Money an economic activity exam 2

Exam II Money and Economic Activity

Name___________________________________ Fall 2012 Part I: MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question. 1) What makes the Federal Reserve so unique compared to other central banks around the world is its 1) ________ A) centralized structure. B) decentralized structure. C) monetary policy functions. D) regulatory functions. 2) Which of the following is an entity of the Federal Reserve System? 2) ________ A) The U. S. Treasury Secretary B) The FDIC C) The Comptroller of the Currency D) The FOMC 3) The Federal Reserve Bank of ________ plays a special role in the Federal Reserve System because it houses the open market desk. 3) ________ A) Chicago B) Boston C) New York D) San Francisco 4) The ability of a central bank to set monetary policy goals is 4) ________ A) policy independence. B) instrument independence. C) political independence. D) goal independence. 5) Members of Congress are able to influence monetary policy, albeit indirectly, through their ability to 5) ________ A) withhold appropriations from the Federal Open Market Committee. B) propose legislation that would force the Fed to submit budget requests to Congress, as must other government agencies. C) withhold appropriations from the Board of Governors. D) instruct the General Accounting Office to audit the foreign exchange market functions of the Federal Reserve. 6) The case for Federal Reserve independence does not include the idea that 6) ________ A) a Federal Reserve under the control of Congress or the president might make the so-called political business cycle more pronounced. B) policy is always performed better by an elite group such as the Fed. C) political pressure would impart an inflationary bias to monetary policy. D) a politically insulated Fed would be more concerned with long-run objectives and thus be a defender of a sound dollar and a stable price level. 7) The strongest argument for an independent Federal Reserve rests on the view that subjecting the Fed to more political pressures would impart 7) ________ A) a countercyclical bias to monetary policy. B) a disinflationary bias to monetary policy. C) an inflationary bias to monetary policy. D) a deflationary bias to monetary policy. 8) The government agency that oversees the banking system and is responsible for the conduct of monetary policy in the United States is 8) ________ A) the United States Treasury. B) the U. S. Gold Commission. C) the Federal Reserve System. D) the House of Representatives. 9) Of the three players in the money supply process, most observers agree that the most important player is 9) _________ A) the FDIC. B) the United States Treasury. C) the Office of Thrift Supervision. D) the Federal Reserve System. 10) Both ________ and ________ are Federal Reserve assets. 10) ______ A) currency in circulation; securities B) securities; loans to financial institutions C) currency in circulation; reserves D) securities; reserves 11) The monetary base consists of 11) ______ A) currency in circulation and reserves. B) reserves and Federal Reserve Notes. C) currency in circulation and the U. S. Treasury's monetary liabilities. D) currency in circulation and Federal Reserve notes. 12) Total reserves are the sum of ________ and ________. 12) ______ A) vault cash; excess reserves B) excess reserves; required reserves C) excess reserves; borrowed reserves D) required reserves; currency in circulation 13) The percentage of deposits that banks must hold in reserve is the 13) ______ A) required reserve ratio. B) total reserve ratio. C) currency ratio. D) excess reserve ratio. 14) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, eight million dollars on deposit with the Federal

Reserve, and one million dollars in required reserves. Given this information, we can say First National Bank has ________ million dollars in excess reserves. 14) ______ A) three B) nine C) ten D) eleven 15) The interest rate the Fed charges banks borrowing from the Fed is the 15) ______ A) federal funds rate. B) prime rate. C) discount rate. D) Treasury bill rate. 16) The monetary base minus currency in circulation equals 16) ______ A) the borrowed base. B) the nonborrowed base. C) reserves. D) discount loans. 17) When the Federal Reserve purchases a government bond from a bank, reserves in the banking system ________ and the monetary base ________, everything else held constant. 17) ______ A) decrease; increases B) decrease; decreases C) increase; decreases D) increase; increases 18) When the Fed sells $100 worth of bonds to First National Bank, reserves in the banking system 18) ______ A) increase by more than $100. B) decrease by $100. C) decrease by more than $100. D) increase by $100. 19) The effect of an open market purchase on reserves differs depending on how the seller of the bonds keeps the proceeds. If the proceeds are kept in currency, the open market purchase ________ reserves; if the proceeds are kept as deposits, the open market purchase ________ reserves. 19) ______ A) has no effect on; has no effect on B) decreases; increases C) increases; has no effect on D) has no effect on; increases 20) When a member of the nonbank public withdraws currency from her bank account, 20) ______ A) both the monetary base and bank reserves fall. B) both the monetary base and bank reserves rise. C) bank reserves fall, but the monetary base remains unchanged. D) the monetary base falls, but bank reserves remain unchanged. 21) In the simple deposit expansion model, if the Fed purchases $100 worth of bonds from a bank that previously had no excess reserves, the bank can now increase its loans by 21) ______ A) $10. B) $100. C) $100 times the reciprocal of the required reserve ratio. D) $100 times the required reserve ratio. 22) If reserves in the banking system increase by $100, then checkable deposits will increase by $1000 in the simple model of deposit creation when the required reserve ratio is 22) ______ A) 0. 20. B) 0. 10. C) 0. 05. D) 0. 01. 23) A simple deposit multiplier equal to one implies a required reserve ratio equal to 23) ______ A) 100 percent. B) 50 percent. C) 25 percent. D) 0 percent. 24) In the simple deposit expansion model, a decline in checkable deposits of $1, 000 when the required reserve ratio is equal to 20 percent implies that the Fed 24) ______ A) sold $200 in government bonds. B) sold $500 in government bonds. C) purchased $200 in government bonds. D) purchased $500 in government bonds. 25) If a bank has excess reserves of $10, 000 and demand deposit liabilities of $80, 000, and if the reserve requirement is 20 percent, then the bank has actual reserves of 25) ______ A) $16, 000. B) $20, 000. C) $26, 000. D) $36, 000. 26) Everything else held constant, an increase in currency holdings will cause 26) ______ A) the money supply to fall. B) the money supply to remain constant. C) the money supply to rise. D) checkable deposits to rise. 27) Everything else held constant, a decrease in holdings of excess reserves will mean 27) ______ A) an increase in discount loans. B) a decrease in checkable deposits. C) a decrease in the money supply. D) an increase in the money supply. 28) In the model of the money supply process, the Federal Reserve's role in influencing the money supply is represented by 28) ______ A) only borrowed reserves. B) both the required reserve ratio and the market interest rate. C) only nonborrowed reserves. D) the required reserve ratio, nonborrowed reserves, and borrowed reserves. 29) If the required reserve ratio is 10 percent, currency in circulation is $400 billion, checkable deposits are $800 billion, and excess reserves total $0. 8 billion, then the money supply is ________ billion. 29) ______ A) $1200 B) $1200. 8 C) $8000 D) $8400 30) If the required reserve ratio is 10 percent, currency in circulation is $400 billion, checkable deposits are $800 billion, and excess reserves total $0. 8 billion, then the M1 money multiplier is 30) ________ A) 2. 5. B) 0. 601. C) 2. 0. D) 1. 67. 31) If the required reserve ratio is 5 percent, currency in circulation is $400 billion, checkable deposits are $800 billion, and excess reserves total $0. 8 billion, then the M1 money multiplier is 31) ______ A) 2. 5. B) 0. 551. C) 2. 3. D) 2. 72. 32) If the required reserve ratio is 10 percent, currency in circulation is $400 billion, checkable deposits are $1000 billion, and excess reserves total $1 billion, then the monetary base is 32) ______ A) $400 billion. B) $401 billion. C) $500 billion. D) $501 billion. 33) Assuming initially that rr = 10%, c = 40%, and e = 0, an increase in rr to 15% causes the M1 money multiplier to ________, everything else held constant. Let rr = the required reserved ratio; c= currency deposit ratio; e = excess reserve deposit ratio. 33) ______ A) decrease from 2. 8 to 2. 55 B) decrease from 2 to 1. 82 C) increase from 2. 55 to 2. 8 D) increase from 1. 82 to 2 34) Factors causing an increase in currency holdings include 34) ______ A) a decrease in bank panics. B) an increase in the cost of acquiring currency. C) an increase in illegal activity. D) an increase in the interest rates paid on checkable deposits. 35) The interest rate charged on overnight loans of reserves between banks is the 35) ______ A) federal funds rate. B) discount rate. C) prime rate. D) Treasury bill rate. 36) If float is predicted to decrease because of unseasonably good weather, the manager of the trading desk at the Federal Reserve Bank of New York will likely conduct a ________ open market ________ of securities. 36) ______ A) dynamic;

purchase B) defensive; sale C) dynamic; sale D) defensive; purchase 37) The most important advantage of discount policy is that the Fed can use it to 37) ______ A) precisely control the monetary base. B) perform its role as lender of last resort. C) punish banks that have deficient reserves. D) control the money supply. 38) When the Fed wants to raise interest rates after banks have accumulated large amounts of excess reserves, it would 38) ______ A) increase the required reserve ratio. B) increase discount rate. C) conduct massive open market purchase. D) increase the interest rate paid on excess reserves. 39) The Fed prefers that so that 39) ________ A) banks borrow reserves from each other; the Fed can monitor banks for credit risk. B) banks borrow reserves from each other ; banks can monitor each other for credit risk. C) banks borrow reserves from the Fed; banks can monitor each other for credit risk. D) banks borrow reserves from the Fed; the Fed can monitor banks for credit risk. 40) If the Fed expects currency holdings to rise, it conducts open market ________ to offset the expected ________ in reserves. 40) ________ A) purchases; decrease B) purchases; increase C) sales; decrease D) sales; increase Part II ESSAY. Write your answer in the space provided. 1) 1) Explain dynamic and defensive open market operations. What is the purpose of each type? Describe two situations when defensive open market operations are used. How are defensive open market operations typically conducted? Dynamic open market operations are strategies in open market operations that are used to increase or decrease the level of funds available in the economy. These strategies are not used when something is expected to happen or when something does happen, they are just used to change the level of reserves. Defensive open market operations are strategies used to counteract other anticipated factors affecting bank reserves. If something is expected or actually does happen, these strategies are used in response. One situation where a defensive open market operation would be used is if a foreign country is expected to sell its US treasury securities holdings in exchange for US dollars, the Federal Reserve might decide to buy treasury securities ahead of time in order to keep the same level of US dollars. Or if float is predicted to decrease because of unseasonably good weather, the manager of the trading desk at the Federal Reserve Bank of New York will likely conduct a defensive open market sale of securities. Defensive open market operations are typically conducted through the buying and selling of government securities in response to an anticipated event or in response to one. Government securities include treasury bonds, notes, and bills. The Fed buys securities when it wants to increase the flow of money, and sells securities when it wants to reduce the flow. 2) Explain two ways by which the Federal Reserve System can increase the monetary base. Why is the effect of Federal Reserve actions on bank reserves less exact than the effect on the monetary base? One way The Federal Reserve System can increase the monetary base is open market purchases. Another way is when the Federal Reserve System extends a discount loan to a bank. The effect of Federal Reserve actions on bank reserves is less exact than the effect on the monetary base because if the person selling the security chooses to keep the proceeds in currency, bank reserves do not increase. Since the Fed can't control the distribution of the monetary base between reserves and currency, it has less control over reserves than the MB. 3) Make the case for and against an independent Federal Reserve. For independent Federal Reserve: - Subjecting the Fed to more political pressures would impart an inflationary bias to monetary policy.

- A politically insulated Fed would be more concerned with long-run objectives and thus be a defender of a sound dollar and a stable price level..
- A Federal Reserve under the control of Congress or the president might make the so-called political business cycle more pronounced. Against Independent Federal Reserve: * The megabanks that run the U. S. banking system use the Federal Reserve as a tool to make money. One of the ways they do this is called the U. S. Treasury carry trade. The Federal Reserve lends huge amounts of money to the big banks for next to nothing, and then these megabanks use all that cash to buy U. S. government debt. * The Federal Reserve manipulates the U. S. economy by setting national interest rates. By keeping rates high or low, the Federal Reserve has the power to create economic growth or to destroy it. They have so much power. * The Federal Reserve also controls the national money supply single handedly. They can pump trillions into the economy or pull trillions out without being accountable to anyone. 4) Explain the Fed's three tools of monetary policy and how each is used to change the money supply. Does each tool affect the monetary base or the money multiplier? The Fed’s three tools of monetary policy are discount policy, open market operations and reserve requirements. The discount policy changes the money supply because it is used to control the price and the amount of discount loans to banks. The discount policy affects the monetary base. Open market operations are used to change the money supply by using the purchases and sales of government securities. Open market operations affects the monetary base. Reserve requirements changes the money supply by setting the percentage of deposits that banks must hold on to in their reserve. Reserve requirements affects the money multiplier.