Final Exam Sample Short Answer Questions. 10 Marks each.

1) The Bank of Canada purchases $10 million worth of government bonds from the chartered banks. The legal reserve requirement is 5%.
Show this transaction on the Banks' balance sheets. What is the total change in the money supply?

2) There is only one chartered bank in the country of Adana, and it has the following assets and liabilities:

Currency reserves	$20 million
Reserves held at the Bank of Adana	$10 million
Loans	$700 million
Securities	$20 million
Deposits	$750 million

a. Assuming that the bank has freely chosen its reserves, what is the desired reserved ratio?
b. If the amount of currency in circulation is $50 million, what is the monetary base? What is the money supply?
c. What is the currency drain ration?

3) Consider the balance sheet in the table below.

Bank of Speedy Creek

Assets		**Liabilities**	
Reserves	60	Deposits	1,000
Securities	100		
Loans	840		
Total	1,000	Total	1,000

Bank of Canada

Assets		**Liabilities**	
Government Securities	9,000	Bank of Canada Notes	10,000
Loans to Bank	500	Chartered banks Deposits	1,000
Other net Assets	2,000	Government Deposits	500
Total	11,500	Total	11,500

Suppose the Bank of Canada buys all $100 of securities from the Bank of Speedy Creek. What happens to the balance sheets of the Bank of Speedy Creek and the Bank of Canada as a result of this action, explaining the process. What does this action do to the reserves in the banking system?

4) The table below shows some exchange rates for the Canadian dollar.

	USD	JPY	CAD
USD	-	0.78	?
JPY	?	-	?
CAD	1.06	0.83	-

a) Fill in the missing values in the table showing all calculations.
b) If you were a trader, could you make money starting with $100 Canadian, buying some USD, using your USD to buy some Japanese Yen, and then use your yen to buy Canadian dollars? (Ignore rounding errors of 1% or less)

5) Suppose that the nominal exchange rate between the Canadian dollar and the euro is 2 euros per dollar, that the price level in Canada is 122.7, and the price level in Europe is 200.5.

a. What is the real exchange rate expressed as units of Eurozone real GDP per units of Canadian real GDP?
b. Does purchasing power hold?
c. If purchasing power does not hold, explain what will happen in the foreign exchange market in the long run to create purchasing power parity.

6. Consider an economy that is in above full-employment equilibrium due to an increase in AD. Prices of productive resources have not changed. With the help of a graph, discuss how the economy returns to full-employment equilibrium with not government intervention.

7. Consider an economy with the following components of aggregate expenditure:

Consumption function: C=20 + 0.8Y
Investment function: I = 30
Government expenditures: G = 8
Export function: X= 4
Import function: M=2 + 0.2Y

There are no taxes so YD = Y

a. What is the marginal propensity to consume in this economy?
b. What is the equation of the aggregate expenditure function in this economy?

c. Find this economy's equilibrium aggregate expenditure and real GDP by completing columns on the table below.

Y	C	I	G	X	M	AE
0						
30						
60						
90						
120						
150						
180						

8. The table below gives some information on the real interest rates, inflation rates, and tax rates from three different countries.

	Ricardia	Barroland	Lafferia
Nominal interest Rate	12%	10%	10%
Inflation Rate	6%	5%	6%
Tax rate	40%	50%	50%
Real, before tax interest rate			
Real, after tax interest rate			
Tax wedge			

a. Complete the table
b. Assuming all other factors are equal, which country has the biggest negative incentive effects for lenders? Lowest costs for investors?

9. How does an open market purchase of government securities lead to a decrease in the overnight rate?
What are the ripple effects of this policy on the different components of aggregate expenditure?

10. Suppose the currency drain is 20% and the required reserve ratio is 10%.

a. What does the money multiplier equal?
b. If the Government purchases $10 million of government securities, by how much will the quantity of money increase or decrease?

11. Suppose there is a $200 billion deflationary gap. If there are no taxes or imports, to restore the economy back to potential GDP, how much should government spending be changed if the MPC is 0.75? Does government spending need to be increased or decreased?

Questions from the Textbook
Chapter 22
12 – 14
Chapter 24
#30, 9, 11, 12,
Chapter 25
14, 15, 18,
Chapter 26
#15, 16, 9, 10
Chapter 27 (to page 662)
#8, 9, 10, 11, 28, 28
Chapter 29
#6, 7, 11,
Chapter 30
34-39