CHAPTER 15
Monetary Policy

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</tr>
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</table>

Multiple Choice Questions
Fed balance sheet and general

Type: A  Topic: 1  E: 269  MA: 269
1. Which of the following is an asset on the consolidated balance sheet of the Federal Reserve Banks?
   A) loans to commercial banks            C) Treasury deposits
   B) Federal Reserve Notes in circulation D) reserves of commercial banks
Answer: A

Type: A  Topic: 1  E: 269  MA: 269
2. Reserves must be deposited in the Federal Reserve Banks by:
   A) only commercial banks which are members of the Federal Reserve System.
   B) all depository institutions, that is, all commercial banks and thrift institutions.
   C) state chartered commercial banks only.
   D) federally chartered commercial banks only.
Answer: B

Type: F  Topic: 1  E: 269  MA: 269
3. The securities held as assets by the Federal Reserve Banks consist mainly of:
   A) corporate bonds.              C) common stock.
   B) Treasury bills and Treasury bonds. D) certificates of deposit.
Answer: B
4. 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 $M3$.
   Answer: B

5. 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
   Answer: A

6. When a commercial bank borrows from a Federal Reserve Bank:
   A) the supply of money automatically increases.
   B) it indicates that the commercial bank is unsound financially.
   C) the commercial bank's lending ability is increased.
   D) the commercial bank's reserves are reduced.
   Answer: C

7. The Federal Reserve Banks sell government securities to the public. 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) of commercial banks are both unchanged.
   Answer: B

8. The Federal Reserve Banks buy government securities from commercial 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.
   Answer: A

9. 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.
   Answer: A
10. Which of the following is a tool of monetary policy?
   A) open market operations
   B) changes in banking laws
   C) changes in tax rates
   D) changes in government spending
   Answer: A

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.
   Answer: C

12. In the United States monetary policy is the responsibility of the:
   A) U.S. Treasury.
   B) Department of Commerce.
   C) Board of Governors of the Federal Reserve System.
   D) U.S. Congress.
   Answer: C

13. The three main tools of monetary policy are:
   A) tax rate changes, the discount rate, and open-market operations.
   B) tax rate changes, changes in government expenditures, and open-market operations.
   C) the discount rate, the reserve ratio, and open-market operations.
   D) changes in government expenditures, the reserve ratio, and the discount rate.
   Answer: C

14. The Fed can change the money supply by:
   A) changing bank reserves through the sale or purchase of government securities.
   B) changing the quantities of required and excess reserves by altering the legal reserve ratio.
   C) changing the discount rate so as to encourage or discourage commercial banks in borrowing from the central banks.
   D) doing all of the above.
   Answer: D
Open-market operations

Type: A Topic: 2 E: 270-271 MA: 270-271
15. Assume the reserve ratio is 25 percent and Federal Reserve Banks buy $4 million of U.S. securities from the public, which deposits this amount into checking accounts. As a result of these transactions, the supply of money is:
   A) not directly affected, but the money-creating potential of the commercial banking system is increased by $12 million.
   B) directly increased by $4 million and the money-creating potential of the commercial banking system is increased by $16 million.
   C) directly reduced by $4 million and the money-creating potential of the commercial banking system is decreased by $12 million.
   D) directly increased by $4 million and the money-creating potential of the commercial banking system is increased by $12 million.
Answer: D

Type: A Topic: 2 E: 274-275 MA: 274-275
16. Assume the legal reserve ratio is 25 percent and the Fourth National Bank borrows $10,000 from the Federal Reserve Bank in its district. As a result:
   A) commercial bank reserves are increased by $10,000.
   B) the supply of money automatically declines by $7,500.
   C) commercial bank reserves are increased by $7,500.
   D) the supply of money is automatically increased by $10,000.
Answer: A

Type: D Topic: 2 E: 270 MA: 270
17. Open-market operations refer to:
   A) purchases of stocks in the New York Stock Exchange.
   B) the purchase or sale of government securities by the Fed.
   C) central bank lending to commercial banks.
   D) the specifying of loan maximums on stock purchases.
Answer: B

Type: A Topic: 2 E: 270-271 MA: 270-271
18. If the Federal Reserve System buys government securities from commercial banks and the public:
   A) commercial bank reserves will decline.
   B) commercial bank reserves will be unaffected.
   C) it will be easier to obtain loans at commercial banks.
   D) the money supply will contract.
Answer: C

Type: A Topic: 2 E: 271 MA: 271
19. The purchase of government securities from the public by the Fed will cause:
   A) commercial bank reserves to decrease.
   B) the money supply to increase.
   C) demand deposits to decrease.
   D) the interest rate to increase.
Answer: B
20. Assume that a single commercial bank has no excess reserves and that the reserve ratio is 20 percent. If this bank sells a bond for $1,000 to a Federal Reserve Bank, it can expand its loans by a maximum of:
   A) $1,000.  B) $2,000.  C) $800.  D) $5,000.
   Answer: A

21. 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.  C) decrease by $2 billion.
   B) remain unchanged.  D) increase by $2 billion.
   Answer: C

22. Which of the following statements is correct?
   A) The supply of money decreases when the Federal Reserve Banks buy government securities from households or businesses.
   B) Excess reserves are the amount by which actual reserves exceed required reserves.
   C) Commercial banks decrease the supply of money when they purchase government bonds from households or businesses.
   D) Commercial bank reserves are a liability to commercial banks but an asset to the Federal Reserve Banks.
   Answer: B

Use the following to answer questions 23-26:

**CONSOLIDATED BALANCE SHEET:**
**COMMERCIAL BANKING SYSTEM**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and net worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>$ 72</td>
</tr>
<tr>
<td>Securities</td>
<td>110</td>
</tr>
<tr>
<td>Loans</td>
<td>60</td>
</tr>
</tbody>
</table>

**CONSOLIDATED BALANCE SHEET:**
**FEDERAL RESERVE BANKS**

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and net worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Securities</td>
<td>$240</td>
</tr>
<tr>
<td>Loans to commercial banks</td>
<td>2</td>
</tr>
</tbody>
</table>

23. Refer to the above balance sheets. The commercial banks have excess reserves of:
   Answer: A
24. Refer to the above balance sheets. The maximum money-creating potential of the commercial banking system is:
   Answer: C

25. Refer to the above balance sheets. 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 $32.
   D) directly increase by $2 and the money-creating potential of the commercial banking system will increase by $6.
   Answer: D

26. Refer to the above balance sheets. Suppose the Federal Reserve Banks sell $2 in securities directly to the commercial banks. As a result of this transaction the supply of money:
   A) will decrease by $2, but the money-creating potential of the commercial banking system will not be affected.
   B) is not directly affected, but the money-creating potential of the commercial banking system will decrease by $8.
   C) will directly increase by $2 and the money-creating potential of the commercial banking system will decrease by $8.
   D) will directly increase by $2 and the money-creating potential of the commercial banking system will increase by $8.
   Answer: B

27. The Federal Reserve System regulates the money supply primarily by:
   A) controlling the production of coins at the United States mint.
   B) altering the reserve requirements of commercial banks and thereby the ability of banks to make loans.
   C) altering the reserves of commercial banks, largely through sales and purchases of government bonds.
   D) restricting the issuance of Federal Reserve Notes because paper money is the largest portion of the money supply.
   Answer: C

28. Assuming no currency drains, when the Federal Reserve Banks purchase government securities the reserves of commercial banks are:
   A) decreased by a multiple of the amount of the purchase.
   B) decreased by the amount of the purchase.
   C) increased by a multiple of the amount of the purchase.
   D) increased by the amount of the purchase.
   Answer: D
29. Which of the following is correct? When the Federal Reserve buys government securities from the public, the money supply:
   A) contracts and commercial bank reserves increase.
   B) expands and commercial bank reserves decrease.
   C) contracts and commercial bank reserves decrease.
   D) expands and commercial bank reserves increase.
   Answer: D

30. Which of the following will happen when the Federal Reserve buys bonds from the public in the open market and cash in the hands of the public does not change?
   A) the required reserve ratio will increase
   B) the money supply will decrease
   C) the deposits of commercial banks will decline
   D) commercial bank reserves will increase
   Answer: D

Use the following to answer questions 31-32:

Answer the next question(s) on the assumption that the legal reserve ratio is 20 percent. Suppose that the Fed sells $500 of government securities to commercial banks and buys $500 of securities from individuals, who deposit the cash in checking accounts.

31. As a result of the above transactions, reserves in the banking system will:
   A) remain unchanged.  B) rise by $100.  C) fall by $100.  D) rise by $1000.
   Answer: A

32. As a result of the above transactions, the supply of money in the economy will:
   A) remain unchanged.  B) rise by $500.  C) fall by $100.  D) fall by $500.
   Answer: A

33. Open-market operations change:
   A) the size of the monetary multiplier, but not commercial bank reserves.
   B) commercial bank reserves, but not the size of the monetary multiplier.
   C) neither commercial bank reserves nor the size of the monetary multiplier.
   D) both commercial bank reserves and the size of the monetary multiplier.
   Answer: B
Use the following to answer questions 34-39:

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.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and net worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>Checkable deposits</td>
</tr>
<tr>
<td>$60</td>
<td>$600</td>
</tr>
<tr>
<td>Securities</td>
<td>Capital stock</td>
</tr>
<tr>
<td>140</td>
<td>260</td>
</tr>
<tr>
<td>Loans</td>
<td></td>
</tr>
<tr>
<td>260</td>
<td></td>
</tr>
<tr>
<td>Property</td>
<td></td>
</tr>
<tr>
<td>400</td>
<td></td>
</tr>
</tbody>
</table>

34. Refer to the above data. The commercial banking system has excess reserves of:
   A) $10 billion. B) $5 billion. C) $2 billion. D) zero.
   Answer: D

35. Refer to the above data. The monetary multiplier for the commercial banking system is:
   Answer: B

36. Refer to the above data. Suppose the Fed sold $10 billion of U.S. securities to the banks. This would:
   A) increase bank reserves to $70 billion, reduce bank-held securities to $130 billion, and increase the money supply (checkable deposits) by $100 billion.
   B) increase bank reserves to $70 billion, reduce bank-held securities to $130 billion, and decrease the money supply (checkable deposits) by $100 billion.
   C) reduce bank reserves to $50 billion, increase bank-held securities to $150 billion, and increase the money supply (checkable deposits) by $100 billion.
   D) reduce bank reserves to $50 billion, increase bank-held securities to $150 billion, and decrease the money supply (checkable deposits) by $100 billion.
   Answer: D

37. Refer to the above data. Suppose the Fed bought $20 billion of U.S. securities from the banks. This would:
   A) increase bank reserves to $80 billion, reduce bank-held securities to $120 billion, and increase the money supply (checkable deposits) by $200 billion.
   B) increase bank reserves to $80 billion, reduce bank-held securities to $120 billion, and decrease the money supply (checkable deposits) by $200 billion.
   C) reduce bank reserves to $40 billion, increase bank-held securities to $160 billion, and increase the money supply (checkable deposits) by $200 billion.
   D) reduce bank reserves to $40 billion, increase bank-held securities to $160 billion, and decrease the money supply (checkable deposits) by $200 billion.
   Answer: A
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38. Refer to the above data. Suppose the Fed wants to increase the money supply by $400 billion to drive down interest rates and stimulate the economy. To accomplish this it could:
   A) sell $20 billion of U.S. securities to the banks.
   B) buy $20 billion of U.S. securities from the banks.
   C) sell $40 billion of U.S. securities to the banks.
   D) buy $40 billion of U.S. securities from the banks.
   Answer: D

39. Refer to the above data. Suppose the Fed wants to reduce the money supply by $400 billion to drive up interest rates and dampen inflation. To accomplish this it could:
   A) sell $20 billion of U.S. securities to the banks.
   B) buy $20 billion of U.S. securities from the banks.
   C) sell $40 billion of U.S. securities to the banks.
   D) buy $40 billion of U.S. securities from the banks.
   Answer: C

 Reserve ratio

40. If the Fed were to increase the legal reserve ratio, we would expect:
   A) lower interest rates, an expanded GDP, and depreciation of the dollar.
   B) lower interest rates, an expanded GDP, and appreciation of the dollar.
   C) higher interest rates, a contracted GDP, and appreciation of the dollar.
   D) higher interest rates, a contracted GDP, and depreciation of the dollar.
   Answer: C

41. An increase in the legal reserve ratio:
   A) increases the money supply by increasing excess reserves and increasing the monetary multiplier.
   B) decreases the money supply by decreasing excess reserves and decreasing the monetary multiplier.
   C) increases the money supply by decreasing excess reserves and decreasing the monetary multiplier.
   D) decreases the money supply by increasing excess reserves and decreasing the monetary multiplier.
   Answer: B

42. When the reserve requirement is increased:
   A) required reserves are changed into excess reserves.
   B) the excess reserves of member banks are increased.
   C) a single commercial bank can no longer lend dollar-for-dollar with its excess reserves.
   D) the excess reserves of member banks are reduced.
   Answer: D
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43. Assume that the commercial banking system has checkable deposits of $10 billion and excess reserves of $1 billion at a time when the reserve requirement is 20 percent. If the reserve requirement is now raised to 30 percent, the banking system then has:
   A) excess reserves of $2 billion.  C) a deficiency of reserves of $0.5 billion.
   B) neither an excess nor a deficiency of reserves.  D) excess reserves of only $0.5 billion.
   Answer: B

44. When the required reserve ratio is increased, the excess reserves of member banks are:
   A) reduced, but the multiple by which the commercial banking system can lend is unaffected.
   B) reduced and the multiple by which the commercial banking system can lend is increased.
   C) increased and the multiple by which the commercial banking system can lend is increased.
   D) reduced and the multiple by which the commercial banking system can lend is reduced.
   Answer: D

45. When the required reserve ratio is decreased, the excess reserves of member banks are:
   A) reduced, but the multiple by which the commercial banking system can lend is unaffected.
   B) reduced and the multiple by which the commercial banking system can lend is increased.
   C) increased and the multiple by which the commercial banking system can lend is increased.
   D) increased and the multiple by which the commercial banking system can lend is reduced.
   Answer: C

46. A decrease in the reserve ratio increases the:
   A) amount of actual reserves in the banking system.
   B) amount of excess reserves in the banking system.
   C) number of government securities held by the Federal Reserve Banks.
   D) ratio of coins to paper currency in the economy.
   Answer: B

47. An increase in the reserve ratio:
   A) increases the size of the spending income multiplier.
   B) decreases the size of the spending income multiplier.
   C) increases the size of the monetary multiplier.
   D) decreases the size of the monetary multiplier.
   Answer: D
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Use the following to answer questions 48-53:

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.

<table>
<thead>
<tr>
<th>Assets</th>
<th>Liabilities and net worth</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves $ 200</td>
<td>Checkable deposits $1000</td>
</tr>
<tr>
<td>Securities $ 300</td>
<td>Capital stock $400</td>
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<tr>
<td>Loans $ 500</td>
<td></td>
</tr>
<tr>
<td>Property $ 400</td>
<td></td>
</tr>
</tbody>
</table>

48. Refer to the above data. The commercial banking system has excess reserves of:
   A) zero.  B) $2 billion.  C) $5 billion.  D) $10 billion.
   Answer: A

49. Refer to the above data. The monetary multiplier for the commercial banking system is:
   Answer: A

50. Refer to the above data. If the Fed increased the reserve requirement from 20 percent to 25 percent, a deficiency of reserves in the commercial banking system of _____ would occur and the monetary multiplier would fall to ____.
   A) $50 billion; 5.  B) $10 billion; 4  C) $50 billion; 4  D) $10 billion; 8
   Answer: C

51. Refer to the above data. If the Fed reduced the reserve requirement from 20 percent to 16 percent, excess reserves in the commercial banking system would increase by _____ and the monetary multiplier would rise to ____.
   A) $10 billion; 5  B) $40 billion; 6.25  C) $10 billion; 10  D) $40 billion; 12.5
   Answer: B

52. 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.
   Answer: A

53. Refer to the above data. Suppose the Fed wants to reduce the money supply by $200 billion to drive up interest rates and dampen inflation. To accomplish this it could increase the reserve requirement from 20 percent to:
   A) 22 percent.  B) 25 percent.  C) 30 percent.  D) 33 percent.
   Answer: B
Discount rate

54. 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.
Answer: B

55. A commercial bank can add to its actual reserves by:
A) lending money to bank customers.
B) buying government securities from the public.
C) buying government securities from a Federal Reserve Bank.
D) borrowing from a Federal Reserve Bank.
Answer: D

56. The interest rate at which the Federal Reserve Banks lend to commercial banks is called the:
Answer: C

57. The discount rate is the rate of interest at which:
A) Federal Reserve Banks lend to commercial banks.
B) savings and loan associations lend to some builders.
C) Federal Reserve Banks lend to large corporations.
D) commercial banks lend to large corporations.
Answer: A

58. 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:
Answer: D

59. When the Fed lends money to a commercial bank, the bank:
A) increases its reserves and enhances its ability to extend credit to bank customers.
B) decreases its reserves and reduces its ability to extend credit to bank customers.
C) pays the Federal funds interest rate on the loan.
D) pays the prime rate interest rate on the loan.
Answer: A
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60. Suppose that, for every 1-percentage point decline in the discount rate, commercial banks collectively borrow an additional $2 billion from Federal Reserve banks. Also assume that reserve ratio is 10 percent. If the Fed lowers the discount rate from 4.0 percent to 3.5 percent, bank reserves will:
   A) increase by $1 billion and the money supply will increase by $5 billion.
   B) decline by $1 billion and the money supply will decline by $10 billion.
   C) increase by $1 billion and the money supply will increase by $10 billion.
   D) increase by $10 billion and the money supply will increase by $100 billion.
   Answer: C

61. Suppose that, for every 1-percentage point decline of the discount rate, commercial banks collectively borrow an additional $2 billion from Federal Reserve banks. Also assume that reserve ratio is 20 percent. If the Fed increases the discount rate from 4.0 percent to 4.25 percent, bank reserves will:
   A) increase by $.5 billion and the money supply will increase by $2.5 billion.
   B) decline by $.5 billion and the money supply will decline by $2.5 billion.
   C) increase by $.75 billion and the money supply will increase by $3.75 billion.
   D) increase by $1 billion and the money supply will increase by $5 billion.
   Answer: A

62. Changes in the discount rate are:
   A) the most powerful and useful tool of monetary policy.
   B) less frequent than changes in the reserve requirement.
   C) more important than open-market operations.
   D) less important than open-market operations in implementing monetary policy.
   Answer: D

Monetary policy and the economy

63. Which of the following best describes the cause-effect chain of an easy money policy?
   A) A decrease in the money supply will lower the interest rate, increase investment spending, and increase aggregate demand and GDP.
   B) A decrease in the money supply will raise the interest rate, decrease investment spending, and decrease aggregate demand and GDP.
   C) An increase in the money supply will raise the interest rate, decrease investment spending, and decrease aggregate demand and GDP.
   D) An increase in the money supply will lower the interest rate, increase investment spending, and increase aggregate demand and GDP.
   Answer: D

64. Upon which of the following industries is a tight money policy likely to be most effective?
   A) furniture    B) clothing    C) food processing    D) residential construction
   Answer: D
65. Assuming government wishes to either increase or decrease the level of aggregate demand, which of the following pairs are not consistent policy measures?
   A) a tax increase and an increase in the money supply
   B) a tax reduction and an increase in the money supply
   C) a reduction in government expenditures and a decline in the money supply
   D) a tax increase and an increase in the interest rate
   Answer: A

66. If the Federal Reserve authorities were attempting to reduce demand-pull inflation, the proper policies would be to:
   A) sell government securities, raise reserve requirements, and raise the discount rate.
   B) buy government securities, raise reserve requirements, and raise the discount rate.
   C) sell government securities, lower reserve requirements, and lower the discount rate.
   D) sell government securities, raise reserve requirements, and lower the discount rate.
   Answer: A

67. A contraction of the money supply:
   A) increases the interest rate and decreases aggregate demand.
   B) increases both the interest rate and aggregate demand.
   C) lowers the interest rate and increases aggregate demand.
   D) lowers both the interest rate and aggregate demand.
   Answer: A

68. If the Fed were to purchase government securities in the open market, we would anticipate:
   A) lower interest rates, an expanded GDP, and depreciation of the dollar.
   B) lower interest rates, an expanded GDP, and appreciation of the dollar.
   C) higher interest rates, a contracted GDP, and depreciation of the dollar.
   D) lower interest rates, a contracted GDP, and appreciation of the dollar.
   Answer: A

69. The purpose of a tight money policy is to:
   A) alleviate recessions.
   B) raise interest rates and restrict the availability of bank credit.
   C) increase aggregate demand and GDP.
   D) increase investment spending.
   Answer: B

70. Monetary policy is expected to have its greatest impact on:
   A) $X_g$
   B) $J_g$
   C) $C$
   D) $G$
   Answer: B
71. Which of the following actions by the Fed would cause the money supply to increase?
   A) purchases of government bonds from banks.  
   B) an increase in the reserve requirement.  
   C) an increase in the discount rate.  
   D) sales of government bonds to the public.
   Answer: A

72. Assume the economy is operating at less than full employment. An easy money policy will cause interest rates to ________, which will ___________ investment spending.
   A) decrease; decrease  
   B) decrease; increase  
   C) increase; increase  
   D) increase; decrease
   Answer: B

73. Which of the following best describes the cause-effect chain of a tight money policy?
   A) A decrease in the money supply will lower the interest rate, increase investment spending, and increase aggregate demand and GDP.
   B) A decrease in the money supply will raise the interest rate, decrease investment spending, and decrease aggregate demand and GDP.
   C) An increase in the money supply will raise the interest rate, decrease investment spending, and decrease aggregate demand and GDP.
   D) An increase in the money supply will lower the interest rate, decrease investment spending, and increase aggregate demand and GDP.
   Answer: B

74. If the economy were encountering a severe recession, proper monetary and fiscal policies would call for:
   A) selling government securities, raising the reserve ratio, lowering the discount rate, and a budgetary surplus.
   B) buying government securities, reducing the reserve ratio, reducing the discount rate, and a budgetary deficit.
   C) buying government securities, raising the reserve ratio, raising the discount rate, and a budgetary surplus.
   D) buying government securities, reducing the reserve ratio, raising the discount rate, and a budgetary deficit.
   Answer: B

75. If severe demand-pull inflation was occurring in the economy, proper government policies would involve a government:
   A) deficit and the purchase of securities in the open market, a higher discount rate, and higher reserve requirements.
   B) deficit and the sale of securities in the open market, a higher discount rate, and lower reserve requirements.
   C) surplus and the sale of securities in the open market, a higher discount rate, and higher reserve requirements.
   D) surplus and the purchase of securities in the open market, a lower discount rate, and lower reserve requirements.
   Answer: C
If the amount of money demanded exceeds the amount supplied, the:
A) demand-for-money curve will shift to the left.  
B) money supply curve will shift to the right.  
C) interest rate will rise.  
D) interest rate will fall.
Answer: C

Use the following to answer questions 77-79:

Refer to the above diagrams. The numbers in parentheses after the AD_1, AD_2, and AD_3, labels indicate the levels of investment spending associated with each curve, respectively. All numbers are in billions of dollars. If the interest rate is 8 percent and the goal of the Fed is full-employment output of Q_f, it should:
A) increase the interest rate from 8 percent to 10 percent.  
B) decrease the interest rate from 8 to 4 percent.  
C) decrease the interest rate from 8 to 6 percent.  
D) maintain the interest rate at 8 percent.
Answer: C

Refer to the above diagrams. The numbers in parentheses after the AD_1, AD_2, and AD_3 labels indicate the levels of investment spending associated with each curve, respectively. All numbers are in billions of dollars. If the interest rate is 4 percent and the Fed desires to undo demand-pull inflation, it should:
A) increase the interest rate from 4 percent to 6 percent.  
B) decrease the interest rate from 4 to 2 percent.  
C) increase investment spending by $20 billion.  
D) maintain the interest rate at 4 percent.
Answer: A

Refer to the above diagrams. The numbers in parentheses after the AD_1, AD_2, and AD_3 labels indicate the levels of investment spending associated with each curve, respectively. All numbers are in billions of dollars. If the interest rate is 6 percent and the goal of the Fed is full-employment output of Q_f, it should:
A) increase the interest rate from 6 percent to 8 percent.  
B) decrease the interest rate from 6 to 4 percent.  
C) decrease the interest rate from 6 to 2 percent.  
D) maintain the interest rate at 6 percent.
Answer: D
Chapter 15: Monetary Policy

80. The purpose of an easy money policy is to shift the:
A) aggregate demand curve leftward. C) aggregate supply curve leftward.
B) aggregate demand curve rightward. D) investment demand curve leftward.
Answer: B

Use the following to answer questions 81-84:

81. Refer to the above diagrams. The numbers in parentheses after the AD, AD, and AD labels indicate the levels of investment spending associated with each curve. All figures are in billions. If the money supply is $M_s$ and the goal of the monetary authorities is full-employment output $Q_f$, they should:
A) increase the money supply from $80 to $100. C) maintain the money supply at $80.$
B) increase the money supply from $80 to $120. D) decrease the money supply from $80 to $60.
Answer: A

82. Refer to the above diagrams. The numbers in parentheses after the AD, AD, and AD labels indicate the levels of investment spending associated with each curve. All figures are in billions. If aggregate demand is AD and the monetary authorities desire to reduce it to AD, they should:
A) increase the interest rate from 3 percent to 9 percent.
B) increase the money supply from $100 to $120.
C) decrease the money supply from $120 to $100.
D) decrease the interest rate from 3 percent to 9 percent.
Answer: C
83. Refer to the above diagrams. The numbers in parentheses after the AD<sub>1</sub>, AD<sub>2</sub>, and AD<sub>3</sub> labels indicate the levels of investment spending associated with each curve. All figures are in billions. Which of the following would shift the money supply curve from $M_{s1}$ to $M_{s3}$?

A) an increase in the discount rate
B) purchases of U.S. securities by the Fed in the open market
C) sales of U.S. securities by the Fed in the open market
D) an increase in the reserve ratio

Answer: B

84. Refer to the above diagrams. The numbers in parentheses after the AD<sub>1</sub>, AD<sub>2</sub>, and AD<sub>3</sub> labels indicate the levels of investment spending associated with each curve. All figures are in billions. If the MPC for the economy described by the figures is .8:

A) an increase in the money supply from $80 to $100 will shift the aggregate demand curve rightward by $50 billion at each price level.
B) an increase in the money supply from $80 to $100 will shift the aggregate demand curve leftward by $40 billion at each price level.
C) a decrease in the interest rate from 9 percent to 6 percent will shift the aggregate demand curve leftward by $100 billion at each price level.
D) a decrease in the interest rate from 6 percent to 3 percent will shift the aggregate demand curve leftward by $50 billion at each price level.

Answer: A

85. An increase in the money supply will:

A) lower interest rates and lower the equilibrium GDP.
B) lower interest rates and increase the equilibrium GDP.
C) increase interest rates and increase the equilibrium GDP.
D) increase interest rates and lower the equilibrium GDP.

Answer: B

86. All else equal, when the Federal Reserve Banks engage in a tight money policy, the prices of government bonds usually:

A) fall.  B) rise.  C) remain constant.  D) move in the same direction as the bonds' interest rate yield.

Answer: A

87. All else equal, when the Federal Reserve Banks engage in an easy money policy, the interest rates received on government bonds usually:

A) fall.  B) rise.  C) remain constant.  D) move in the same direction as the bonds' price.

Answer: A
Use the following to answer questions 88-91:

Answer the next question(s) on the basis of the information in the following table.

<table>
<thead>
<tr>
<th>Money supply</th>
<th>Money demand</th>
<th>Interest rate</th>
<th>Investment (at interest rate shown)</th>
</tr>
</thead>
<tbody>
<tr>
<td>$400</td>
<td>$600</td>
<td>2%</td>
<td>$700</td>
</tr>
<tr>
<td>400</td>
<td>500</td>
<td>3</td>
<td>600</td>
</tr>
<tr>
<td>400</td>
<td>400</td>
<td>4</td>
<td>500</td>
</tr>
<tr>
<td>400</td>
<td>300</td>
<td>5</td>
<td>300</td>
</tr>
<tr>
<td>400</td>
<td>200</td>
<td>6</td>
<td>200</td>
</tr>
</tbody>
</table>

88. Refer to the above table. The equilibrium interest rate in this economy is:
   A) 3 percent.  B) 4 percent.  C) 5 percent.  D) 6 percent.
   Answer: B

89. Refer to the above table. An interest rate of 2 percent is not sustainable because:
   A) the demand for bonds in the bond market will fall and the interest rate will fall.
   B) the demand for bonds in the bond market will rise and the interest rate will fall.
   C) the supply of bonds in the bond market will decline and the interest rate will rise.
   D) the supply of bonds in the bond market will rise and the interest rate will rise.
   Answer: D

90. Refer to the above table. The amount of investment that will be forthcoming in this economy is:
   A) $700.  B) $600.  C) $500.  D) $300.
   Answer: C

91. Refer to the above table. Suppose the legal reserve requirement is 10 percent and initially there are no excess reserves in the banking system. If the Fed wished to reduce the interest rate by 1 percentage point, it would:
   A) sell $10 of government bonds in the open market.
   B) buy $100 of government bonds in the open market.
   C) sell $100 of government bonds in the open market.
   D) buy $10 of government bonds in the open market.
   Answer: A

92. The price of government bonds and the interest rate received by a bond buyer are:
   A) positively related.
   B) unrelated.
   C) negatively related.
   D) independent of Federal Reserve open-market operations.
   Answer: C
Chapter 15: Monetary Policy

93. A tight money policy is designed to shift the:  
   A) aggregate demand curve rightward.  
   B) aggregate demand curve leftward.  
   C) aggregate supply curve rightward.  
   D) aggregate supply curve leftward.  
   Answer: B

94. If the economy is operating in the relatively steep (upper) portion of its aggregate supply curve, a reduction in the money supply will:  
   A) increase the interest rate and increase employment.  
   B) reduce the interest rate and increase employment.  
   C) increase the interest rate and reduce the price level, assuming it is flexible downward.  
   D) reduce the interest rate and increase the price level.  
   Answer: C

95. The sale of government bonds by the Federal Reserve Banks to commercial banks will:  
   A) increase aggregate supply.  
   B) decrease aggregate supply.  
   C) increase aggregate demand.  
   D) decrease aggregate demand.  
   Answer: D

96. Assume that the price level is flexible both upward and downward and that the Fed's policy is to keep the price level from either rising or falling. If aggregate supply increases in the economy, the Fed:  
   A) will have to increase interest rates to keep the price level from falling.  
   B) will have to reduce the money supply to keep the price level from rising.  
   C) will have to increase the money supply to keep the price level from falling.  
   D) can keep the price level stable without altering the money supply or interest rate.  
   Answer: C

97. If the demand for money increases and the Fed wants interest rates to remain unchanged, which of the following would be appropriate policy?  
   A) recall Federal Reserve Notes from circulation  
   B) raise the legal reserve requirement  
   C) buy bonds in the open market  
   D) raise the discount rate  
   Answer: C

Assessment/recent policy

98. Which of the following has bolstered the case for active monetary policy?  
   A) budget surpluses  
   B) increasing globalization of financial markets  
   C) the success of monetary policy in helping the economy emerge from the 1990-1991 recession and sustain economic growth through the 1990s  
   D) a decreasing role of banks and thrifts in the financial industry  
   Answer: C
Chapter 15: Monetary Policy

99. According to studies and recent experience:
   A) globalization of financial markets has undermined the Fed's ability to change interest rates through monetary policy.
   B) the shrinking market share of banks and thrifts relative to other financial institutions has caused the Fed to lose control over the money supply and therefore its ability to affect interest rates.
   C) tight money policies work; easy money policies do not.
   D) the Fed has retained its ability to control the money supply and affect interest rates, even in the face of globalization of financial markets and the declining role of banks and thrifts in financial markets.
   Answer: D

100. One of the strengths of monetary policy relative to fiscal policy is that monetary policy:
   A) can be implemented more quickly.
   B) is subject to closer political scrutiny.
   C) does not produce a net export effect.
   D) entails a larger spending income multiplier effect on real GDP.
   Answer: A

101. The problem of cyclical asymmetry refers to the idea that:
   A) a tight money policy can force a contraction of the money supply, but an easy money policy may not achieve an expansion of the money supply.
   B) the monetary authorities have been less willing to use an easy money policy than they have a tight money policy.
   C) cyclical downswings are typically of longer duration than cyclical upswings.
   D) an easy money policy can force an expansion of the money supply, but a tight money policy may not achieve a contraction of the money supply.
   Answer: A

102. An easy money policy may be less effective than a tight money policy because:
   A) the Federal Reserve Banks are always willing to make loans to commercial banks which are short of reserves.
   B) fiscal policy always works at cross purposes with an easy money policy.
   C) changes in exchange rates complicate an easy money policy more than it does a tight money policy.
   D) commercial banks may not be able to find loan customers.
   Answer: D

103. An easy money 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.
   Answer: B
104. Some economists contend that the velocity of money often changes in such a way as to frustrate monetary policy. Which of the following statements is consistent with this thinking?

A) An increase in the money supply will increase the interest rate and reduce the amount of money held as an asset.
B) A decrease in the money supply will decrease the interest rate and increase the amount of money held as an asset.
C) A decrease in the money supply will increase the interest rate and reduce the amount of money held as an asset.
D) An increase in the money supply will lower the interest rate and reduce the amount of money held as an asset.

Answer: C

105. A tight money policy could be offset by:

A) a deterioration in the profit expectations of businesses.
B) a budget surplus.
C) a decline in the velocity of money.
D) an increase in the velocity of money.

Answer: D

106. Monetary policy is thought to be:

A) equally effective in moving the economy out of a depression as in controlling demand-pull inflation.
B) more effective in moving the economy out of a depression than in controlling demand-pull inflation.
C) more effective in controlling demand-pull inflation than in moving the economy out of a depression.
D) only effective in moving the economy out of a depression.

Answer: C

107. Monetary policy:

A) is less politically acceptable than is fiscal policy.
B) will be weakened if the velocity of money changes in the same direction as the money supply.
C) will be weakened if the velocity of money changes in the opposite direction as the money supply.
D) is designed primarily to alter the velocity of money.

Answer: C

108. The impact of monetary policy on investment spending may be weakened:

A) because of the Treasury's desire for high interest rates.
B) if velocity changes in the same direction as the money supply.
C) if the investment-demand curve shifts to the right during inflation and to the left during recession.
D) if the investment-demand curve is very flat.

Answer: C
109. Since 1980, U.S. monetary policy has been:
   A) highly erratic, causing rising inflation and unemployment.
   B) relatively successful in controlling inflation and promoting full employment.
   C) partly responsible for the increase in the natural rate of unemployment.
   D) of secondary importance to fiscal policy in stabilizing the economy.
   Answer: B

110. The Fed directly sets:
   A) the prime interest rate but not the Federal funds rate.
   B) both the Federal funds rate and the prime interest rate.
   C) neither the Federal funds rate nor the prime interest rate.
   D) the discount rate and the prime interest rate.
   Answer: C

111. Which of the following will likely accompany an easy money policy?
   A) a higher prime interest rate  C) a higher discount rate
   B) a lower Federal funds rate  D) higher income tax rates
   Answer: B

112. A Federal funds rate reduction that is caused by monetary policy will:
   A) increase the prime interest rate.  C) increase the Fed's discount rate.
   B) decrease the size of the monetary multiplier.  D) decrease the prime interest rate.
   Answer: D

113. To reduce the Federal funds rate, the Fed can:
   A) buy government bonds from the public.  C) increase the prime interest rate.
   B) increase the discount rate.  D) sell government bonds to commercial banks.
   Answer: A

114. 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: D

115. To increase the Federal funds rate, the Fed can:
   A) buy government bonds from the public.  C) decrease the prime interest rate.
   B) decrease the discount rate.  D) sell government bonds to commercial banks.
   Answer: D
116. Recently, the Fed has communicated changes in its monetary policy by announcing changes in its policy targets for the:
   A) growth of the money supply.  
   B) Federal funds rate.  
   C) prime interest rate.  
   D) U.S. dollar-foreign currency exchange rate.
   Answer: B

117. The prime interest rate:
   A) affects investment spending while the Federal funds rate affects consumption spending.
   B) affects consumption spending while the Federal funds rate affects investment spending.
   C) has no affect on exchange rates and net exports.
   D) affects investment spending while the Federal funds rate affects overnight borrowing of bank reserves.
   Answer: D

118. The Federal funds rate is:
   A) higher than the prime interest rate.
   B) lower than the prime interest rate.
   C) always equal to the Fed's discount rate.
   D) equal to the prime interest rate minus the Fed's discount rate.
   Answer: B

119. In recent years, the Federal Reserve has:
   A) paid closer attention to $M_1$ than $M_2$ in setting monetary targets.
   B) relied more on changes in the discount rate than open-market operations in establishing monetary policy.
   C) has increased $M_2$ at a fixed annual rate, regardless of the health of the economy.
   D) taken an activist, pragmatic approach to monetary policy, paying close attention to interest rates.
   Answer: D

120. If the Fed wants to lower the Federal funds rate, it should:
   A) increase the discount rate.  
   B) increase the reserve ratio.  
   C) buy government securities in the open market.  
   D) sell government securities in the open market.
   Answer: C

121. Other things equal, which of the following would increase the Federal funds rate?
   A) a decrease in loan demand in the Federal funds market
   B) a decrease in the reserve ratio
   C) Fed purchases of government securities from banks
   D) a decline in excess reserves in the banking system
   Answer: D
Chapter 15: Monetary Policy

122. The benchmark interest rate that banks use as a reference point for a variety of consumer and business loans is the:
   Answer: B

123. The prime interest rate usually:
   A) rises when the Federal funds rate rises.
   B) rises when the discount rate falls.
   C) falls when the Federal funds rate rises.
   D) falls when the Fed sells bonds in the open market.
   Answer: A

124. In 1999 and 2000 the Fed increased the Federal funds rate several times. The Fed's purpose was to:
   A) prevent rising inflation. B) reduce the unemployment rate. C) stimulate economic growth. D) strengthen the international value of the dollar.
   Answer: A

125. Between January 2001 and June 2003, the Fed reduced the Federal funds rate from 6 percent to 1 percent. The Fed's purpose was to:
   A) prevent rising inflation. B) reduce the public debt. C) promote recovery from recession. D) strengthen the international value of the dollar.
   Answer: C

126. To reduce the Federal funds rate, the Fed would:
   A) increase the discount rate. B) increase the reserve requirement. C) sell government securities. D) buy government securities.
   Answer: D

127. 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.
   Answer: A

128. In the last-half of the 1990s, Japan:
   A) successfully used monetary policy to overcome recession.
   B) had poor success using monetary policy to overcome recession.
   C) abandoned monetary policy in favor of fiscal policy in fighting inflation.
   D) successfully used monetary policy to reduce rapid inflation.
   Answer: B
129. Compared with fiscal policy, monetary policy is:
   A) quicker and easier to implement.
   B) slower and more cumbersome to implement.
   C) more dependent on Congressional action.
   D) more likely to produce an offsetting net export effect.
   Answer: A

Use the following to answer questions 130-132:

<table>
<thead>
<tr>
<th>(1) Interest</th>
<th>(2) Investment</th>
<th>(3) Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>4%</td>
<td>$100</td>
<td>$80</td>
</tr>
<tr>
<td>5</td>
<td>90</td>
<td>70</td>
</tr>
<tr>
<td>6</td>
<td>80</td>
<td>60</td>
</tr>
<tr>
<td>7</td>
<td>70</td>
<td>50</td>
</tr>
<tr>
<td>8</td>
<td>60</td>
<td>40</td>
</tr>
</tbody>
</table>

130. Refer to the above table, in which investment is in billions. Suppose the Fed reduces the interest rate from 6 percent to 5 percent. Given columns (1) and (2), investment will:
   A) decline by $20 billion.
   B) increase by $20 billion.
   C) decline by $10 billion.
   D) increase by $10 billion.
   Answer: D

131. Refer to the above table, in which investment is in billions. Suppose the Fed reduces the interest rate from 6 to 5 percent at a time when the investment demand declines from that shown by columns (1) and (2) to that shown by columns (1) and (3). As a result of these two occurrences, investment will:
   A) increase by $10 billion.
   B) decrease by $10 billion.
   C) increase by $20 billion.
   D) decrease by $20 billion.
   Answer: B

132. The result demonstrated in the previous question illustrates:
   A) the crowding out problem.
   B) the net export effect.
   C) a potential weakness of monetary policy.
   D) a potential strength of monetary policy.
   Answer: C
133. Inflation targeting consists of the Fed:
   A) using monetary policy to reduce the annual inflation rate by a set amount each year until the rate of inflation is zero.
   B) using monetary policy to hold the price of a fixed basket of commodities (wheat, gold, pork, and so on) to a 1 to 2 percent annual increase.
   C) identifying the sources of inflation and recommending structural changes in the economy that would relieve upward price pressures.
   D) regularly stating an explicit goal for the rate of inflation over some future period, such as the following two years.
   Answer: D

134. Proponents of inflation targeting say it would:
   A) remove the need for countercyclical fiscal policy.
   B) increase the transparency of monetary policy and increase Fed accountability.
   C) do away with the need for the Fed to engage in open market operations.
   D) help coordinate fiscal and monetary policy.
   Answer: B

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   A) remove the need for countercyclical fiscal policy.
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   C) do away with the need for the Fed to engage in open market operations.
   D) help coordinate fiscal and monetary policy.
   Answer: B

International complications

136. Other things equal, a tight money policy will:
   A) decrease the international value of the dollar.
   B) increase GDP.
   C) reduce net exports.
   D) increase net exports.
   Answer: C
Use the following to answer questions 137-138:

![Diagram of aggregate supply and demand curves](image)

137. Refer to the above diagram. The shift of the aggregate demand curve from $AD_1$ to $AD_2$ might result from the Fed:

A) selling bonds in the open market.  
B) increasing the discount rate.  
C) increasing the reserve ratio.  
D) buying bonds in the open market.

Answer: D

138. Refer to the above diagram. Which of the following would explain why the policy described in the previous question might shift the aggregate demand curve to $AD_3$ rather than to $AD_2$?

A) the domestic interest rate rises, the dollar depreciates, and net exports fall  
B) the domestic interest rate rises, the dollar appreciates, and net exports fall  
C) the domestic interest rate falls, the dollar depreciates, and net exports rise  
D) the domestic interest rate falls, the dollar appreciates, and net exports rise

Answer: C

139. Other things equal, an easy money policy will:

A) reduce net exports.  
B) increase interest rates.  
C) reduce the international value of the dollar.  
D) reduce GDP.

Answer: C

140. A particular change in money supply will produce a smaller net export effect:

A) the steeper is the money demand curve.  
B) the flatter is the money demand curve.  
C) the steeper is the money supply curve.  
D) the flatter is the money supply curve.

Answer: A
141. Under some conditions, proper domestic monetary policy may be at odds with the goal of correcting a trade imbalance because:
   A) changes in the domestic interest rate cause changes in domestic investment spending.
   B) changes in the domestic interest rate tend to cause changes in the international value of the dollar.
   C) the domestic interest rate varies inversely with the value of the dollar.
   D) changes in the interest rate cause changes in domestic saving.
   Answer: B

142. The net export effect:
   A) strengthens the stimulative effect of an expansionary fiscal policy.
   B) weakens the stimulative effect of an easy money policy.
   C) strengthens the stimulative effect of an easy money policy.
   D) has no perceptible impact on stabilization policies.
   Answer: C

143. An easy money policy in the United States is most likely to:
   A) decrease the foreign demand for dollars and appreciate the international value of the dollar.
   B) decrease the foreign demand for dollars and depreciate the international value of the dollar.
   C) increase the foreign demand for dollars and appreciate the international value of the dollar.
   D) increase the foreign demand for dollars and depreciate the international value of the dollar.
   Answer: B

144. A tight money policy in the United States is most likely to:
   A) depreciate the international value of the dollar and increase American net exports.
   B) depreciate the international value of the dollar and decrease American net exports.
   C) appreciate the international value of the dollar and increase American net exports.
   D) appreciate the international value of the dollar and decrease American net exports.
   Answer: D

145. International flows of financial capital in response to interest rate changes in the United States:
   A) weaken domestic monetary policy through an offsetting net export effect.
   B) strengthen domestic monetary policy through a supporting net export effect.
   C) strengthen domestic fiscal policy through an offsetting net export effect.
   D) weaken domestic monetary policy through an offsetting real wealth effect.
   Answer: B

146. All else equal, an easy money policy in the United States:
   A) increases U.S. imports.  C) reduces the foreign demand for U.S. dollars.
   B) increases the international value of the dollar.  D) aggravates an existing U.S. trade deficit.
   Answer: C
147. An easy money policy is appropriate for the alleviation of domestic:
A) unemployment and compatible with the goal of correcting a trade deficit.
B) unemployment and compatible with the goal of correcting a trade surplus.
C) inflation and compatible with the goal of correcting a trade deficit.
D) inflation and compatible with the goal of correcting a trade surplus.
Answer: A

148. Assume the United States is experiencing a 6 percent annual rate of inflation and is also incurring a trade deficit. All else equal, the use of appropriate monetary policy to reduce inflation would:
A) cause the dollar to depreciate in value.
B) have no impact on the U.S. trade deficit.
C) decrease the U.S. trade deficit.
D) increase the U.S. trade deficit.
Answer: D

149. Suppose the United States is experiencing an 8 percent rate of unemployment with stable prices and a trade deficit. All else equal, the use of appropriate monetary policy to reduce unemployment would:
A) cause the dollar to appreciate in value.
B) have no impact on the U.S. trade deficit.
C) decrease the U.S. trade deficit.
D) increase the U.S. trade deficit.
Answer: C

150. Which of the following is correct?
A) An easy money policy will cause the dollar to depreciate and will increase U.S. net exports.
B) An easy money policy will cause the dollar to depreciate and will decrease U.S. net exports.
C) An easy money policy will cause the dollar to appreciate and will increase U.S. net exports.
D) An easy money policy will cause the dollar to depreciate and will decrease U.S. net exports.
Answer: A

151. Which of the following is correct?
A) A tight money policy will cause the dollar to appreciate and U.S. net exports to increase.
B) A tight money policy will cause the dollar to appreciate and U.S. net exports to decrease.
C) A tight money policy will cause the dollar to depreciate and U.S. net exports to increase.
D) A tight money policy will cause the dollar to depreciate and U.S. net exports to decrease.
Answer: B

AD-AS/policy summary

152. 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.
Answer: C
Chapter 15: Monetary Policy

153. Other things equal, an increase in input prices will:
   A) reduce aggregate supply and reduce real output.
   B) increase the interest rate and lower the international value of the dollar.
   C) increase aggregate supply and increase the price level.
   D) increase net exports, increase investment, and reduce aggregate demand.
   Answer: A

154. Other things equal, a tight money policy during a period of demand-pull inflation will:
   A) lower the interest rate, increase investment, and reduce net exports.
   B) lower the price level, increase investment, and increase aggregate demand.
   C) increase productivity, aggregate supply, and real output.
   D) increase the interest rate, reduce investment, and reduce aggregate demand.
   Answer: D

155. 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.
   Answer: B

156. Other things equal, a depreciation of the U.S. dollar would:
   A) increase the price of imported resources and decrease aggregate supply.
   B) decrease net exports and aggregate demand.
   C) increase consumption, investment, net export, and government spending.
   D) decrease aggregate supply and decrease aggregate demand.
   Answer: A

Consider This Questions

157. (Consider This) The possible asymmetry of monetary policy is the central idea of the:
   A) invisible hand concept.  B) ratchet analogy.  C) pushing-on-a-string analogy.  D) bandwagon effect.
   Answer: C

158. (Consider This) The pushing-on-a-string analogy makes the point that, monetary policy may be better at:
   A) controlling demand-pull inflation than cost-push inflation.
   B) pulling the aggregate demand curve leftward than pushing it rightward.
   C) pulling the unemployment rate downward than pushing the economic growth rate upward.
   D) keeping rapid inflation from occurring than reducing it once it has begun.
   Answer: B
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Last Word Questions

159. (Last Word) The current chair of the Board of Governors of the Federal Reserve System is:
   Answer: C

160. (Last Word) Which of the following metaphors best fits the Fed's role in using monetary policy to stabilize the economy?
   A) Fed as a warrior   B) Fed as a mechanic   C) Fed as a fall guy   D) Fed as a cosmic force
   Answer: B

161. (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
   Answer: C

162. (Last Word) Which of the following metaphors best fits the Fed's goal of maintaining price stability?
   A) Fed as a warrior   B) Fed as a mechanic   C) Fed as a fall guy   D) Fed as a cosmic force
   Answer: A

True/False Questions

163. The Fed reduces interest rates mainly by selling government securities.
   Answer: False

164. The Fed increases interest rates mainly by selling government securities.
   Answer: True

165. If the economy is operating in the relative flat (lower) part of its aggregate supply curve, a tight money policy will increase real output but not the price level.
   Answer: False

166. In the last half of the 1990s monetary policy was highly effective in the United States but highly ineffective in Japan.
   Answer: True
167. Alan Greenspan is the current chair of the Council of Economic Advisers.  
Answer: False

168. A change in the reserve ratio will affect both the amount of the banking system's excess reserves and the multiple by which the system can lend on the basis of excess reserves.  
Answer: True

169. The prime interest rate and the Federal funds rate normally change in opposite directions.  
Answer: False

170. The largest single liability of the Federal Reserve Banks is their outstanding loans to commercial banks.  
Answer: False

171. An easy money policy is one that reduces the supply of money.  
Answer: False

172. Changes in the interest rate are more likely to affect investment spending than consumer spending.  
Answer: True

173. The job of the Fed in limiting the supply of money may be made more complex if commercial banks initially have substantial excess reserves.  
Answer: True

174. Other things equal, an easy money policy will shift the economy's aggregate demand curve to the right.  
Answer: True

175. A tight money policy may be frustrated if the investment-demand curve shifts to the left.  
Answer: False

176. A tight money policy reduces investment spending and shifts the economy's aggregate demand curve to the right.  
Answer: False