

Questions 1 – 2 refer to the following.

The amount of currency (in the hands of the non-bank public) is \$3,000.

The amount of deposits is \$10,000.

The required reserve ratio is 0.10.

Excess reserves are \$1000.

1. What is the value of reserves?
 - a. \$1,000
 - b. \$2,000
 - c. \$3,000
 - d. \$4,000
 - e. \$5,000

2. What is the value of the monetary base?
 - a. \$1,000
 - b. \$2,000
 - c. \$3,000
 - d. \$5,000
 - e. none of the above

3. From 1933 – 1935, there were a number of developments that improved the state of the economy. Which of the following had no immediate impact, but made a profound contribution to the long-term stability of the banking system?
 - a. The New Deal programs
 - b. The US purchases of gold on the open market
 - c. The transferal of the power to change the reserve requirement ration from Congress to the Fed
 - d. The creation of the Federal Deposit Insurance Corporation (FDIC)
 - e. All of the above

4. The rapid decline in aggregate demand observed in March of 1937 was likely caused by
 - a. The payment of the Soldier's Bonus to WWI veterans
 - b. The Fed doubling the reserve requirement ratio
 - c. Open market purchases of bonds by the Fed
 - d. The establishment of the FDIC
 - e. Great Britain abandoning the gold standard

5. When the Fed was created in 1913, the purpose of the Fed was to
 - a. ensure the growth rate of the money supply is constant, and the Fed was largely successful at achieving this goal
 - b. ensure the growth rate of the money supply is constant, but the Fed failed miserably
 - c. to inject reserves into the banking system during times of illiquidity, and the Fed was largely successful
 - d. to inject reserves into the banking system during times of illiquidity, but the Fed failed miserably
 - e. to aid in the prosecution of drug-related offenses

6. Suppose the desired cash balance ratio (aka money demand) is $\frac{1}{2}$, the money supply is \$2000, and the level of real GDP is \$1000. What is the price level?
 - a. 0.25
 - b. 0.5
 - c. 1
 - d. 2
 - e. 4

7. An increase in money demand (aka the desired cash balance ratio) will cause
- an increase in aggregate demand
 - a decrease in aggregate demand
 - an increase in long run aggregate supply
 - a decrease in short run aggregate supply
 - none of the above
8. An increase in money supply will cause
- an increase in aggregate demand, and thus higher real GDP in the short run
 - an increase in aggregate demand, and thus lower real GDP in the short run
 - a decrease in aggregate demand, and thus higher real GDP in the short run
 - a decrease in aggregate demand, and thus lower real GDP in the short run
 - no change in aggregate demand, and no change in real GDP in the short run
9. A decrease in the nominal interest rate would (hint: there are a few steps here)
- lower the cost of holding money, and thus lead to a decrease in the price level
 - lower the cost of holding money, and thus lead to an increase in the price level
 - increase the cost of holding money, and thus lead to a decrease in the price level
 - increase the cost of holding money, and thus lead to an increase in the price level
 - leave the cost of holding money unchanged
10. Suppose there is a decrease in aggregate demand. During the transition from the new short run equilibrium to the new long run equilibrium, what would we observe?
- Falling price level, falling real GDP
 - Falling price level, rising real GDP
 - Rising price level, falling real GDP
 - Rising price level, rising real GDP
 - Rising price level, but no change in real GDP
11. Suppose there is an increase in Long Run Aggregate Supply (perhaps due to a sudden influx of immigrants). As a result, in the long run, we will observe
- higher prices and higher real GDP
 - higher prices and lower real GDP
 - lower prices and higher real GDP
 - lower prices and lower real GDP
 - lower prices and no change in real GDP
12. Prior to Y2K, many people began “currency hoarding”, fearing a financial disaster brought on by computer problems. That is, they began to withdraw large sums of money from their checking accounts. This “currency hoarding” would cause
- an increase in the money multiplier, and hence an increase in aggregate demand
 - a decrease in the money multiplier, and hence a decrease in aggregate demand
 - an increase in the monetary base, and hence an increase in aggregate demand
 - a decrease in the monetary base, and hence a decrease in aggregate demand
 - a simultaneous decrease in the money multiplier and increase in the monetary base
13. If for whatever reason, the reserve-deposit ratio were to increase, which of the following would result in the short run?
- lower price level and lower real GDP
 - lower price level and higher real GDP
 - higher price level and higher real GDP
 - higher price level and lower real GDP
 - lower price level and no change in real GDP

14. If for whatever reason, the currency-deposit rate were to increase, which of the following would result in the long run?
- higher price level and lower real GDP
 - higher price level and higher real GDP
 - lower price level and higher real GDP
 - lower price level and lower real GDP
 - lower price level and no change in real GDP
15. Suppose for some wicked reason, that the short run aggregate supply curve is perfectly elastic (horizontal). A decline in aggregate demand would cause which of the following in the short run?
- higher prices and real GDP
 - lower prices and lower real GDP
 - higher prices and lower real GDP
 - lower prices and higher real GDP
 - none of the above
16. An decrease in the reserve requirement ratio will
- decrease the monetary base
 - decrease the money multiplier
 - increase the desired cash balance ratio
 - increase aggregate demand
 - none of the above
17. An open market purchase of bonds by the Fed will
- increase the monetary base and thus increase the money supply
 - decrease the money multiplier and thus decrease the money supply
 - simultaneously decrease the monetary base and increase the money multiplier, thereby leaving money supply unchanged
 - increase the monetary base and thus decrease the money supply
 - both (b) and (d) are correct
18. An increase in the discount rate will, in principle (textbook story)
- increase member bank borrowing of reserves, increase the reserve-deposit ratio, and decrease the money supply
 - reduce the currency -deposit ratio, increase the money multiplier, and thus increase the money supply
 - decrease member borrowing of reserves, decreases the base, and thus decrease the money supply
 - increase aggregate demand
 - both (b) and (d)
19. What is the monetary system currently used in the United States?
- fiat money – dollars have no intrinsic value
 - commodity backed money – dollars are backed by gold stored at Fort Knox
 - commodity based – gold coins circulate as money (hint: do you have any gold in your pocket?)
 - none of the above
 - getting colder
20. When it lowers the discount rate, the Fed is signaling it intention to
- decrease reserve requirements in the future
 - lower the money multiplier, by lowering the C/D ratio
 - increase open market purchases, thereby increasing the money supply
 - decrease aggregate demand, by decreasing the money supply
 - both (b) and (d) are correct

21. When we derived the short run aggregate supply curve, we assumed that
- input prices are sticky (fixed)
 - output prices adjust quickly
 - output prices are sticky (fixed)
 - both (a) and (b)
 - both (a) and (c)

Extra Credit. If you answer this question **correctly, 4 points will be added to your score**. If you answer this question **incorrectly, 4 points will be subtracted** from your score.

22. Which of the following describes the lecture Dr. Robert Barro gave on Friday?
- it was sparsely attended (few people attended)
 - he clearly ran out of time and rushed to finish
 - he clearly had too much time and tried to stretch to take up the allotted time
 - both (a) and (b)
 - both (a) and (c)

Short Answer

1. (6 pts) Suppose the Fed wanted to raise the federal funds rate. How would the Fed go about this? A sketch of any relevant curves would be a plus.

2. (4 pts) During times of banking panics, the banking system as a whole needs more reserves. True or False – “Federal Funds Rate borrowing is likely to help the banking system out of a panic.” Explain your answer briefly.

3. (6 pts) Here's an excerpt from an old Federal Open Market Committee press release (9/24/2002) where the Fed mentions it's goals for monetary policy.

“...its long-run goals of **price stability** and sustainable **economic growth**...”

Pick any Fed monetary policy tool that will improve the economic growth outlook. (An increase in X or a decrease in Y). Then take the same policy and tell me what effect it would have on the price level. For the policy you have chosen -- are these two mentioned goals consistent?