

The Last One!

Place your name on the back of this sheet of paper and nowhere else. Staple your answers 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) (25 points) Explain how “moral hazard” affects banks. What can banks do to reduce it? Explain how the banks’ actions reduce the problem.

- 2) (10 points each) For each of the following events, determine what happens to M1 and M2. Explain your logic.
 - A) You move \$400 from your savings account to your checking account.
 - B) You pay your tuition bill with a check.
 - C) You pay for your \$4,000 worth of books with a credit card.
 - D) You take \$100 cash out of a money market deposit account.

- 3) (15 points) Would M1 or M2 be a better predictor of future economic activity? Explain your logic.

- 4) (20 points) How can the Federal Reserve increase the money supply using open market operations? Explain why that would increase the money supply.