

Quiz 1: Money supply process and Tools of monetary policy

EE432: Monetary theory and policy

Semester 1/2018

Instruction: Choose the best answer.

1) High-powered money minus reserves equals

- A) reserves.
- B) currency in circulation.
- C) the monetary base.
- D) the nonborrowed base.

→ high-powered money is another name of monetary base.

2) When a primary dealer buys a government bond from the Federal Reserve, reserves in the banking system _____ and the monetary base _____, everything else held constant.

- A) increase; increases
- B) increase; decreases
- C) decrease; increases
- D) decrease; decreases

3) The Fed does not tightly control the monetary base because it does NOT completely control

- A) open market purchases.
- B) open market sales.
- C) borrowed reserves.
- D) the discount rate.

3/c; you can't force ppl to borrow from Fed in the discount window.

4) In the simple model of multiple deposit creation in which banks do not hold excess reserves, the increase in checkable deposits equals the product of the change in reserves and the

- A) reciprocal of the excess reserve ratio.
- B) simple deposit expansion multiplier.
- C) reciprocal of the simple deposit multiplier.
- D) discount rate.

→ simple deposit expansion multiplier = $\frac{1}{r}$

5) The money supply is _____ related to the nonborrowed monetary base, and _____ related to the level of borrowed reserves.

- A) positively; negatively
- B) negatively; not
- C) positively; positively
- D) negatively; negatively

b/c.

A	L
FR ↑	R ↓ C

 } one of them must increase → MB ↑

6) A central bank's purchase of gold, SDRs, a deposit denominated in a foreign currency or any other asset is just an open market _____ of these assets, _____ the monetary base.

- A) purchase; raising
 B) sale; raising
 C) purchase; lowering
 D) sale; lowering

7) Assuming initially that the required reserve ratio = 10%, the currency-deposit ratio = 40%, and the excess reserve ratio = 0, an increase in the required reserve ratio to 15% causes the M1 money multiplier to _____, everything else held constant.

- A) increase from 2.55 to 2.8
 B) decrease from 2.8 to 2.55
 C) increase from 1.82 to 2
 D) decrease from 2 to 1.82

$$m = \frac{1 + 0.4}{0.1 + 0.4} = \frac{1.4}{0.5} = 2.8$$

8) The increase in the availability of ATMs has caused the cost of acquiring currency to _____ which will cause the currency ratio to _____, everything else held constant.

- A) increase; increase
 B) increase; decrease
 C) decrease; increase
 D) decrease; decrease

$$\frac{C}{D} \downarrow \rightarrow m \uparrow$$

9) The monetary liabilities of most central banks include

- A) securities and loans to financial institutions.
 B) currency in circulation and reserves. *just definition.*
 C) securities and reserves.
 D) currency in circulation and loans to financial institutions.

10) In the market for reserves, if the federal funds rate is above the interest rate paid on excess reserves, then an open market _____ the supply of reserves, raising the federal funds interest rate, everything else held constant.

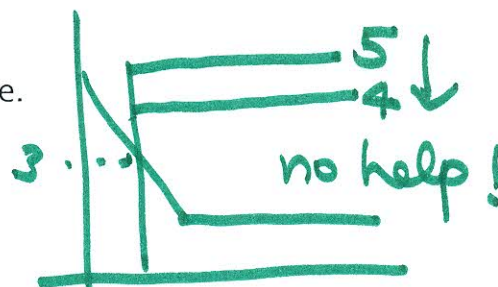
- A) sale decreases
 B) sale increases
 C) purchase increases
 D) purchase decreases

to raise Fedfund, need to lower reserve →

11) Everything else held constant, in the market for reserves, when the federal funds rate is 3%, lowering the discount rate from 5% to 4%

- A) lowers the federal funds rate.
 B) raises the federal funds rate.
 C) has no effect on the federal funds rate.
 D) has an indeterminate effect on the federal funds rate.

OMO sale.



12) _____ are the most important monetary policy tool because they are the primary determinant of changes in the _____, the main source of fluctuations in the money supply.

- A) Open market operations; monetary base
- B) Open market operations; money multiplier
- C) Changes in reserve requirements; monetary base
- D) Changes in reserve requirements; money multiplier

13) Open market purchases raise the _____ thereby raising the _____.

- A) money multiplier; money supply
- B) money multiplier; monetary base
- C) monetary base; money supply
- D) monetary base; money multiplier

→ money multiplier does not change.

14) Open market sales _____ reserves and the monetary base thereby _____ the money supply.

- A) raise; lowering
- B) raise; raising
- C) lower; lowering
- D) lower; raising

15) From before the financial crisis began in September of 2007 to when the crisis was over at the end of 2009, amount of Federal Reserve assets rose, leading to

- A) a huge increase in the monetary base.
- B) a huge expansion of the money supply.
- C) an economic expansion.
- D) a high inflation.

→ A is the best answer.

→ M^s rises but not

a huge expansion as hoped for.

16) The Fed's open market operations normally involve only the purchase of government securities, particularly those that are short-term. However, during the crisis, the Fed started new programs to purchase _____

- A) mortgage-backed securities and long-term Treasuries.
- B) mortgage-backed securities and Treasury bills.
- C) commercial papers and short-term Treasuries.
- D) Treasury bills and Treasury notes.

QE₁ / QE₃ Buy MBS

QE₂ buy long-term Bond.

17) To lower interest rates on residential mortgages to stimulate the housing market, the Fed extended its open market operations to purchase

- A) mortgage-backed securities.
- B) commercial papers.
- C) long-term Treasuries.
- D) Treasury bills and Treasury notes.

Directly
Increase demand for MBS
pushing MBS rate down.

18) Which of the following statements is an example of the Fed's conditional commitment policy?

- A) "In these circumstances, the Committee believes that policy accommodation can be maintained for a considerable period."
- B) "The Committee anticipates that weak economic conditions are likely to warrant exceptionally low levels of the federal funds rate for some time."
- C) "Policy accommodation can be removed at a pace that is likely to be measured."

- D) "The exceptionally low range for the federal funds rate will be appropriate at least as long as the unemployment rate remains above 6-1/2 percent, and inflation between one and two years ahead is projected to be no more than a half percentage point above the Committee's 2 percent longer-run goal."

↳ Condition on "unemployment" rate might be adjusted

19) The primary indicator of the BOT's stance on monetary policy is

- A) the discount rate.
- B) the federal funds rate.
- C) the BIBOR.
- D) the 1-day RP rate.

when the
condition has
been met.

20) The equivalent to the Federal Reserve's discount rate in the European System of Central Banks, the BOE and the BOT is the

- A) federal funds rate.
- B) marginal lending rate.
- C) deposit facility rate.
- D) lombard rate.

but, nothing
will get to change
the rate before
we see the
unemployment
down.