

Answer on Question #38013 – Economics – Macroeconomics

Assignment

How does the money supply change as a result of (a) an increase in the discount rate, (b) an open market purchase, (c) an increase in the required reserve ratio?

Solution

In economics, the money supply or money stock, is the total amount of monetary assets available in an economy at a specific time.

a. An increase in the discount rate makes it more expensive for commercial banks to borrow money, which results in a decrease in the supply of money in the economy.

b. Purchasing on the open market lead to increase in money supply by increasing available funds for private banks to loan through fractional-reserve banking (the issue of new money through loans) and thus the amount of bank reserves and the monetary base rise.

c. An increase in the required reserve ratio has the effect of reducing the money supply, because banks have fewer funds to lend money.