Unit 5 AP Questions

In Country Z, the required reserve ratio is 10 percent. Assume that the central bank sells $50 million in government securities on the open market.

(a) Calculate each of the following.

(i) The total change in reserves in the banking system

(ii) The maximum possible change in the money supply

(b) Using a correctly labeled graph of the money market, show the impact of the central bank's bond sale on the nominal interest rate.

(c) What is the impact of the central bank's bond sale on the equilibrium price level in the short run?

(d) As a result of the price level change in part (c), are people with fixed incomes better off, worse off, or unaffected? Explain.

2. (a) Assume that businesses are granted a tax credit on spending for machinery. Using a correctly labeled graph of the loanable funds market, show the effect of the business sector's response on the real interest rate.

(b) Now assume instead that the tax rate on interest income from household savings is lowered and there is no change in government budget deficit. Using a second correctly labeled graph of the loanable funds market, show the effect of the households' response on the real interest rate.

(c) Given your answer to part (b), explain what will happen to the country's production possibilities curve in the long run.