AP Macroeconomics: Objective 4.6-7 Practice – Money Supply

1. Assume that all banks are using a reserve ratio of 20%.

   a) Using T-Accounts, describe the expansion of a $100 deposit as it moves through three banks.

   b) What is the total money supply after the third bank makes its loans?

   c) Using the money multiplier, what will be the total money supply generated by this original deposit?

2. Assume that the reserve requirement is 10% and banks are not holding any excess reserves.

   a) If the Federal Reserve buys $10 million of government bonds, what will be the effect on the money supply? By a maximum of how much?

   b) If the Fed wanted to use a different method than buying bonds to have the same effect on the money supply, what two alternative actions could it use?

   c) What would be the maximum net change in the money supply if a person deposited $1000 in the bank?