[Note: Your homeworks must be filed via Turnitin by 17.00pm on the due date.]

1. Read chapter 25 from Hubbard and O’Brien.

2. Define “Fiat money”, “Commodity Money”, “Base Money”, “M1”, “M2”, “Nominal Interest Rate”, “Real Interest Rate”, “Bank Run”, “Open Market Operation”, and “Velocity of Money” with one or two sentences each. Do not use the definitions in the book; provide your own definitions in a way anyone can understand.

3. Find the Turkish monetary base, M1 and M2 series for as long a history as possible and plot the series. Has the M2 to base money ratio been constant over time? Can you interpret the changes in that ratio? Now find the real M2 (M2 with base year prices). Plot that time series. What do you see? Does real money increase as inflation increases?

4. Describe the functions of money in your own words. Can you think of “things” that fulfill some of these functions but not all of them?

5. Describe the money creation process in an economy where the reserve requirement is 25 percent by presenting the successive balance sheets of two banks for three “rounds”. Assume that the first bank gets a deposit of 100YTL and that a loan from a bank ends up being deposited at the other bank. If the initial deposit was 100YTL, how much will M1 be at the end of the money creation process?

6. Assume that Mr. A needs to borrow 100 liras from Ms. B. Would Ms. B lend her money to Mr. A to be paid back 100 liras a year from now if they both are certain that there will be no inflation? Would the required repayment change if they expect five percent inflation? Does it matter for Ms. B if actual inflation turns out to be lower than expected? Discuss using the appropriate terminology.