

1) What are the three functions something must perform to be money?

- A) medium of exchange
- B) store of value
- C) unit of account

2) The required reserve ratio is 20% (.20). If a depositor withdraws \$1 million from his or her bank, what is the maximum amount by which the money supply will contract? Is this the same as the amount by which deposits contract? Why or why not?

The deposit multiplier is equal to the inverse of the required reserve ratio. Therefore, $1/.2 = 5$ is the value of the multiplier. One million dollars withdrawn from the banking system results in a contraction in deposits equal to five million dollars. The money supply contracts by only four million dollars, however, because the initially withdrawn million has only been converted from deposits (one form of money) into cash (a second form of money).