

ECO 301: Money and Banking

Week 1 Homework: Introduction to Financial Markets and Money

Directions: Provide written answers for the following questions and prompts. You may print these sheets and put your answers in the space provided or you may use your own paper to write your answers.

When you have finished, scan or take pictures of your work, combine all images to a single PDF document, assure that all pictures are oriented right-side up, and upload your work as a single PDF document to the Canvas Assignment area. You may use <https://www.easypdfcloud.com/> to combine your images to a single PDF file. The iPhone Notes app can also scan and combine all pages to a single PDF document, using the *Scan Document* feature (not the *Take Picture* feature).

1. Define liquidity. Order the following assets from most liquid to least liquid. You can indicate ties for assets that have similar liquidity. Give a definition for each asset in your own words and describe why the asset is fairly liquid or illiquid.
 - M1 money
 - M2 money
 - House
 - Mortgage held by a bank
 - 10-year sub-prime corporate bond
 - 1-year prime corporate bond
 - 30-day U.S. treasury bills
 - Money market mutual funds
 - Stock market mutual funds

2. Suppose the Federal Reserve engages in monetary policy that leads to higher interest rates. Describe the expected change in desired behavior for each of the following decisions. Describe the direction of the change and provide your reasoning.
- (a) Consumer borrowing

 - (b) Consumer saving

 - (c) Consumer spending

 - (d) Corporate borrowing

 - (e) Business investment (investment defined in the macroeconomic sense)

 - (f) Bank lending
3. Define hyperinflation. Describe at least two reasons why hyperinflation is bad for the economy. What function of money is hindered with hyperinflation?
4. Define a financial crisis. What function of financial markets are hindered during a financial crisis, and how does this affect the broader economy.