

The last one!

Place your name on the back of this sheet of paper and nowhere else. Staple your answers face up on the front of this sheet of paper. Failure to follow these directions will cost you 1 point. Your assignment will be typed, except graphs can be drawn by hand and mathematical equations can be done by hand. Failure to type it will cost you 10 points. If you use double-sided printing or print on the back of scrap paper, I will give you one additional point.

1) (10 points each) For each of the following events, determine what will happen to M1 and M2. Explain your logic. If you make any assumptions, state them and why you made them.

A) You move \$500 from a savings account to a checking account.

B) You pay for one of your textbooks in the bookstore with a check for \$400.

C) You use a credit card to buy a \$300 textbook online.

2) (25 points) What is meant by *adverse selection*? Give an example from the banking industry. Explain one method they use to reduce the problem. How does that reduce the problem?

3) (25 points) What is meant by *moral hazard*? Define FDIC insurance and explain how its existence can increase moral hazard in the banking industry.

4) (20 points) Draw the MS/MD diagram. Illustrate the effects of an increase in GDP. Explain why the curve(s) moved as drawn. What happens to the quantity of money and the interest rate?