

3. Suppose the monetary supply is \$6.5 trillion, the required reserve ratio is 5%, the ratio of currency to deposits is 10%, and the fraction of deposits that banks hold in reserves over the legal requirement is 5%.

(a) (5 points) What is the monetary base?

(b) (5 points) How much money is held in currency?

(c) (5 points) How much money is held in deposits?

(d) (5 points) How much money is being held in reserves?

4. Using the same information as the previous question, suppose the Federal Reserve increased the required reserve ratio to 10%.

(a) (5 points) What will be the change in money supply?

(b) (5 points) All other things remaining equal, describe and illustrate the impact on interest rates.

5. (10 points) Which is larger, the M1 money multiplier, or the M2 money multiplier? Describe *intuitively* why this should be so (Intuitively means don't describe what is happening to an equation. Describe instead what is happening in the economy.)

6. (10 points) Suggest one weakness of the Federal Reserve System and suggest how the system might be changed for the better.

7. (10 points) The Federal Reserve currently follows a long term policy that promotes low, stable inflation. It has been suggested that a better policy would be to promote a long run average inflation rate of 0%. Suggest one argument for this change in policy, and one argument against it.