Money and Banking, Assignment 4

Due date: **April 28th** (Thursday, in-class)

Part I **Multiple Choices**: (only one of the four options is correct)

1) Which of the following are reported as liabilities on a bank's balance sheet?
A) Reserves
B) Checkable deposits
C) Loans
D) Deposits with other banks

2) The share of checkable deposits in total bank liabilities has
A) expanded moderately over time.
B) expanded dramatically over time.
C) shrunk over time.
D) remained virtually unchanged since 1960.

3) Bank loans from the Federal Reserve are called ________ and represent a ________ of funds.
A) discount loans; use
B) discount loans; source
C) fed funds; use
D) fed funds; source

4) Which of the following are not reported as assets on a bank's balance sheet?
A) Cash items in the process of collection
B) Deposits with other banks
C) U.S. Treasury securities
D) Checkable deposits

5) Bank's make their profits primarily by issuing
A) equity.
B) negotiable CDs.
C) loans.
D) NOW accounts.

6) Banks may borrow from or lend to another bank in the Federal Funds market. A loan of excess reserves from one bank to another bank is recorded as a(n) ________ for

the borrowing bank and a(n) ________ for the lending bank.
A) asset; asset
B) asset; liability
C) liability; liability
D) liability; asset

7) In general, banks make profits by selling ________ liabilities and buying ________ assets.
A) long-term; shorter-term
B) short-term; longer-term
C) illiquid; liquid
D) risky; risk-free

8) When $1 million is deposited at a bank, the required reserve ratio is 20 percent, and the bank chooses not to make any loans but to hold excess reserves instead, then, in the bank's final balance sheet,
A) the assets at the bank increase by $1 million.
B) the liabilities of the bank decrease by $1 million.
C) reserves increase by $200,000.
D) liabilities increase by $200,000.

9) If, after a deposit outflow, a bank needs an additional $3 million to meet its reserve requirements, the bank can
A) reduce deposits by $3 million.
B) increase loans by $3 million.
C) sell $3 million of securities.
D) repay its discount loans from the Fed.

10) The political business cycle refers to the phenomenon that just before elections, politicians enact ________ policies. After the elections, the bad effects of these policies (for example, ________) have to be counteracted with ________ policies.
A) expansionary; higher unemployment; contractionary
B) expansionary; a higher inflation rate; contractionary
C) contractionary; higher unemployment; expansionary
D) contractionary; a higher inflation rate; expansionary

11) What makes the Federal Reserve so unique compared to other central banks around the world is its
A) centralized structure.

B) decentralized structure.
C) regulatory functions.
D) monetary policy functions.

12) The Federal Reserve Banks are ________ institutions since they are owned by the ________.
A) quasi-public; private commercial banks in the district where the Reserve Bank is located
B) public; private commercial banks in the district where the Reserve Bank is located
C) quasi-public; Board of Governors
D) public; Board of Governors

13) The nine directors of the Federal Reserve Banks are split into three categories: ________ are professional bankers, ________ are leaders from industry, and ________ are to represent the public interest and are not allowed to be officers, employees, or stockholders of banks.
A) 5; 2; 2
B) 2; 5; 2
C) 4; 2; 3
D) 3; 3; 3

14) While the discount rate is "established" by the regional Federal Reserve Banks, in truth, the rate is determined by
A) Congress.
B) the president of the United States.
C) the Senate.
D) the Board of Governors.

15) Under the European System of Central Banks, the Governing Council is similar in structure to the ________ of the Federal Reserve System.
A) Board of Governors
B) Federal Open Market Committee
C) Federal Reserve Banks
D) Federal Advisory Council

16) Members of the Board of Governors are
A) chosen by the Federal Reserve Bank presidents.
B) appointed by the newly elected president of the United States, as are cabinet positions.
C) appointed by the president of the United States and confirmed by the Senate.
D) never allowed to serve more than 7-year terms.

17) The Federal Open Market Committee consists of the
A) five senior members of the seven-member Board of Governors.
B) seven members of the Board of Governors and seven presidents of the regional Fed banks.
C) seven members of the Board of Governors and five presidents of the regional Fed banks.
D) twelve regional Fed bank presidents and the chairman of the Board of Governors.

18) Although neither ________ nor the ________ are officially set by the Federal Open Market Committee, decisions concerning these policy tools are effectively made by the committee.
A) margin requirements; discount rate
B) margin requirements; federal funds rate
C) reserve requirements; discount rate
D) reserve requirements; federal funds rate

19) Members of Congress are able to influence monetary policy, albeit indirectly, through their ability to
A) withhold appropriations from the Board of Governors.
B) withhold appropriations from the Federal Open Market Committee.
C) propose legislation that would force the Fed to submit budget requests to Congress, as must other government agencies.
D) instruct the General Accounting Office to audit the foreign exchange market functions of the Federal Reserve.

20) Which of the following statements comparing the European System of Central Banks and the Federal Reserve System is **TRUE**?
A) The budgets of the Federal Reserve Banks are controlled by the Board of Governors, while the National Central Banks control their own budgets and the budget of the European Central Bank.
B) The European Central Bank has similar power over the National Central Banks when compared to the level of power the Board of Governors has over the Federal Reserve Banks.
C) Just like the Federal Reserve System, monetary operations are centralized in the European System of Central Banks with the European Central Bank.
D) The European Central Bank's involvement in supervision and regulation of financial

1. Question 24 in the textbook. (page. 225)

Answer:

Denote this percentage as x. In order to give Ron sufficient incentive to work hard, we need to make sure that he has a higher expected payment when he works hard. That is

$$20\% \cdot 10{,}000 \cdot x + 80\% \cdot 50{,}000 \cdot x - 1000 > 60\% \cdot 10{,}000 \cdot x + 40\% \cdot 50{,}000 \cdot x$$

which leads to

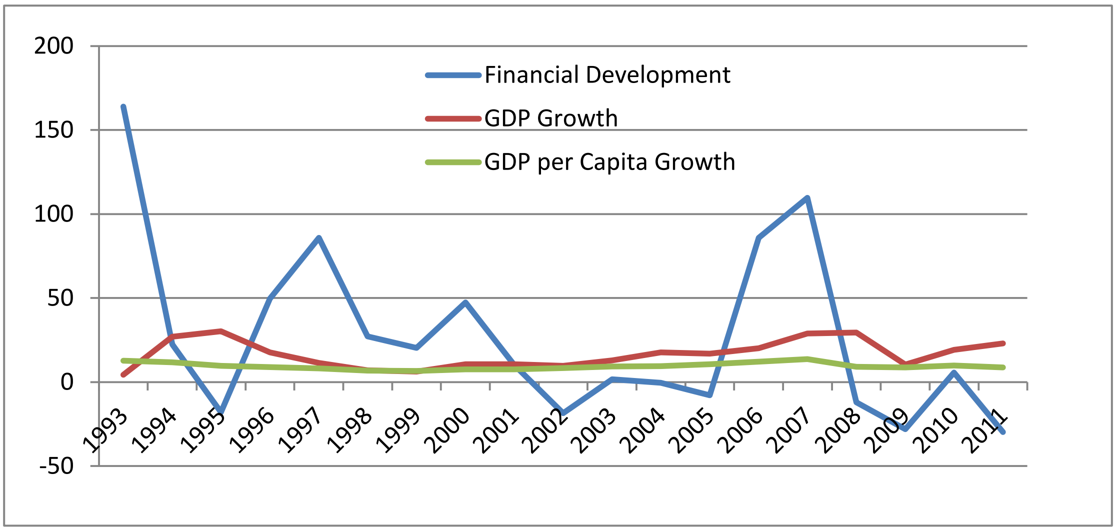
$$x > 6.25\%$$

2. In the textbook, the author briefly talked about if China is a counter example on the relationship between financial development and growth. However, the author's argument is quit vague and you can actually get a better picture by digging out some data by yourself.

   Go to http://data.worldbank.org/data-catalog/global-financial-development, where the World Bank provides a rich dataset about the financial development in the countries all over the world. Find out the data for China in the dataset. Let's use "Stock market capitalization to GDP (%)" as the indicator of financial development. The dataset also provides the GDP and GDP per capital for China as well. Calculate the growth rate of these three series, and plot them in one graph. Does your graph prove that China is indeed a counter example of the relationship between financial development and economic growth? Note that because of missing data, your plot should start at 1993 and end in 2011.

Answer:

The graph should look similar to the following one:



According to this graph, there is little correlation between financial development and growth (in terms of both GDP and GDP per capita) in China. Hence indeed China is kind of a counter-example to the argument that financial development stimulates economic growth.