

**Economics 470/570**  
**Fall 2012**  
**Midterm Exam**

**Name:** \_\_\_\_\_

**Part I - Definitions. Define each of the following (4 points each, 20 points total).**

1. Liquidity
2. Taylor rule
3. Discount rate
4. Monetary base
5. Indirect and direct finance

**Part II. Answer each of the following questions (16 points each, 80 points total).**

1. (a) What are the three functions of money? Relative to a barter economy, what problems are overcome by the use of money? (b) To be useful as a medium of exchange, what properties should money have? (c) Why is there more than one definition of the money supply?
2. (a) Who is on the FOMC? (b) What does the FOMC do? (c) How are regional Fed presidents selected?
3. (a) Use t-accounts to show how bank reserves change when the Fed sells a \$1,000 T-bill to a bank. (b) Assuming that the reserve requirement is 10%, and that currency and excess reserve holdings are both zero, show the first two steps of the multiple deposit creation process. (c) Why does the multiplier fall when the currency to demand deposit ratio increases?
4. (a) Explain why the federal funds rate cannot fall below the interest rate paid on reserves, and why it cannot rise above the discount rate. (b) Show graphically how an increase in financial market risk impacts the federal funds rate, and (c) how the Fed would respond in order to return the federal funds rate to its target value.
5. (a) Use the quantity theory to derive the classical money demand function. (b) Explain the difference between the classical and Cambridge money demand functions. (c) Explain the speculative demand for money.