

The Fed requires banks to always have some money readily available to meet consumers' demand for cash.

- \* The amount, set by the Fed, is the Required Reserve Ratio.
- \* The Required Reserve Ratio is the % of demand deposits (checking account balances) that must not be loaned out.
- \* Typically the Required Reserve Ratio = 10%

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# AP Tips & Tricks

\* The AP test only uses four numbers for the required reserve ratio. These numbers are:

without needing one.

* 5%	*	5%
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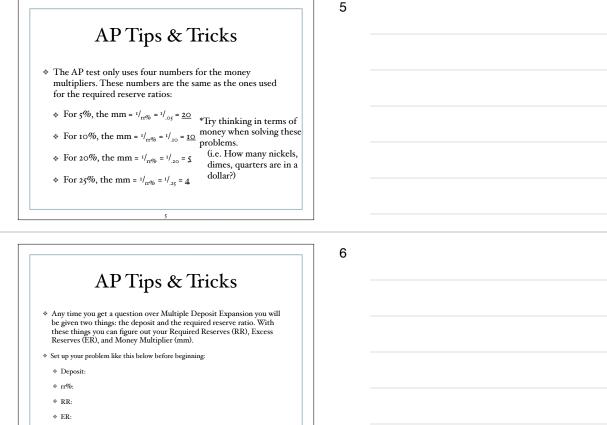
- \*Remember, you don't \* 10% get a calculator on the AP test so the numbers
- \* 20% are kept easy to solve
- \* 25%

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- The Money Multiplier
- Similar to the spending multiplier, the money multiplier shows us the impact of a change in demand deposits on loans and eventually the money supply.
- To calculate the money multiplier, divide 1 by the required reserve ratio.
  - Money multiplier =  $\frac{1}{reserve ratio}$  (AKA)  $\frac{1}{rr\%}$
  - Ex. If the reserve ratio is 25%, then the multiplier = 4.

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- Why? 1/ .25 = 4



- \* mm:

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# The 3 types of questions the AP test will ask you dealing with consumers:

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- \* Type 1: Calculate the amount the bank can initially lend
  - i.e. the amount of Excess Reserves after fulfilling their reserve requirements
- \* Type 2: Calculate the max change in Demand Deposits
- \* Type 3: Calculate the change in the money supply

### Example 1

 Assume that Mr. Hess Deposits \$1,000 worth of cash into his checking account and that the reserve requirement is 10%.
 Determine the maximum amount that the commercial bank can initially lend.

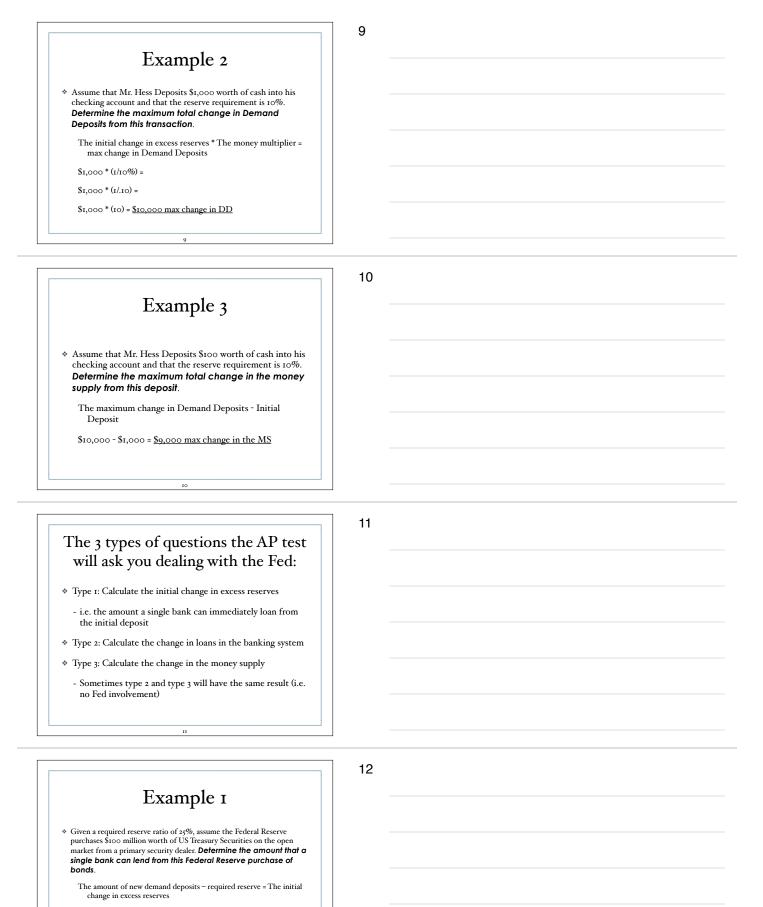
The amount of new demand deposits – required reserve = The initial change in excess reserves

\$1,000 - (10% \* \$1,000) =

\$1,000 - (.10 \* \$1,000) =

\$1,000 - \$100 = <u>\$900 in ER</u>

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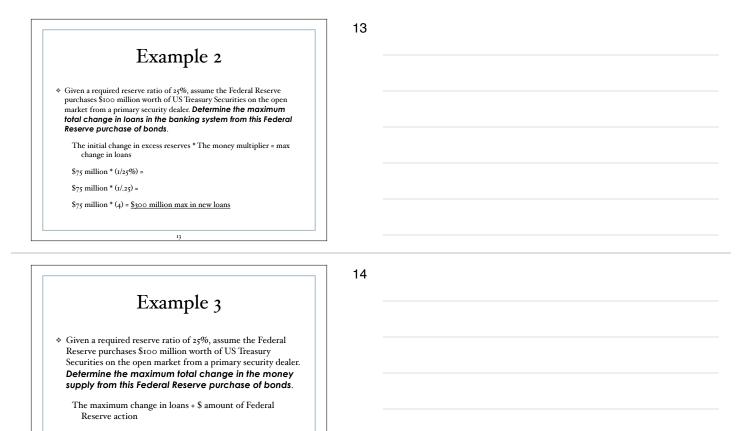


\$100 million - (25% \* \$100 million) =

\$100 million - (.25 \* \$100 million) =

\$100 million - \$25 million = <u>\$75 million in ER</u>

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\$300 million + \$100 million = <u>\$400 million max change in</u> the money supply

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Summary
Every time you put money into the bank, the bank is able to create new money by loaning out your deposit. There are several measures in place, including the FDIC, to protect your money should a bank become insolvent.
The most common rr% on the AP Macro test is 10%, however, 5%, 20%, and 25% can appear frequently as well.
The money multipliers used in AP Macro are 20 (5% rr), to (ro% rr), 5 (20% rr), and 4 (25% rr).

\* Always include your units, whether it be Dollars, Euros, Yen, etc.

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#### Still confused? \* Check out these FRQs listed below on the College Board website for more help. We will go over them in class as well. \* 2009 #3 \* 2006B #2 \* 2009 B #3 \* 2004 #3 \* 2007 #2 \* 2001 #3

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