

Creating Money through Lending

Problem 1

\$5000 in cash is deposited at Bank A.
The reserve requirement is 20%,

Person 1

Bank A

Δ Deposit _____ Δ M1 _____
Only money created with this transaction

Reserve Requirement _____ Excess Reserves _____

Person 2

Bank B

Bank A loans its excess reserve to Corporation Z and it deposits the money into Bank B.

Δ Deposit _____ Δ M1 _____
Only money created with this transaction

Reserve Requirement _____ Excess Reserves _____

Person 3

Bank C

Bank B loans its excess reserve to Joe and he deposits the money into Bank C.

Δ Deposit _____ Δ M1 _____
Only money created with this transaction

Reserve Requirement _____ Excess Reserves _____

Person 4

Bank D

Bank C loans its excess reserve to Mary and she deposits the money into Bank D.

Δ Deposit _____ Δ M1 _____
Only money created with this transaction

Reserve Requirement _____ Excess Reserves _____

How much M1 has been created through lending at this point (add up all the changes to M1)?

How much would M1 equal if this lending continues forever (use the money multiplier formula)?

