1. Suppose banks act to keep 15% of their checking account deposits in liquid reserves. In an economy in which M1 consists only of checking accounts (there is no currency that circulates), what effect does an open market purchase by the Fed of $10,000 worth of government securities have on the money supply? An open market sale of the same amount? Does it matter if the purchase or sale is from or to an individual (like you or me) or a bank? (We didn’t discuss this in class, but think about it.)

2. Using simplified balance sheets for the public sector, the banking system, and the Fed, show that gold plays no role in supporting the US money supply.

3. Predict the effect of the following external events on real wages, employment, full-employment output, the real interest rate, private saving and investment, in the long run. In making your prediction, assume all other external factors remain the same.
   a. An increase in taxes, under the conventional view of government finance.
   b. An increase in taxes, under the Ricardian view of government finance.
   c. An increase in capital goods.
   d. An increase in stock prices.
   e. An increase in government spending.
   f. A decrease in the labor force participation rate.

4. Carefully describe how Federal Reserve monetary policy, and its concern for controlling the rate of inflation, can lead to a downward sloping aggregate demand curve; i.e., a negative relationship between the rate of inflation and desired aggregate spending.

5. Suppose the US economy is in long-run equilibrium, where the inflation rate is 2%. The Fed, however, fears that inflationary pressures are building, so it immediately tightens its policy, even before inflation changes. Use graphs if they help.
   a. Explain the effect this policy change will have on the macro economy in the short-run and the transition to the long-run.
   b. Suppose the Fed wants to maintain an inflation rate of 2% in the long-run. How will that affect your answer to part (a)?