

Write a short answer essay to each of the following questions.

1. Explain the Balance Sheet of a Bank. What are its assets? What are its liabilities? What is a reserve? What is a deposit?

The balance sheet of a commercial bank provides a picture of its functioning. It is a statement that shows its assets and liabilities on a particular date at the end of one year. The assets are shown on the right-hand side and the liabilities on the left-hand side of the balance sheet. As in the case of a company, the assets and liabilities of a bank must balance. The assets of a bank are those items from which it receives income and profit. The first item on the assets side is the cash in a liquid form consisting of coins and currency notes lying in reserve. The liabilities of commercial banks are claims on it. These are the items that form the sources of its funds. Of the liabilities, the share capital of the bank is the first item that is contributed by its shareholders and is a liability to them. The second item is the reserve fund. It consists of accumulated resources that are meant to meet contingencies such as losses in any year. Bank reserves are the cash minimums that must be kept on hand by financial institutions in order to meet central bank requirements. The bank cannot lend the money but must keep it in the vault, on-site or at the central bank, in order to meet any large and unexpected demand for withdrawals. A deposit is an act of placing cash with some entity, most commonly with a financial institution, such as a bank.

2. If the fractional reserve ratio is 5% (not the usual 10%), how much money would eventually be created by the new deposit of \$1000. If the fractional reserve ratio is 5% you will multiply by 5 instead of 10 if reserve ratio was 10%. So you would multiply 1000 by 5 and your profit would be 5000.

3. Suppose the FOMC of the Federal Reserve system decided to increase the money supply by \$100 million. If the required reserve ratio is 10%, how could the Fed increase the money supply? In order for the FOMC they would have to increase the money supply by 10 million dollars as the reserve ratio of 10% would be 100 million multiplied by 1/10.

4. What are the four main functions of the Fed? (One is to be the bank for the US Government. What are the other three?)

Fed discharges the duty of regulating and supervising the functions of these commercial banks. Fed is the custodian of their cash reserves. Fed is lender of last resort. Whenever banks are lack of funds, they can take loans from the Fed. Fed acts as a bank of central clearance, settlements and transfers.