

Pre-Test Chapter 14 ed17

Multiple Choice Questions

1. Federal Reserve Notes in circulation are:

- A. an asset as viewed by the Federal Reserve Banks.
- B. a liability as viewed by the Federal Reserve Banks.
- C. neither an asset nor a liability as viewed by the Federal Reserve Banks.
- D. part of $M1$, but not of $M2$ or MZM .

2. Which of the following is an asset on the consolidated balance sheet of the Federal Reserve Banks?

- A. loans to commercial banks
- B. Federal Reserve Notes in circulation
- C. Treasury deposits
- D. reserves of commercial banks

Answer the next question(s) on the basis of the following table in which columns (1) and (2) indicate the transactions demand (D_t) for money and columns (1) and (3) show the asset demand (D_a) for money:

(1) Interest rate	(2) D_t	(3) D_a
12%	\$100	\$ 0
10	100	20
8	100	40
6	100	60
4	100	80
2	100	100

3. Refer to the above data. If the money supply is \$160, the equilibrium interest rate will be:

- A. 10 percent.
- B. 8 percent.
- C. 6 percent.
- D. 4 percent.

4. An expansionary monetary policy may be frustrated if the:

- A. demand-for-money curve shifts to the left.
- B. investment-demand curve shifts to the left.
- C. saving schedule shifts downward.
- D. investment-demand curve shifts to the right.

5. Assume the economy is operating at less than full employment. An expansionary monetary policy will cause interest rates to _____, which will _____ investment spending.

- A. decrease; decrease
- B. decrease; increase
- C. increase; increase
- D. increase; decrease

6. Projecting that it might temporarily fall short of legally required reserves in the coming days, the Bank of Beano decides to borrow money from its regional Federal Reserve Bank. The interest rate on the loan is called the:

- A. prime rate.
- B. Federal funds rate.
- C. Treasury bill rate.
- D. discount rate.

7. Other things equal, a reduction in income taxes would:

- A. reduce productivity and reduce aggregate supply.
- B. increase consumption and increase aggregate demand.
- C. increase the supply of money and reduce investment.
- D. increase government spending and increase aggregate demand.

8. Generally, the prime interest rate:

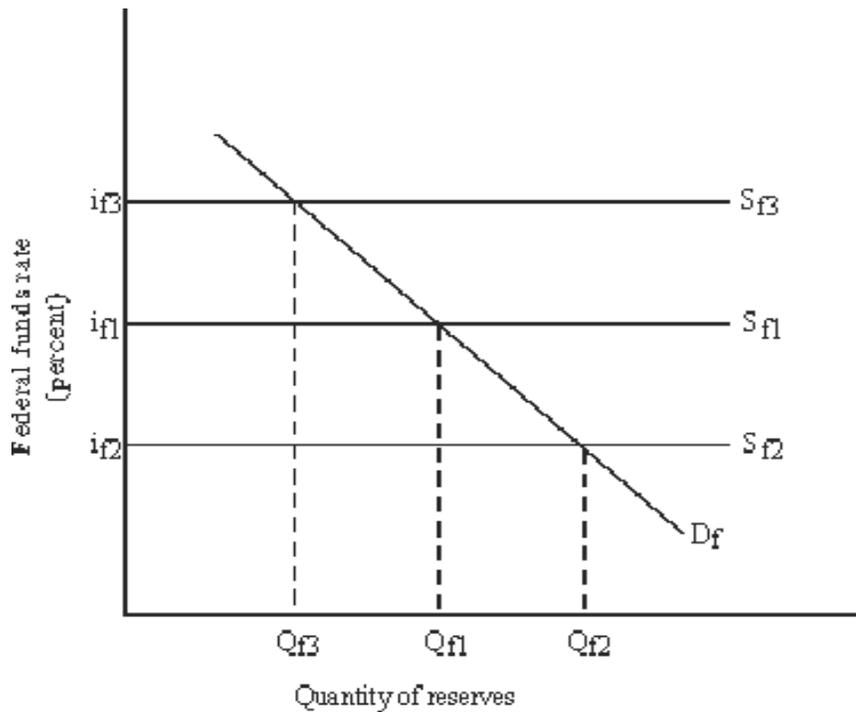
- A. moves in the opposite direction as the Federal funds rate.
- B. remains constant over long periods of time.
- C. is highly inflexible downward.
- D. moves in the same direction as the Federal funds rate.

Answer the next question(s) on the basis of the following table:

Interest rate	Transaction demand for money	Asset demand for money	Money supply
2%	\$220	\$300	\$460
4	220	280	460
6	220	260	460
8	220	240	460
10	220	220	460

9. The total demand for money curve in the above market for money would graph as a:

- A. vertical line.
- B. horizontal line.
- C. line sloping upward to the right.
- D. line sloping downward to the right.



10. Refer to the above diagram for the Federal funds market. If the Fed wants the Federal funds rate to fall from i_1 to i_2 , it can use open market operations to:

- A. increase the demand for Federal funds.
- B. increase the supply of Federal funds.
- C. decrease the supply of Federal funds rate.
- D. decrease commercial bank reserves.

11. Commercial banks and thrifts usually hold only small amounts of excess reserves because:

- A. the presence of such reserves tends to boost interest rates and reduce investment.
- B. the Fed constantly uses open market operations to eliminate excess reserves.
- C. the Fed does not pay interest on reserves.
- D. the Fed does not want commercial banks and thrifts to be too liquid.

12. Which of the following will *increase* commercial bank reserves?

- A. the purchase of government bonds in the open market by the Federal Reserve Banks
- B. a decrease in the reserve ratio
- C. an increase in the discount rate
- D. the sale of government bonds in the open market by the Federal Reserve Banks

13. The opportunity cost of holding money:

- A. is zero because money is not an economic resource.
- B. varies inversely with the interest rate.
- C. varies directly with the interest rate.
- D. varies inversely with the level of economic activity.

14. (Last Word) Which of the following metaphors best fits the tendency of the administration and congressional representatives to blame the Fed for the economy's difficulties?

- A. Fed as a warrior
- B. Fed as a mechanic
- C. Fed as a fall guy
- D. Fed as a cosmic force

15. To increase the Federal funds rate, the Fed can:

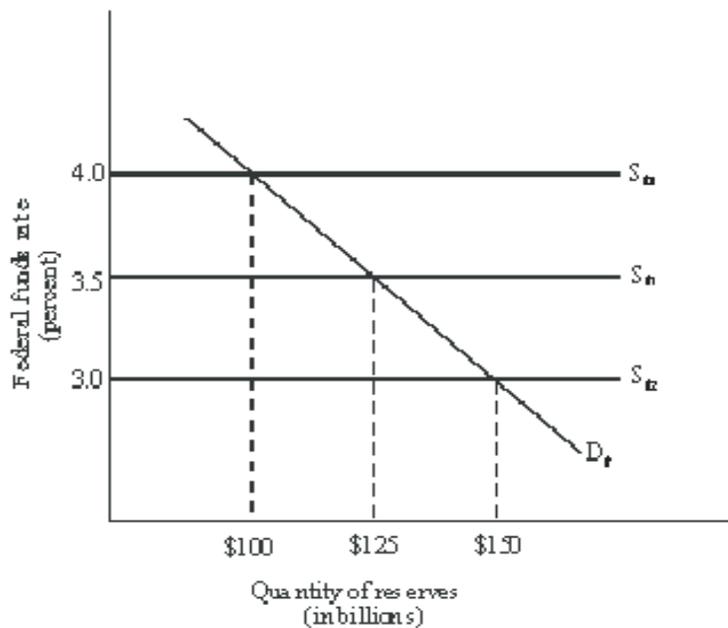
- A. buy government bonds from the public.
- B. decrease the discount rate.
- C. decrease the prime interest rate.
- D. sell government bonds to commercial banks.

Answer the next question(s) on the basis of the following consolidated balance sheet of the commercial banking system. Assume that the reserve requirement is 10 percent. All figures are in billions and each question should be answered independently of changes specified in the preceding ones.

<u>Assets</u>		<u>Liabilities and net worth</u>	
Reserves	\$ 60	Checkable deposits	\$600
Securities	140	Stock shares	260
Loans	260		
Property	400		

16. Refer to the above data. The monetary multiplier for the commercial banking system is:

- A. 5.
- B. 10.
- C. 12.5.
- D. 20.



17. Refer to the above diagram for the Federal funds market. If the Federal funds rate rose from 3.5 percent to 4.0 percent, which of the following is the most likely explanation?

- A. The Fed sold bonds to banks.
- B. The Fed bought bonds from banks.
- C. The demand for Federal funds fell.
- D. The Fed raised the prime interest rate.

18. The above data suggest that the amount of money demanded for transactions:

- A. varies directly with the interest rate.
- B. varies inversely with the interest rate.
- C. varies inversely with nominal GDP.
- D. is independent of the interest rate.

19. Suppose the Federal Reserve Banks sell \$2 billion of government bonds to the public which pays for them by drawing checks. As a result, commercial bank reserves will:

- A. increase by \$10 billion.
- B. remain unchanged.
- C. decrease by \$2 billion.
- D. increase by \$2 billion.

20. (Consider This) The Fed's ability to alter the level of reserves in the banking system is the main idea of the:

- A. sponge analogy.
- B. squeegee analogy.
- C. pushing-on-a-string analogy.
- D. hose analogy.

21. Refer to the above diagram for the Federal funds market. If the quantity of reserves rises from \$100 billion to \$150 billion, we can expect:
- A. the Federal funds rate to fall to 3.5 percent.
 - B. the discount rate to fall to 4.0 percent.
 - C. the prime interest rate to fall below 4.0 percent.
 - D. banks to become more cautious in lending.
22. The commercial banking system borrows from the Federal Reserve Banks. As a result, the checkable deposits:
- A. of commercial banks are unchanged, but their reserves increase.
 - B. and reserves of commercial banks both decrease.
 - C. of commercial banks are unchanged, but their reserves decrease.
 - D. and reserves of commercial banks are both unchanged.
23. To increase the Federal funds rate, the Fed would:
- A. sell government securities.
 - B. buy government securities.
 - C. reduce the discount rate.
 - D. decrease the reserve requirement.
24. The Fed's initial step in pursuing restrictive monetary policy using the Federal funds rate is to.
- A. announce a higher target.
 - B. sell bonds to banks and the public.
 - C. raise the discount rate.
 - D. raise the prime interest rate.
25. Other things equal, an increase in productivity will:
- A. reduce aggregate supply and increase real output.
 - B. reduce both the interest rate and the international value of the dollar.
 - C. increase both aggregate supply and real output.
 - D. increase net exports, increase investment, and reduce aggregate demand.
26. Refer to the above table. The equilibrium interest rate is:
- A. 2 percent.
 - B. 4 percent.
 - C. 6 percent.
 - D. 8 percent.
27. The Federal funds rate is the interest rate that _____ charge(s) _____.
- A. banks; other banks.
 - B. the Fed; commercial banks.
 - C. banks; their best corporate customers.
 - D. banks; on federal student loans.

Answer the next question(s) on the basis of the following consolidated balance sheet of the commercial banking system. Assume that the reserve requirement is 20 percent. All figures are in billions and each question should be answered independently of changes specified in all preceding ones.

<u>Assets</u>		<u>Liabilities and net worth</u>	
Reserves	\$ 200	Checkable deposits	\$1000
Securities	300	Stock shares	400
Loans	500		
Property	400		

28. Refer to the above data. Suppose the Fed wants to increase the money supply by \$1000 billion to drive down interest rates and stimulate the economy. To accomplish this it could lower the reserve requirement from 20 percent to:

- A. 10 percent.
- B. 12 percent.
- C. 14 percent.
- D. 12 percent.

29. The discount rate is the interest:

- A. rate at which the central banks lend to the U.S. Treasury.
- B. rate at which the Federal Reserve Banks lend to commercial banks.
- C. yield on long-term government bonds.
- D. rate at which commercial banks lend to the public.

**CONSOLIDATED BALANCE SHEET:
COMMERCIAL BANKING SYSTEM**

<u>Assets</u>		<u>Liabilities and net worth</u>	
Reserves	\$ 72	Checkable deposits	\$240
Securities	110	Loans from Federal	
Loans	60	Reserve Banks	2

**CONSOLIDATED BALANCE SHEET:
FEDERAL RESERVE BANKS**

<u>Assets</u>		<u>Liabilities and net worth</u>	
Securities	\$240	Reserves of commercial	
Loans to commercial		Banks	\$72
banks	2	Treasury deposits	30
		Federal Reserve Notes	140

30. Refer to the above balance sheets and assume the reserve ratio is 25%. Suppose the Federal Reserve Banks buy \$2 in securities from the public, which deposits this amount into checking accounts. As a result of these transactions, the supply of money will:
- A. be unaffected but the money-creating potential of the commercial banking system will increase by \$6.
 - B. directly decrease by \$2 and the money-creating potential of the commercial banking system will be unaffected.
 - C. directly increase by \$8 and the money-creating potential of the commercial banking system will increase by an additional \$32.
 - D. directly increase by \$2 and the money-creating potential of the commercial banking system will increase by an additional \$6.

Pre-Test Chapter 14 ed17 **Key**

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|-------|-------|-------|
| 1. B | 11. C | 21. B |
| 2. A | 12. A | 22. A |
| 3. C | 13. C | 23. A |
| 4. B | 14. C | 24. A |
| 5. B | 15. D | 25. C |
| 6. D | 16. B | 26. D |
| 7. B | 17. A | 27. A |
| 8. D | 18. D | 28. A |
| 9. D | 19. C | 29. B |
| 10. B | 20. A | 30. D |