Note: the best way to study for the exam is to:

* Start by reading the lecture notes twice (if you don´t, your study will be of a much lower quality).
* And then answer the weekly questions.

Reserve **some hours (perhaps 4)** every week to answer the questions. If you answer them properly, then you’ll have to study much less before for the tests. Students who choose not to answer the weekly questions seldom pass the course.

**Warning:** in June you’ll have **exams of 5 different courses.** Therefore, if you do not study properly while answering the weekly questions, your chances of passing this course will be much lower.

The answers to Week 1’s questions should **be handed to me at the beginning of the next lecture.** They should be **manuscript (not typewritten)** and preferably based on schemes (as I do in the slides). Keep a copy for yourself.

Please write **WEEK 1 in bold** at the beginning of your answers.

**Week 1**

**Note: M1=C + CD; M2= C+CD+SD.**

**1.**a)Which are the components of the MB?

b) What is money? Which are its components?

**The old view of money creation**

Assume no circulation.

**2.** According to the old view, assuming R/CD = 0.5 if a first bank receives 100 euros from the CB, what happens to:

a) the amount of credit it extends? And to the amount of money it creates? Explain.

b) the amount of credit extended by a 2nd bank that receives the deposit from the borrower of the 1st bank? Explain.

c) the amount of credit extended by the whole banking system? And to the amount of money thereby created? Explain.

**3.** In the previous example:

a) Who took the initiative that led to the creation of money? Explain.

b) What determined the quantity of money in the economy? Explain.

**The new view of money creation**

**4.** Which variable is fixed by the CB?

**5.** Explain the specific process that makes money appear in the economy.

**6.** Does money constitute net wealth? Explain.

**7.** Explain the specific act that makes money disappear from the economy.

**8.** Suppose that in a certain day 50b€ of new bank loans are extended and 10b€ of outstanding bank debts are repaid. What’s the change in the quantity of money in that day? Explain.

**9.** According to the new view:

a) Who takes the initiative that leads to the creation of money? Explain.

b) What determines the quantity of money in the economy? Explain.

**…**

**In all the remaining answers, assume (unless stated otherwise) no circulation, R/CD=10%; R/SD=0%, icredit = 5%, iCB = 4%, iSD=3%.**

**10. a)** When a bank extends a credit of 100€ **and nothing else happens,** it is obliged to back it with how much reserves? Explain.

**b)** How much will the bank profit from that operation?

**11. a)** How much reserves each bank must obtain if: bank 1 grants credit of 100€ and the agent uses the money to make a payment in favour of bank 2, and bank 2 also grants creditof 100€, and the agent uses the money to make a payment in favour of bank 1, **and nothing else happens**?

b) How much will each bank profit from the mentioned operations? Explain.

**12. a)** How much reserves each bank must obtain if: bank 1 grants credit (100€) and the agent uses the money to make a payment in favour of bank 2, and bank 2 also grants credit (100€) and the agent uses the money to make a payment in favour of bank 1, **and then each recipient of the payment transfers his checkable deposits into his savings account**?

b) How much will each bank profit from the mentioned operations? Explain.

**13. a)** How much reserves each bank must obtain if: bank 1 grants credit of 100€ and the agent uses the money to make a payment in favour of bank 2, and bank 2 also grants credit **but of 109€,** and the agent uses the money to make a payment in favour of bank 1, **and nothing else happens**?

b) How much will each bank profit from the mentioned operations? Explain.

**14. a)** How much reserves each bank must obtain if: bank 1 grants credit of 100€ and **the agent withdraws 6€** and uses the rest of the money to make a payment of 94€ in favour of bank 2; and bank 2 also grants creditof 100€, and the agent uses the money to make a payment in favour of bank 1, **and nothing else happens**?

b) How much will each bank profit from the mentioned operations? Explain.

**15.** Consider an economy with a single bank. If this provides credit of 100 millions euros, and the recipients of the payments made with that credit keep the money as CDs:

**a)** How much reserves does **the single bank** need to obtain? Explain.

**b)** How much does the bank profit from that credit? Explain.

**…**

**16.** Suppose that, due a big increase in optimism, at the current interest rate households and businesses triple the amount of credit they demand from banks.

**a)** If banks grant the credit demanded, what will happen to the quantity of money and to AD?

**b)** Banks may be unable to grant the credit demanded. Why?

**c)** If banks don´t face the restriction mentioned in your answer to b), may anything end up preventing the threefold increase in credit? Explain.