Write in the box the number of the question you are answering on this page as it is designated in the examination.

2

2A

(a) This ~~to~~ transaction does not change the money supply, because the money supply contains both the cash owned by individuals and the cash in the bank account.

(b) i) As the bank will keep 20 percent of its deposit (10 percent reserve requirement plus ~~at~~ 10 percent additional reserves), the bank ~~will~~ can increase its loans by \$7,200 (\$9,000 x 0.8) to the maximum.

ii) In this case, the ~~money multipl~~ monetary multiplier is 5 $(=\frac{1}{0.2})$. Therefore, the maximum increase in the money supply generated from this transaction is \$36,000 (\$7,200 x 5) if people repeat the transaction of depositing and the banks keep no more than 20 percent of their deposits.

(c). i) The money supply will increase because the government finances the spending by drawing money out of the central bank. The money supply increases by \$9,000.

ii) As government acts on an expansionary fiscal policy, the price level will go up. This increase in the price level will also increase the transaction demand of money by the people. So, the money demand will increase.