ii) Given your answer to part (a)(i), what will happen to the price of government bonds?

(b) Using a correctly labeled graph of the money market, show the effect of the open market operation from part (a)(i) on the nominal interest rate.

(c) Assume that the Federal Reserve buys government bonds from commercial banks. Based only on this transaction, will the level of required reserves in the commercial banks increase, decrease, or remain the same?

(d) Another monetary policy action involves changing the discount rate. Define the discount rate.

A drop in credit card fees causes people to use credit cards more often for transactions and demand less money.

(a) Using a correctly labeled graph of the money market, show how the nominal interest rate will be affected.

(b) Given the interest rate change in part (a), what will happen to bond prices in the short run?

(c) Given the interest rate change in part (a), what will happen to the price level in the short run? Explain.

(d) Identify an open-market operation the Federal Reserve could use to keep the nominal interest rate constant at the level that existed before the drop in credit card fees. Explain.