Chapter 10 The Money Supply and the Federal Reserve System

10.1 An Overview of Money

1) Money is
A) the same as income.
B) anything that is generally accepted as a medium of exchange.
C) the value of all coins and currency in circulation at any time.
D) backed by gold in Fort Knox.
Answer: B

2) Any transaction that involves exchanging one good for another without using money is considered a
A) liquidity transaction. B) barter transaction.
C) deferred payment. D) black market exchange.
Answer: B

3) Jacob makes excellent tamales and Amanda is very good at mowing lawns. Amanda agrees to mow Jacob′s lawn, if he makes her a dozen tamales. This is an example of
A) legal tender. B) barter.
C) commodity money. D) fiat money.
Answer: B

4) Which of the following factors causes the barter system to be inefficient?
A) Its cost of transaction is too low.
B) The cost associated with information search is too low.
C) It requires a double coincidence of wants.
D) It requires high liquidity.
Answer: C

5) Josie wants to trade swimming lessons for cooking lessons. Maria wants to trade cooking lessons for swimming lessons. Josie and Maria have
A) the basis for a liquidity exchange. B) a double incidence of demand.
C) the basis for a double fiat exchange. D) a double coincidence of wants.
Answer: D

6) The development of money as a medium of exchange has facilitated the expansion of trade because
A) holding money increases people′s wealth.
B) holding money increases people′s income.
C) money eliminates the ″double coincidence of wants″ problem.
D) no other mediums of exchange are available.
Answer: C

7) When money is used as a medium of exchange
A) the need for a barter system diminishes.
B) the cost of transactions increases.
C) the need for a banking system in the economy decreases.
D) it reduces the number of transactions in the economy.
Answer: A

8) Betty won $500 in a poker tournament. She deposits her $500 winnings into a money market fund so that she can use the money next year to help her pay for a trip to Las Vegas. This is an example of money serving as a(n)
A) unit of account. B) medium of exchange.
C) store of value. D) investment good.
Answer: C

9) When you pay $8 for salad you ordered for lunch, you are using money as a(n)
A) store of value. B) investment good.
C) medium of exchange. D) unit of account.
Answer: C

10) Veronica received a federal income tax rebate check of $600 in May 2008. Veronica put this money in a saving account so that she could spend it when she went on vacation in July 2008. This is an example of money serving as a(n)
A) store of value. B) medium of exchange.
C) unit of account. D) investment good.
Answer: A

11) When you keep your savings in a saving account, you are using money as a(n)
A) investment good. B) store of value.
C) medium of exchange. D) unit of account.
Answer: B

12) The main disadvantage of using money as a store of value is that
A) money is not portable.
B) it requires a double coincidence of wants.
C) currency is intrinsically worthless.
D) the value of money actually falls when the prices of goods and services rise.
Answer: D

13) The liquidity property of money is the property that makes money
A) a good medium of exchange and a good unit of account.
B) a good store of value and a good unit of account.
C) a good medium of exchange and a good store of value.
D) a good store of value and a good standard of deferred payment.
Answer: C

14) When the manager of a department store attaches price tags to his/her products, he/she is using money as a
A) medium of exchange. B) store of value.
C) unit of transfer. D) unit of account.
Answer: D

15) Circuit City, a retailer of electronics, has 2,000 different products in inventory. Circuit City reports its inventory is worth $12 million. This is an example of using money as a
A) medium of exchange. B) unit of account.
C) standard of deferred payment. D) store of value.
Answer: B

16) Denny's lists the price of a Grand Slam Breakfast at $4.99 a plate. Listing the price on the menu is an example of money serving as a(n)
A) store of value. B) unit of account.
C) medium of exchange. D) investment good.
Answer: B

17) When Mexico experiences a period of high inflation and Mexicans lose confidence in their peso as a store of value, which of the following would be most likely to occur?
A) The demand for pesos would increase.
B) The buying power of the peso would increase.
C) The value of foreign currencies would depreciate relative to the peso.
D) Mexicans would use a different currency as a medium of exchange.
Answer: D

18) A currency that is not backed by gold, silver, or any other precious commodity equal to the face value of the money is known as
A) fake money. B) weak money.
C) token money. D) commodity money.
Answer: C

19) After World War II, cigarettes were used as money in Germany. This is an example of
A) fiat money. B) legal money.
C) token money. D) commodity money.
Answer: D

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20) The U.S. dollar is an example of fiat money because
A) it is the strongest currency in the world.
B) it is the most widely used currency in international trade.
C) it is backed by a large reserve of gold and silver.
D) by law, it is decreed as money.
Answer: D

21) Which of the following is an example of fiat money?
A) cigarettes B) an ounce of gold
C) a U.S. one-hundred dollar bill D) a government bond
Answer: C

22) Money that a government has required to be accepted in settlement of debts is
A) fiat money. B) commodity money.
C) barter money. D) legal tender.
Answer: D

23) To ensure that paper money will be accepted, the U.S. government implicitly promises the public that
A) it will not print money so fast that it loses its value.
B) it will not change the rate at which the dollar is exchanged for other currencies.
C) it will always remain the strongest currency of all industrialized nations.
D) the U.S. monetary system will always be backed by a precious metal.
Answer: A

24) Currency debasement occurs when
A) the value of money falls as a result of a rapid increase in its supply.
B) the government requires that a certain form of money must be accepted in settlement of debts.
C) items are designated as money that are intrinsically worthless.
D) items are used as money that also have intrinsic value in some other use.
Answer: A

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25) Assume that in the country of Salmon, the government tripled the money supply overnight. As a result of this action, the price of a loaf of bread increased from 1 bill to 100 bills. This is an example of
A) a change in the legal tender.
B) a change from commodity money to fiat money.
C) currency debasement.
D) deflation.
Answer: C

26) Currency held outside banks + demand deposits + travelers checks + other checkable deposits =
A) $M3$. B) $M2 - M1$. C) $M3 - M1$. D) $M1$.
Answer: D

27) Transaction money is
A) $M1$. B) $M2$. C) $M3$. D) $M4$.
Answer: A

28) Traveler′s checks are
A) not money. B) included in $M1$ and $M2$.
C) not included in $M2$. D) not included in $M1$.
Answer: B

29) Which of the following is included in $M2$, but not included in $M1$?
A) currency held outside banks B) travelers checks
C) demand deposits D) savings accounts
Answer: D

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30) Jaime transfers $2,500 from his checking account to his savings account. This transaction will
A) decrease both $M1$ and $M2$. B) not change $M1$ and decrease $M2$.
C) decrease $M1$ and not change $M2$. D) increase both $M1$ and $M2$.
Answer: C

31) Ruby transfers $700 from her saving account to her checking account. This transaction will
A) increase $M1$ and not change $M2$. B) not change $M1$ and decrease $M2$.
C) increase both $M1$ and $M2$. D) decrease both $M1$ and $M2$.
Answer: A

32) Teddy transfers $175 from his money market fund to his checking account. This transaction will
A) decrease $M2$ and increase $M1$. B) increase $M1$, but leave $M2$ unchanged.
C) decrease $M1$ and increase $M2$. D) decrease both $M1$ and $M2$.
Answer: B

33) Which of the following would NOT be counted as part of $M1$?
A) demand deposits B) traveler's check
C) money market accounts D) currency
Answer: C

34) Saving account balances are included in
A) $M1$. B) $M2$.
C) neither $M1$ nor $M2$. D) both $M1$ and $M2$.
Answer: B

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35) Which of the following would NOT be included in $M2$?
A) demand deposits B) money market accounts
C) checking accounts D) Treasury bonds
Answer: D

36) Included in $M2$ are
A) bank loans. B) credit cards.
C) bank capital. D) demand deposits.
Answer: D

37) Which of the following would NOT be included in $M1$?
A) demand deposits B) money market accounts
C) checking accounts D) traveler's checks
Answer: B

38) Currency held outside banks is included in
A) both $M1$ and $M2$. B) $M2$ only.
C) $M1$ only. D) neither $M1$ nor $M2$.
Answer: A

39) Close substitutes for transactions money are known as
A) fiat monies. B) near monies.
C) commodity monies. D) token monies.
Answer: B

40) Which of the following is the best example of a near money?
A) a valuable painting B) a dollar bill
C) a Treasury bond D) a money market account
Answer: D
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41) An equation for $M1$ is
A) $M2$ + Savings Accounts - Currency Held Outside Banks + Other Near Monies.
B) $M2$ - Savings Accounts - Money Market Accounts - Other Near Monies.
C) Money Market Accounts + Automatic-transfer Savings Accounts.
D) $M2$ + Near Monies.
Answer: B
42) The main advantage of using $M2$ instead of $M1$ as the measure for money is that
A) $M2$ can be measured more accurately.
B) $M2$ includes only instantly accessible assets.
C) $M2$ is sometimes more stable.
D) $M2$ varies as the interest rate varies.
Answer: C

43) Commercial banks
A) implement monetary policy.
B) are nonprofit organizations that lend and borrow funds.
C) are financial intermediaries that lend funds and accept deposits.
D) hold reserves against bank capital.
Answer: C

44) Among the assets of a commercial bank are
A) loans. B) demand deposits.
C) savings deposits. D) time deposits.
Answer: A

45) Among the liabilities of commercial banks are
A) loans. B) demand deposits.
C) reserves. D) government securities.
Answer: B

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46) Net worth is
A) assets - liabilities. B) assets + capital.
C) assets - capital. D) assets + liabilities.
Answer: A

47) Related to the *Economics in Practice* on p. 183 [495]: In the Solomon Islands, dolphin teeth are used as currency. In this instance, dolphin teeth would be considered

A) fiat money. B) token money.
C) commodity money. D) legal tender.
Answer: C

48) Related to the *Economics in Practice* on p. 183 [495]: In the Solomon Islands, dolphin teeth are used as currency. Using dolphin teeth to make a purchase would be using the teeth as a(n)
A) medium of exchange. B) store of value.
C) unit of account. D) legal tender.
Answer: A

2 True/False
1) When you use money to fill your car with gas every week, you are using money as a unit of account.
Answer: FALSE

2) Money is anything that generally is accepted as a medium of exchange.
Answer: TRUE

3) In an economy that uses fiat money, there is no need for double coincidence of wants.
Answer: TRUE

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4) When you take $100 from your saving account and deposit it in your checking account, *M*2 decreases.
Answer: FALSE

5) If all banks are loaned up and so will not make further loans, a $1,000 deposit creates $1,000 in new money.
Answer: FALSE

6) Fiat money is money the government says is money.
Answer: TRUE

7) The M1 definition of money includes money market accounts.
Answer: FALSE

8) The M2 definition of money includes demand deposits.
Answer: TRUE

10.2 How Banks Create Money
1) Napoli National Bank has liabilities of $3 million and net worth of $200,000. Napoli National Bank′s assets are
A) $200,000. B) $3 million C) $3.2 million. D) $2.8 million.
Answer: C

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2) Saturn County Savings and Loan has liabilities of $400,000 and net worth of $125,000. Saturn County Savings and Loan′s assets are
A) $525,000. B) $275,000. C) $400,000. D) $125,000.
Answer: A

3) Thompson National Trust has assets of $500,000 and liabilities of $400,000. Thompson National Trust′s net worth is
A) $900,000. B) $400,000. C) $100,000. D) $500,000.

Answer: C

4) A commercial bank lists
A) loans as liabilities. B) deposits as liabilities.
C) required reserves as liabilities. D) excess reserves as liabilities.
Answer: B

5) Things that a firm owns that are worth something are classified as
A) liabilities. B) assets. C) deposits. D) net worth.
Answer: B

6) Which of the following is considered a liability to a bank?
A) time deposits B) reserves
C) the bank′s loans D) the bank′s buildings and equipment
Answer: A

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7) The central bank of the United States is known as the
A) Federal Reserve System.
B) Federal Deposit Insurance Corporation.
C) Department of the Treasury.
D) Federal Savings and Loan Insurance Corporation.
Answer: A

8) A loan made by a bank is considered ________ of that bank.
A) a liability B) capital C) net worth D) an asset
Answer: D

9) A checking deposit in a bank is considered ________ of that bank.
A) an asset B) a liability C) net worth D) capital
Answer: B

Refer to the information provided in Table 10.1 below to answer the questions that follow.
Table 10.1

Table 10.1

First Charter Bank

Assets		Liabilities	
Reserves	—	$800	Deposits
Loans	—	$400	Net Worth
Total	—	$1,200	Total

10) Refer to Table 10.1. The required reserve ratio is 25%. If the First Charter Bank is meeting its reserve requirement and has no excess reserves, its reserves equal
A) $100. B) $200. C) $600. D) $300.
Answer: B

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11) Refer to Table 10.1. The required reserve ratio is 25%. If the First Charter Bank is meeting its reserve requirement and has no excess reserves, its loans equal

A) $900. B) $1,000. C) $600. D) $1,800.
Answer: B

12) Refer to Table 10.1. First Charter Bank's total assets are
A) $1,200. B) $400. C) $800. D) $2,400
Answer: A

Refer to the information provided in Table 10.2 below to answer the questions that follow.
Table 10.2

Table 10.2

First Commercial Bank

Assets		**Liabilities + Net Worth**	
Reserves:	$800,000	$2 million	Deposits
Required	$200,000	$500,000	Net Worth
Excess	—		
Loans	—		
Total	$2.5 million	$2.5 million	Total

13) Refer to Table 10.2. First Commercial Bank′s excess reserves equal $________.
A) 600,000 B) 1,000,000 C) 200,000 D) 1,500,000
Answer: A

14) Refer to Table 10.2. The required reserve ratio
A) is 5%.
B) is 10%.
C) is 20%.
D) cannot be determined from the given information.
Answer: B

15) Refer to Table 10.2. First Commercial Bank′s total loans equal $________.
A) 1,000,000 B) 5,000,000 C) 2,500,000 D) 1,700,000.
Answer: D

Refer to the information provided in Table 10.3 below to answer the questions that follow.
Table 10.3

Table 10.3

People's Bank

Assets		Liabilities + Net Worth	
Reserves:	$300,000	$500,000	Deposits
Required	$100,000	—	Net Worth
Excess	—		
Loans	—		
Total	$800,000	$800,000	Total

16) Refer to Table 10.3. The net worth of People′s Bank is $________.
A) 1,000,000 B) 200,000 C) 800,000 D) 300,000
Answer: D

17) Refer to Table 10.3. The required reserve ratio is
A) 25%. B) 20%. C) 50%. D) 10%.
Answer: B

18) Refer to Table 10.3. People′s Bank excess reserves are $________.
A) 200,000 B) 100,000 C) 300,000 D) 400,000
Answer: A

19) Refer to Table 10.3. Total loans of People′s Bank equal $________.
A) 100,000 B) 400,000 C) 500,000 D) 800,000
Answer: C

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20) Crescent City Bank has $200 million in deposits. Crescent City Bank is meeting its reserve requirement and has no excess reserves. It has $40 million in reserves. Crescent City Bank faces a required reserve ratio of
A) 5%. B) 4%. C) 20%. D) 25%.
Answer: C

21) Narnia National Bank has $750 million in deposits. The required reserve ratio is 30%. Narnia National Bank must keep ________ in reserves.
A) $125 million B) $150 million C) $225 million D) $250 million
Answer: C

22) Neon Bank has $300 million in deposits. The required reserve ratio is 25%. Neon Bank must keep ________ in reserves.
A) $275 million B) $145 million C) $75 million D) $120 million
Answer: C

23) The Intracoastal Bank has $5 million in deposits and $500,000 in reserves. If the required reserve ratio is 5%, excess reserves are equal to
A) $125,000. B) $500,000. C) zero. D) $250,000.
Answer: D

24) The Bank of Arugula has $9 million in deposits and $900,000 in reserves. If the required reserve ratio is 10%, excess reserves are equal to
A) $90,000. B) $180,000. C) $81,000. D) zero.
Answer: D

25) The Bank of Red Oak has $2 million in deposits and $400,000 in reserves. If excess reserves are equal to $100,000, the required reserve ratio is
A) 15%. B) 10%. C) 20%. D) 5%.
Answer: A

Refer to the information provided in Table 10.4 below to answer the questions that follow .
Table 10.4

Table 10.4

First Charter Bank

Assets		Liabilities	
Reserves	$1.2 million	$8 million	Deposits
Loans	$6.8 million		
Total	$8 million	$8 million	Total

26) Refer to Table 10.4. If the required reserve ratio is 15%, First Charter Bank
A) is loaned up.
B) has too few reserves on hand.
C) is meeting its required reserve ratio and has $200,000 in excess reserves.
D) has excess reserves of $100,000.
Answer: A

27) Refer to Table 10.4. First Charter Bank could make additional, first round loans of $400,000 if the required reserve ratio were
A) 10%. B) 8%. C) 7.5%. D) 12%.
Answer: A

28) Refer to Table 10.4. If the required reserve ratio were changed to 5% and First Charter Bank continues to hold $1,200,000 in reserves, its excess reserves will be
A) $600,000. B) $1,000,000. C) $800,000. D) $400,000.
Answer: C

29) Dollar Bank is currently loaned up. If the required reserve ratio is lowered,
A) Dollar Bank's net worth will increase.
B) Dollar Bank will have excess reserves that it can lend out.
C) Dollar Bank will still be loaned up because it did not receive any additional deposits.
D) Dollar Bank's actual reserves will increase, but it will still be loaned up.
Answer: B

30) When a bank has no excess reserves, and thus can make no more loans, it is said to be
A) bankrupt.
B) ripe for a takeover.
C) in receivership.
D)loaned up.
Answer: D

31) Commercial banks create money through
A) printing treasury notes.
B) making loans.
C) facilitating borrowing from the Federal Reserve to the public.
D) reducing risk in the economy.
Answer: B

32) The multiple by which total deposits can increase for every dollar increase in reserves is the
A) required reserve ratio.
B) bank′s line of credit.
C) deposit insurance limit.
D) money multiplier.
Answer: D

33) Suppose the required reserve ratio is 20%. A $40 million cash deposit will, at most, allow an expansion of the money supply to
A) $20 million.
B) $80 million.
C) $200 million.
D) $800 million.
Answer: C

34) Suppose the required reserve ratio is 15%. A $10 million deposit will, at most, allow an expansion of the money supply to
A) $147.5 million.
B) $250 million.
C) $150 million.
D) $66.7 million.
Answer: D
35) The required reserve ratio is 5%. The money multiplier is
A) 0.5.
B) 5.
C) 15.
D) 20.
Answer: D

36) The required reserve ratio is 50%. The money multiplier is
A) 2.5.
B) 10.
C) 5.
D) 2.
Answer: D

37) If the money multiplier is 8, the required reserve ratio is
A) 8%.
B) 16%.
C) 12.5%.
D) 20%.
Answer: C

38) Assume that banks become more conservative in their lending policies and start holding someexcess reserves. Compared to a situation in which banks are not holding excess reserves, thesize of the money supply will be
A) zero.
B) larger.
C) the same.
D) smaller.
Answer: D

39) As commercial banks keep more excess reserves, money creation
A) increases.
B) decreases.
C) remains the same.
D) could either increase or decrease.
Answer: B

Refer to the information provided in Scenario 10.1 below to answer the questions that follow .
SCENARIO 10.1: The following table shows the changes in deposits, reserves, and loans of 4 banks as a result of a $100,000 initial deposit in Bank No. 1. Assume all banks are loaned up.

	New Deposit	Required Reserve	Loans
Bank No. 1	$100,000.00	$5,000.00	$95,000.00
Bank No. 2	$95,000.00	$4,750.00	$90,250.00
Bank No. 3	$90,250.00	$4,512.50	$85,737.00
Bank No. 4	$85, 737.50	$4,286.90	$81,450.63

40) Refer to Scenario 10.1. What is the required reserve ratio?
A) 4%
B) 5%
C) 8%
D) 10%
Answer: B

41) Refer to Scenario 10.1. What is the money multiplier in this economy?
A) 20
B) 10
C) 50
D) 16.67
Answer: A

42) Refer to Scenario 10.1. Based on the initial $100,000 deposit, the money supply will, at most,expand to
A) $1 million.
B) $2 million.
C) $50 million.
D) $16.67 million.
Answer: B

43) Refer to Scenario 10.1. If the required reserve ratio were changed to 10%, total loans of BankNo. 2 will change to
A) 81,000.
B) 90,000.
C) 85,000.
D) 77,440.
Answer: A

2 True/False
1) Only the required reserve ratio determines how much money the Federal Reserve can create.
Answer: FALSE

2) Excess reserves in a bank are the difference between required reserves and the bank′s total net worth.
Answer: FALSE

3) Among the assets of commercial banks are demand deposits.

Answer: FALSE

4) The amount of money banks can loan out is determined by the discount rate.

Answer: FALSE

5) Among the liabilities of commercial banks are deposits.
Answer: TRUE

6) Since they must lend money to make money, all banks are necessarily insolvent.
Answer: FALSE

10.3 The Federal Reserve System
1) The Federal Reserve System consists of ________ Federal Reserve Banks.
A) 8
B) 10
C) 12
D) 14
Answer: C

Topic: The Federal Reserve System

2) Which of the following activities is one of the responsibilities of the Federal Reserve?
A) issuing new bonds to finance the federal budget deficit
B) loaning money to other countries that are friendly to the United States
C) assisting banks that are in a difficult financial position
D) auditing the various agencies and departments of the federal government
Answer: C

Topic: The Federal Reserve System

3) Among the members of the Federal Open Market Committee
A) is the Secretary of the Treasury.
B) is the Comptroller of the Currency.
C) are the seven members of the Board of Governors of the Fed.
D) is the Chair of the Senate Banking Committee.
Answer: C

Topic: The Federal Reserve System

4) The Board of governors of the Fed
A) are appointed by the House of Representatives.
B) has 12 members.
C) have a 7-year term.
D) is headquartered in Washington, D.C.
Answer: D

Topic: The Federal Reserve System

5) The Fed
A) issues deposits to the public.
B) lends money to foreign governments.
C) clears inter-bank payments.
D) lends money to the public.
Answer: C

Topic: The Federal Reserve System

2 True/False
1) The President of the NY Federal Reserve Bank is always a member of the Federal Open Market committee.
Answer: TRUE

Topic: The Federal Reserve System

2) The Chair of the Fed also serves as one of the Reserve Bank Presidents.
Answer: FALSE

Topic: The Federal Reserve System

3) The Fed acts as a lender of last resort for the banking system.
Answer: TRUE

Topic: The Federal Reserve System

4) The members of the Board of Governors of the Fed make up a majority of the Federal Open Market Committee.
Answer: TRUE

Topic: The Federal Reserve System

5) The Fed is a division of the Department of the Treasury.
Answer: FALSE

Topic: The Federal Reserve System

10.4 How the Federal Reserve Controls the Money Supply

1 Multiple Choice

1) Which of the following instruments is NOT used by the Federal Reserve to change the money supply?
A) the discount rate
B) the required reserve ratio
C) the federal tax code
D) open market operations
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

2) The Federal Open Market Committee (FOMC) directs the Open Market Desk to
A) determine the required reserve ratio.
B) determine the discount rate.
C) buy or sell government securities.
D) determine the federal funds rate.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

3) Which of the following is NOT a tool available to the Fed to change the supply of money?
A) open market operations
B) the required reserve ratio
C) the money multiplier
D) the discount rate
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

4) The discount rate is
A) the interest rate commercial banks charge each other for borrowing funds.
B) the interest rate commercial banks charge their new customers.
C) the interest rate the Fed charges commercial banks for borrowing funds.
D) the interest rate commercial banks charge their most creditworthy customers.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

5) A decrease in the required reserve ratio
A) will increase the money supply.
B) will decrease the money supply.
C) will not change the money supply.
D) will decrease the discount rate.
Answer: A

Topic: How the Federal Reserve Controls the Money Supply

6) Assume that all commercial banks are loaned up. Total deposits in the banking system are $200 million. The required reserve ratio is increased. The money supply will
A) decrease.
B) increase.
C) not change because there was no change in deposits.
D) not change because the required reserve ratio has no impact on money supply.
Answer: A

Topic: How the Federal Reserve Controls the Money Supply

7) The Fed has tended not to use changes in the reserve requirement as a means of controlling the money supply because
A) only banks that are members of the Fed are subject to reserve requirements, and most banks do not belong to the Fed.
B) a change in the reserve requirement has only a very small impact on the money supply.
C) it is a crude monetary policy tool because a change in the requirement does not affect banks until about two weeks after the change is implemented.
D) it takes a long time for the Congress to approve a change in the reserve requirement.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

8) The interest rate banks pay to borrow money from the Fed is the
A) federal funds rate.
B) discount rate.
C) prime lending rate.
D) reserve rate.
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

9) Which of the following represents an action by the Federal Reserve that is designed to increase the money supply?
A) a decrease in the required reserve ratio
B) an increase in the discount rate
C) a decrease in federal tax rates
D) selling government securities in the open market
Answer: A

Topic: How the Federal Reserve Controls the Money Supply

10) Which of the following represents an action by the Federal Reserve that is designed to increase the money supply?
A) buying government securities in the open market
B) an increase in the required reserve ratio
C) a decrease in federal spending
D) an increase in the discount rate
Answer: A

Topic: How the Federal Reserve Controls the Money Supply

11) Of the tools available to the Fed to regulate the money supply, which is the least used?
A) the federal funds rate
B) the reserve ratio
C) tax cutting
D) the open-market operations
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

12) If the Fed sells government securities, then there is
A) an increase in the supply of money.
B) a decrease in the supply of money.
C) a decrease in the discount rate.
D) an increase in the required reserve ratio.
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

13) Which of the following represents an action by the Federal Reserve that is designed to decrease the money supply?
A) a decrease in the discount rate
B) a decrease in federal spending
C) selling government securities in the open market
D) a decrease in the required reserve ratio
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

14) When the Fed raises the required reserve ratio, the banks′ excess reserves will initially ________ and the money supply ________.
A) remains constant; decreases
B) decrease; decreases
C) increase; remain constant
D) increase; increases
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

15) The best instrument for controlling week-to-week changes in the money supply is
A) the required reserve ratio.
B) moral suasion.
C) open-market operations.
D) the discount rate.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

16) Which of the following statements is FALSE?
A) Open-market operations can be used by the Federal Reserve with some precision.
B) Open-market operations are extremely flexible.
C) The Federal Reserve undertakes open-market operations on an infrequent basis.
D) Open-market operations have a fairly predictable effect on the supply of money.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

17) An open-market purchase of securities by the Fed results in ________ in reserves and ________ in the supply of money.
A) an increase; a decrease
B) a decrease; a decrease
C) an increase; an increase
D) a decrease; an increase
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

18) An open-market sale of securities by the Fed results in ________ in reserves and ________ in the supply of money.
A) an increase; a decrease
B) an increase; an increase
C) a decrease; an increase
D) a decrease; a decrease
Answer: D

Topic: How the Federal Reserve Controls the Money Supply

19) Assume there is no leakage from the banking system and that all commercial banks are loaned up. The required reserve ratio is 16%. If the Fed sells $5 million worth of government securities to the public, the change in the money supply will be

A) -$16 million.
B) -$31.25 million.

C) -$21 million.
D) -$11.75 million.
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

20) Assume there is no leakage from the banking system and that all commercial banks are loaned up. The required reserve ratio is 10%. If the Fed buys $10 million worth of government securities from the public, the change in the money supply will be
A) $1 million.
B) $110 million.
C) $100 million.
D) $10 million.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

21) The money supply has increased from $1.4 trillion to $1.45 trillion. Which of the following could have caused this increase?
A) The Fed sold government securities to the public.
B) Consumers who were holding money outside the banking system deposit this money.
C) The Fed increased the discount rate.
D) Commercial banks began to hold excess reserves.
Answer: B

Topic: How the Federal Reserve Controls the Money Supply

22) If the Fed sets the money supply independent of the interest rate, then the money supply curveis
A) upward sloping.
B) downward sloping.
C) vertical.
D) horizontal.
Answer: C

Topic: How the Federal Reserve Controls the Money Supply

2 True/False
1) A decrease in the required reserve ratio increases the money supply.
Answer: TRUE

Topic: How the Federal Reserve Controls the Money Supply

2) A sale of government securities to the public by the Federal Reserve will increase the money supply.
Answer: FALSE

Topic: How the Federal Reserve Controls the Money Supply

3) The discount rate cannot be used to control the money supply with great precision because its effects on banks′ demand for reserves are uncertain.
Answer: TRUE

Topic: How the Federal Reserve Controls the Money Supply

4) The tool most frequently used by the Fed to change the money supply is changing the required reserve ratio.
Answer: FALSE

Topic: How the Federal Reserve Controls the Money Supply

5) If the Fed buys securities on the open market, it will increase the money supply.
Answer: TRUE

Topic: How the Federal Reserve Controls the Money Supply