

Questions 1 - 3 refer to the following information:

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

The amount of deposits is \$20,000 (in the hands of the non-bank public)

The required reserve ratio is 0.10

Excess reserves are zero.

1. What is the value of reserves?
 - a. \$200
 - b. \$400
 - c. \$1,000
 - d. \$2,000
 - e. \$4,000

2. What is value of the money supply?
 - a. \$25,000
 - b. \$23,000
 - c. \$20,000
 - d. \$18,000
 - e. \$5,000

3. What is the value of the monetary base?
 - a. \$1,000
 - b. \$3,000
 - c. \$5,000
 - d. \$20,000
 - e. \$24,000

4. Given your answers to #2 and #3, what is the value of the money multiplier?
 - a. 5
 - b. 4.6
 - c. 4.0
 - d. 2.0
 - e. none of the above

5. If the monetary base is \$600 and the desired cash balance ratio is 0.5, the money supply
 - a. \$300
 - b. \$1200
 - c. cannot be determined based on this information
 - d. depends on the magnitude of the money multiplier
 - e. both (c) and (d) are correct

6. A rise in aggregate demand will cause
 - a. only an rise in real GDP in the long run
 - b. a rise in both prices and real GDP in the long run
 - c. a fall in both prices and real GDP in the short run
 - d. both (a) and (c)
 - e. none of the above

7. Suppose there is an increase in aggregate demand. During the transition from the new SR equilibrium to the new LR equilibrium, what would we observe?
 - a. Falling price level, and falling real GDP
 - b. Falling price level, and rising real GDP
 - c. Rising price level, and falling real GDP
 - d. Rising price level, and rising real GDP
 - e. Rising price level, but no change in GDP

8. If for whatever reason, the reserve-deposit ratio were to increase, which of the following would result in the short 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
9. 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
10. An increase in 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
11. An open market sale of bonds by the Fed will
- decrease the monetary base and thus decrease the money supply
 - increase the money multiplier and thus increase the money supply
 - simultaneously increase the monetary base and decrease the money multiplier, thereby leaving money supply unchanged
 - decrease the monetary base and thus increase the money supply
 - both (b) and (d) are correct
12. An increase in the discount rate will, in principle,
- 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)
13. Which of the following statements concerning the federal funds rate are true?
- Banks prefer to borrow at the federal funds rate (from other banks) rather than using the discount rate, because they fear the Fed may view discount rate borrowing as a sign of financial weakness
 - The Fed prefers that banks borrow reserves from other banks, rather than using the discount rate
 - The Fed actually has a target range for the federal funds rate, and uses the discount rate to keep the federal funds rate within its target
 - Discount rate borrowing actually creates reserves, while federal funds rate borrowing merely rearranges reserve
 - all of the above

14. A bank run would cause which of the following affects?
- an increase in C/D , and hence a decrease in the money multiplier, μ
 - a decrease in C/D , and hence a decrease in the money multiplier, μ
 - an increase in R/D , and hence a decrease in the money multiplier, μ
 - a decrease in R/D , and hence an increase in the money multiplier, μ
 - a decrease in the base

Short answer questions

Some are from old tests, some I just thought of. There is some redundancy here, especially in regard to the banking panic story. Notice the progression from #1 to #3.

- What's the textbook story on what happens when there is an increase in the discount rate?
- Congratulations, you have just been appointed Chairman of the Board of Governors of the Fed. Your staff tells you that the goal of the Fed is to keep the FFR near its target. You and your staff agree that the federal funds rate (FFR) is "too high". How could you use the discount rate to lower the FFR? Explain. Your score will be related to the quality of your explanation. A sketched graph may be a plus.
- In the meeting discussing the policy change you made in question #2, one of your snotty staffers has the audacity to suggest the following: she claims that as a practical matter, there is little borrowing that occurs at the discount rate. Thus, your answer to the first part of the question may not have the desired affect on the FFR. What other actions can you take to further lower the FFR (besides/in addition to changing the DR)? Explain. Again, your score will be related to the quality of your explanation.
- Explain how banks create money. The more jargon, the better.
- Explain what happens during a banking panic. What incentives to the general public have? What happens to some of the important variables we always talk about?
- During times of banking panics, the banking system as a whole needs more reserves. True or false, and explain: FFR borrowing will be likely to help the banking system out of a panic.
- Characterize the Fed's performance regarding monetary policy during the period during and directly surrounding the Great Depression in two words or less.
- For which of these two changes in monetary policy, would you expect a larger increase in real GDP?
Policy A – the Fed lowers the discount rate by 0.50%, which was exactly what everyone expected.
Policy B – the Fed lowers the discount rate by 0.25%, which was entirely unexpected.
- True or false, and explain. The Fed controls all short-term interest rates.
- Consider the following scenarios.
Scenario #1: $r = 3\%$, $\pi^e = 5\%$, $R = 8\%$. Now, there is an increase in expected inflation such that $\pi^e = 7\%$. Explain what happens as a result. Would the amount of investment change? Are lenders worse off, better off, or neither? Borrowers?
Scenario #2: $\pi^e = 5\%$, $R = 8\%$. Now, it turns out actual inflation is 7% ($\pi = 7\%$). Explain what happens as a result. Are lenders worse off, better off, or neither? Borrowers?

Answers:

Multiple Choice:

1-5 DBCBE

6-10 ECDEB

11-14 ACEA