4 Banks and monetary policy – Part 2 — Answers

Answers

Work through these after you have tried the questions yourself.

2.1 banks keep only a fraction of deposits as reserves and lend out the rest; those loans are re-deposited and re-lent, multiplying the money supply.
2.2 $\frac{1}{0.20} = 5$.
2.3 $500 \times 5 = \$2500$.
2.4 it lowers interest rates; it is used to fight a recession (to boost demand).
2.5 more money supply lowers the interest rate, which raises investment and consumption, shifting aggregate demand right and raising output.