FUN Set 4.2

Name: ________________________

54. Suppose that all banks keep only the minimum reserves required by law and that there are no currency drains. The legal reserve requirement is 10 percent. If Maggie deposits the $100 bill she received as a graduation gift from her grandmother into her checking account, the maximum increase in the total money supply will be

(A) $10
(B) $100
(C) $900
(D) $1,000
(E) $1,100

39. When an economy is operating below the full-employment level of output, an appropriate monetary policy would be to increase which of the following?

(A) The discount rate
(B) The required reserve ratio
(C) The international value of the dollar
(D) Open market purchases of government bonds
(E) Government expenditure on goods and services

18. Which of the following sequences of events would occur if the Federal Reserve implemented contractionary monetary policy?

(A) Interest rates increase, investment and consumption spending decrease, aggregate demand decreases, and output and prices decrease.
(B) Interest rates increase, investment and consumption spending decrease, aggregate demand increases, and output and prices decrease.
(C) Interest rates increase, investment and consumption spending increase, aggregate demand decreases, and output and prices decrease.
(D) Interest rates decrease, investment and consumption spending decrease, aggregate demand decreases, and output and prices decrease.
(E) Interest rates decrease, investment and consumption spending decrease, aggregate demand decreases, and output and prices increase.

13. Which Federal Reserve action can shift the aggregate demand curve to the left?

(A) Lowering the federal funds rate
(B) Lowering income taxes
(C) Lowering reserve requirements
(D) Raising the discount rate
(E) Raising government spending on national defense

45. The Federal Reserve decreases the federal funds rate by

(A) decreasing the reserve requirement
(B) decreasing the discount rate
(C) increasing the discount rate
(D) selling government bonds on the open market
(E) buying government bonds on the open market

16. Which of the following will lead to a decrease in a nation's money supply?

(A) A decrease in income tax rates
(B) A decrease in the discount rate
(C) An open market purchase of government securities by the central bank
(D) An increase in reserve requirements
(E) An increase in government expenditures on goods and services

12. Which of the following is most likely to occur if the Federal Reserve engages in open market operations to reduce inflation?

(A) A decrease in interest rates
(B) A decrease in reserves in the banking system
(C) A decrease in the government deficit
(D) An increase in the money supply
(E) An increase in exports

23. In the short run, an expansionary monetary policy would most likely result in which of the following changes in the price level and real gross domestic product (GDP) ?

	Price Level	Real GDP
(A)	Decrease	Increase
(B)	No change	Decrease
(C)	Increase	No change
(D)	Increase	Decrease
(E)	Increase	Increase

46. Assume that the required reserve ratio is 10 percent, banks keep no excess reserves, and borrowers deposit all loans made by banks. Suppose you have saved $100 in cash at home and decide to deposit it in your checking account. As a result of your deposit, the money supply can increase by a maximum of

(A) $800
(B) $900
(C) $1,000
(D) $1,100
(E) $1,200

23. In the short run, an expansionary monetary policy would most likely result in which of the following changes in the price level and real gross domestic product (GDP) ?

	Price Level	Real GDP
(A)	Decrease	Increase
(B)	No change	Decrease
(C)	Increase	No change
(D)	Increase	Decrease
(E)	Increase	Increase

57. For which of the following sets of unemployment and inflation rates will a central bank be most reluctant to increase the rate of growth in the money supply?

	Unemployment Rate	Inflation Rate
(A)	10%	2%
(B)	10%	5%
(C)	10%	10%
(D)	5%	5%
(E)	5%	10%

If the reserve requirement is 25 percent and banks hold no excess reserves, an open market sale of $400,000 of government securities by the Federal Reserve will

(A) increase the money supply by up to $1.6 million
(B) decrease the money supply by up to $1.6 million
(C) increase the money supply by up to $300,000
(D) increase the money supply by up to $100,000
(E) decrease the money supply by up to $100,000

To counteract a recession, the Federal Reserve should

(A) raise the reserve requirement and the discount rate
(B) sell securities on the open market and raise the discount rate
(C) sell securities on the open market and lower the discount rate
(D) buy securities on the open market and raise the discount rate
(E) buy securities on the open market and lower the discount rate

The purchase of bonds by the Federal Reserve will have the greatest effect on real gross domestic product if which of the following situations exists in the economy?

(A) The required reserve ratio is high, and the interest rate has a large effect on investment spending.
(B) The required reserve ratio is high, and the interest rate has a small effect on investment spending.
(C) The required reserve ratio is low, and the interest rate has a large effect on investment spending.
(D) The required reserve ratio is low, and the marginal propensity to consume is low.
(E) The marginal propensity to consume is high, and the interest rate has a small effect on investment spending.

2009 Practice FRQ

1. Assume that the United States economy is in long-run equilibrium with an expected inflation rate of 6 percent and an unemployment rate of 5 percent. The nominal interest rate is 8 percent.

   (a) Using a correctly labeled graph with both the short-run and long-run Phillips curves and the relevant numbers from above, show the current long-run equilibrium as point A.

   (b) Calculate the real interest rate in the long-run equilibrium.

   (c) Assume now that the Federal Reserve decides to target an inflation rate of 3 percent. What open-market operation should the Federal Reserve undertake?

   (d) Using a correctly labeled graph of the money market, show how the Federal Reserve's action you identified in part (c) will affect the nominal interest rate.

   (e) How will the interest rate change you identified in part (d) affect aggregate demand in the short run? Explain.

   (f) Assume that the Federal Reserve action is successful. What will happen to each of the following as the economy approaches a new long-run equilibrium?

      (i) The short-run Phillips curve. Explain.

      (ii) The natural rate of unemployment

2009B Practice FRQ

In Country Z, the required reserve ratio is 10 percent. Assume that the central bank sells $50 million in government securities on the open market.

(a) Calculate each of the following.

   (i) The total change in reserves in the banking system

   (ii) The maximum possible change in the money supply

(b) Using a correctly labeled graph of the money market, show the impact of the central bank's bond sale on the nominal interest rate.

(c) What is the impact of the central bank's bond sale on the equilibrium price level in the short run?

(d) As a result of the price level change in part (c), are people with fixed incomes better off, worse off, or unaffected? Explain.

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3. Assume that the reserve requirement is 20 percent and banks hold no excess reserves.

   (a) Assume that Kim deposits $100 of cash from her pocket into her checking account. Calculate each of the following.

      (i) The maximum dollar amount the commercial bank can initially lend

      (ii) The maximum total change in demand deposits in the banking system

      (iii) The maximum change in the money supply

   (b) Assume that the Federal Reserve buys $5 million in government bonds on the open market. As a result of the open market purchase, calculate the maximum increase in the money supply in the banking system.

   (c) Given the increase in the money supply in part (b), what happens to real wages in the short run? Explain.

2. Assume that an economy is in long-run equilibrium. Assume that consumers wish to hold less money because they use credit cards more frequently to purchase goods and services than cash.

   (a) Draw a correctly labeled graph of the money market and show the effect of the reduced holdings of money on the equilibrium nominal interest rate in the short run.

   (b) Based on the change in the interest rate in part (a), what will happen to each of the following in the short run?

      (i) Prices of previously issued bonds

      (ii) The price level and real income. Explain.

   (c) With a constant money supply, based on your answer to part b(ii), will the velocity of money increase, decrease, or remain the same, or is the change indeterminate?

   (d) If the central bank wishes to reverse the change in the interest rate identified in part (a), what open market operation would it use?