CHAPTER 14 How Banks and Thrifts Create Money

Торіс		Question numbers	
1.	Bank balance sheets	1-9	
2.	Banks and money creation	10-91	
3.	Monetary multiplier	92-102	
4.	Combined topics	103-109	
	Last Word	110-113	
	True-False	114-124	

Multiple Choice Questions

Bank balance sheets

- 1. Which of the following statements is correct?
 - A) The actual reserves of a commercial bank equal its excess reserves minus its required reserves.
 - B) A bank's liabilities plus its net worth equal its assets.
 - C) When borrowers repay bank loans, the supply of money increases.
 - D) A single commercial bank can safely lend a multiple amount of its excess reserves.
- 2. A bank that has assets of \$85 billion and a net worth of \$10 billion must have:
 - A) liabilities of \$75 billion.
 - B) excess reserves of \$10 billion.
 - C) liabilities of \$10 billion.
 - D) excess reserves of \$75 billion.
- 3. A bank that has liabilities of \$150 billion and a net worth of \$20 billion must have:
 - A) excess reserves of \$130 billion.
 - B) assets of \$150 billion.
 - C) excess reserves of \$150 billion.
 - D) assets of \$170 billion.
- 4. If a bank has liabilities that exceed its net worth it:
 - A) will not be able to meet the legal reserve ratio.
 - B) is considered to be insolvent.
 - C) most likely is a heavy borrower from its district Federal Reserve Bank.
 - D) may or may not be a profitable firm.
- 5. Which of the following describes the identity embodied in a balance sheet?
 - A) Net Worth plus Assets equal Liabilities
 - B) Assets plus Liabilities equal Net Worth
 - C) Assets equal Liabilities plus Net Worth
 - D) Assets plus Reserves equal Net Worth

- 6. The claims of the owners of a firm against the firm's assets are called:
 - A) working capital.
 - B) assets.
 - C) net worth.
 - D) liabilities.
- 7. Which of the following are all assets to a commercial bank?
 - A) demand deposits, capital stock, and reserves
 - B) vault cash, property, and reserves
 - C) vault cash, property, and capital stock
 - D) vault cash, capital stock, and demand deposits
- 8. The reserves of a commercial bank consist of:
 - A) the amount of money market funds it holds.
 - B) deposits at the Federal Reserve Bank and vault cash.
 - C) government securities that the bank holds.
 - D) the bank's net worth.
- 9. A commercial bank's reserves are:
 - A) liabilities to both the commercial bank and the Federal Reserve Bank holding them.
 - B) liabilities to the commercial bank and assets to the Federal Reserve Bank holding them.
 - C) assets to both the commercial bank and the Federal Reserve Bank holding them.
 - D) assets to the commercial bank and liabilities to the Federal Reserve Bank holding them.

Banks and money creation

- 10. The goldsmith's ability to create money was based on the fact that:
 - A) withdrawals of gold tended to exceed deposits of gold in any given time period.
 - B) consumers and merchants preferred to use gold for transactions, rather than paper money.
 - C) the goldsmith was required to keep 100 percent gold reserves.
 - D) paper money in the form of gold receipts was rarely redeemed for gold.
- 11. When the receipts given by goldsmiths to depositors were used to make purchases:
 - A) the gold standard was created.
 - B) existing banking laws were violated.
 - C) the receipts became in effect paper money.
 - D) a fractional reserve banking system was created.
- 12. The primary purpose of the legal reserve requirement is to:
 - A) prevent banks from hoarding too much vault cash.
 - B) provide a means by which the monetary authorities can influence the lending ability of commercial banks.
 - C) prevent commercial banks from earning excess profits.
 - D) provide a dependable source of interest income for commercial banks.

- 13. The ABC Commercial Bank has \$5,000 in excess reserves and the reserve ratio is 30 percent. The bank must have:
 - A) \$90,000 in outstanding loans and \$35,000 in reserves.
 - B) \$90,000 in checkable deposit liabilities and \$32,000 in reserves.
 - C) \$20,000 in checkable deposit liabilities and \$10,000 in reserves.
 - D) \$90,000 in checkable deposit liabilities and \$35,000 in reserves.
- 14. Which one of the following is presently a major deterrent to bank panics in the United States?
 - A) the legal reserve requirement
 - B) the fractional reserve system
 - C) the gold standard
 - D) deposit insurance
- 15. Commercial banks monetize claims when they:
 - A) collect checks through the Federal Reserve System.
 - B) make loans to the public.
 - C) accept repayment of outstanding loans.
 - D) borrow from the Federal Reserve Banks.
- 16. Most modern banking systems are based on:
 - A) money of intrinsic value.
 - B) commodity money.
 - C) 100 percent reserves.
 - D) fractional reserves.
- 17. Money is destroyed when:
 - A) loans are made.
 - B) checks written on one bank are deposited in another bank.
 - C) loans are repaid.
 - D) the net worth of the banking system declines.
- 18. Checkable deposits are also called:
 - A) checking accounts.
 - B) high-powered money.
 - C) savings balances.
 - D) Federal Reserve Notes.
- 19. Suppose a commercial bank has checkable deposits of \$100,000 and the legal reserve ratio is 10 percent. If the bank's required and excess reserves are equal, then its actual reserves:
 - A) are \$30,000.
 - B) are \$10,000.
 - C) are \$20,000.
 - D) cannot be determined from the given information.
- 20. Banks create money when they:
 - A) add to their reserves in the Federal Reserve Bank.

- B) accept deposits of cash.
- C) sell government bonds.
- D) exchange checkable deposits for the IOU's of businesses and individuals.
- 21. When a check is drawn and cleared, the
 - A) reserves and deposits of both the bank against which the check is cleared and the bank receiving the check are unchanged by this transaction.
 - B) bank against which the check is cleared loses reserves and deposits equal to the amount of the check.
 - C) bank receiving the check loses reserves and deposits equal to the amount of the check.
 - D) bank against which the check is cleared acquires reserves and deposits equal to the amount of the check.
- 22. Suppose the ABC bank has excess reserves of \$4,000 and outstanding checkable deposits of \$80,000. If the reserve requirement is 25 percent, what is the size of the bank's actual reserves?
 - A) \$16,000
 - B) \$84,000
 - C) \$24,000
 - D) \$20,000
- 23. Excess reserves refer to the:
 - A) difference between a bank's vault cash and its reserves deposited at the Federal Reserve Bank.
 - B) minimum amount of actual reserves a bank must keep on hand to back up its customers deposits.
 - C) difference between actual reserves and loans.
 - D) difference between actual reserves and required reserves.
- 24. Suppose the reserve requirement is 10 percent. If a bank has \$5 million of checkable deposits and actual reserves of \$500,000, the bank:
 - A) can safely lend out \$500,000.
 - B) can safely lend out \$5 million.
 - C) can safely lend out \$50,000
 - D) cannot safely lend out more money
- 25. A reserve requirement of 20 percent means a bank must have \$1000 of reserves if its checkable deposits are: A) \$100.
 - B) \$1.000.
 - C) \$5,000.
 - D) \$12,000.
- 26. Assume that a bank initially has no excess reserves. If it receives \$5,000 in cash from a depositor and the bank finds that it can safely lend out \$4,500, the reserve requirement must be:
 - A) zero.
 - B) 10 percent.
 - C) 20 percent.
 - D) 25 percent
- 27. Suppose the reserve requirement is 20 percent. If a bank has checkable deposits of \$4 million and actual reserves of \$1 million, it can safely lend out:A) \$1 million.

- B) \$1.2 million.
- C) \$200,000.
- D) \$800,000.
- 28. Suppose that a bank's actual reserves are \$5 million, its checkable deposits are \$5 million, and its excess reserves are \$3 million. The reserve requirement must be:
 - A) 40 percent.
 - B) 20 percent.
 - C) 10 percent.
 - D) 5 percent.
- 29. Assume the Continental National Bank's balance statement is as follows:

Assets		Liabilities and net worth	
Reserves	\$ 40,000	Checkable deposits	\$130,000
Loans	25,000	Capital stock	45,000
Securities	110.000	_	

Assuming a legal reserve ratio of 20 percent, how much excess reserves would this bank have after a check for \$10,000 was drawn and cleared against it?

- A) \$3,000
- B) \$24,000
- C) \$6,000
- D) \$16,000
- 30. The reserve ratio refers to the ratio of a bank's:
 - A) reserves to its liabilities and net worth.
 - B) capital stock to its total assets.
 - C) checkable deposits to its total liabilities.
 - D) reserves and vault cash to its checkable deposits.
- 31. The amount that a commercial bank can lend is determined by its:
 - A) required reserves.
 - B) excess reserves.
 - C) outstanding loans.
 - D) outstanding checkable deposits.
- 32. A commercial bank can expand its excess reserves by:
 - A) demanding and receiving payment on an overdue loan.
 - B) buying bonds from a Federal Reserve Bank.
 - C) buying bonds from the public.
 - D) paying back money borrowed from a Federal Reserve Bank.
- 33. Commercial banks create money when they:
 - A) accept cash deposits from the public.
 - B) purchase government securities from the central banks.
 - C) create checkable deposits in exchange for IOUs.
 - D) raise their interest rates.

- 34. Banks destroy money when they:
 - A) buy government bonds.
 - B) accept deposits of cash into checkable accounts.
 - C) fail to reissue loans that are paid off.
 - D) clear checks against another bank.
- 35. Individual commercial banks are limited in their ability to create money by lending because:
 - A) lending is likely to result in the loss of reserves to other banks.
 - B) only the Treasury and the Federal Reserve Banks are authorized to create new money.
 - C) the Board of Governors prohibits bank lending when the result is an expansion of the money supply.
 - D) banking is a highly competitive industry.
- 36. Assume Company X deposits \$100,000 in cash in commercial Bank A. If no excess reserves exist at the time this deposit is made and the reserve ratio is 20 percent, Bank A can increase the money supply by a maximum of:
 - A) \$50,000.
 - B) \$180,000.
 - C) \$80,000.
 - D) \$500,000.
 - E) \$100,000.
- 37. Assume that Smith deposits \$600 in currency into her checking account in the XYZ Bank. Later that same day Jones negotiates a loan for \$1,200 at the same bank. In what direction and by what amount has the supply of money changed?
 - A) decreased by \$600
 - B) increased by \$1,800
 - C) increased by \$600
 - D) increased by \$1,200
- 38. Assume the Standard Internet Company negotiates a loan for \$5,000 from the Metro National Bank and receives a checkable deposit for that amount in exchange for its promissory note (IOU). As a result of this transaction:
 - A) the supply of money is increased by \$5,000.
 - B) the supply of money declines by the amount of the loan.
 - C) a claim has been "demonetized."
 - D) the Metro Bank acquires reserves from other banks.

Use the following to answer questions 39-43:

Use the following balance sheet for the ABC National Bank in answering the next question(s). Assume the required reserve ratio is 20 percent.

Assets		Liabilities and net worth	
Reserves	\$ 27,000	Checkable deposits	\$110,000
Loans	50,000	Capital stock	200,000
Securities	33,000		
Property	200,000		

- 39. Refer to the above data. This commercial bank has excess reserves of:
 - A) \$0.
 - B) \$3,000.
 - C) \$12,000.
 - D) \$5,000.

40. Refer to the above data. This bank can safely expand its loans by a maximum of:

- A) \$7,000.
- B) \$25,000.
- C) \$12,000.
- D) \$5,000.
- 41. Refer to the above data. Assuming the bank has a check cleared against it for the amount loaned in the previous question, its reserves and checkable deposits will now be:
 - A) \$25,000 and \$122,000 respectively.
 - B) \$22,000 and \$110,000 respectively.
 - C) \$32,000 and \$115,000 respectively.
 - D) \$22,000 and \$105,000 respectively.
- 42. Refer to the above data. After the transaction described in the previous question is completed, the bank will now have excess reserves of:
 - A) \$0.
 - B) \$3,000.
 - C) \$12,000.
 - D) \$5,000.
- 43. Refer to the above data. If the original bank sheet was for the commercial banking *system*, rather than a single bank, loans and checkable deposits could have been expanded by a maximum of:
 - A) \$8,000.
 - B) \$15,000.
 - C) \$48,000.
 - D) \$25,000.
- 44. A single commercial bank must meet a 25 percent reserve requirement. If the bank has no excess reserves initially and \$5,000 of cash is deposited in the bank, it can increase its loans by a maximum of:
 - A) \$1,250.
 - B) \$120,000.
 - C) \$5,000.
 - D) \$3,750.
- 45. When a bank loan is repaid the supply of money:
 - A) is constant, but its composition will have changed.
 - B) is decreased.
 - C) is increased.
 - D) may either increase or decrease.

- 46. If you deposit a \$50 bill in a commercial bank that has a 10 percent legal reserve requirement the bank will:
 - A) have \$45 of additional excess reserves.
 - B) be capable of lending an additional \$500.
 - C) be capable of lending an additional \$50.
 - D) have \$50 of required reserves.
- 47. When a commercial bank has excess reserves:
 - A) it is in a position to make additional loans.
 - B) its actual reserves are less than its required reserves.
 - C) it is charging too high an interest rate on its loans.
 - D) its reserves exceed its assets.
- 48. If we both have checking accounts in the same commercial bank and I write a check in your favor for \$200, the bank's:
 - A) balance sheet will be unchanged.
 - B) reserves and checkable deposits will both decline by \$200.
 - C) liabilities will decline by \$200, but its net worth will increase by \$200.
 - D) assets and liabilities will both decline by \$200.
- 49. Which of the following is *correct*?
 - A) Both the granting and repaying of bank loans expand the aggregate money supply.
 - B) Granting and repaying bank loans do not affect the money supply.
 - C) Granting a bank loan destroys money; repaying a bank loan creates money.
 - D) Granting a bank loan creates money; repaying a bank loan destroys money.
- 50. If the reserve requirement is 10 percent, how much *excess* reserves does a bank acquire when a business deposits a \$500 check drawn on another bank?
 - A) \$450
 - B) \$550
 - C) \$5000
 - D) \$500
- 51. The amount of reserves that a commercial bank is required to hold is equal to:
 - A) the amount of its checkable deposits.
 - B) the sum of its checkable deposits and time deposits.
 - C) its checkable deposits multiplied by the reserve requirement.
 - D) its checkable deposits divided by its total assets.
- 52. Banks create money when they:
 - A) allow loans to mature.
 - B) accept deposits of cash.
 - C) buy government bonds from households.
 - D) sell government bonds from households.
- 53. In prosperous times banks are likely to hold very small amounts of excess reserves because:
 - A) the Fed wants commercial banks to increase the money supply during economic expansions.

- B) it is very costly to transfer funds between commercial banks and the central banks.
- C) the Federal Reserve Banks do not pay interest on bank reserves.
- D) the Federal Reserve Banks want to minimize their interest payments on such deposits.
- 54. Which of the following is *correct*?
 - A) Required reserves *minus* actual reserves *equal* excess reserves.
 - B) Required reserves equal excess reserves minus actual reserves.
 - C) Required reserves *equal* actual reserves *plus* excess reserves.
 - D) Actual reserves minus required reserves equal excess reserves.

Use the following to answer questions 55-56:

Answer the next question(s) on the basis of the following balance sheet for the First National Bank of Bunco. All figures are in millions.

Assets		Liabilities and net worth	
Reserves	\$20	Checkable Deposits	\$100
Securities	25	Capital Stock	50
Loans	15		
Property	90		

55. Refer to the above data. If this bank has excess reserves of \$6 million, the legal reserve ratio must be:

- A) 10 percent.
- B) 12 percent.
- C) 14 percent.
- D) 20 percent.
- 56. Refer to the above data. Suppose that customers of this bank collectively write checks for cash at the bank in the amount of \$6 million. As a result, the bank's excess reserves diminish to:
 - A) \$0.
 - B) \$6 million.
 - C) \$.72 million.
 - D) \$.84 million.
- 57. When a bank has a check drawn and cleared against it:
 - A) excess reserves in the banking system decline.
 - B) the nation's total money supply falls.
 - C) the bank's balance sheet does not change.
 - D) the amount of required reserves the bank must have will fall.
- 58. A bank's actual reserves can be found by:
 - A) adding its required and excess reserves.
 - B) subtracting its required reserves from its excess reserves.
 - C) multiplying its excess reserves by the reserve ratio.
 - D) multiplying its checkable deposits by the reserve ratio.
- 59. Suppose a savings and loan association has checkable deposits of \$500,000 and the legal reserve ratio is 10

percent. If the institution has excess reserves of \$4,000, then its actual reserves are:

- A) \$46,000.
- B) \$50,000.
- C) \$54,000.
- D) \$4,000.

60. The legal reserve ratio applies to checkable deposits at:

- A) national banks.
- B) credit unions.
- C) savings and loans.
- D) institutions of all of the above types.
- 61. Suppose a commercial banking system has \$100,000 of outstanding checkable deposits and actual reserves of \$35,000. If the reserve ratio is 20 percent, the banking system can expand the supply of money by the maximum amount of:
 - A) \$122,000.
 - B) \$175,000.
 - C) \$300,000.
 - D) \$75,000.
- 62. If a portion of the loans extended by commercial banks is taken as cash rather than as checkable deposits, the maximum money-creating potential of the commercial banking system will:
 - A) be equal to twice the reciprocal of the reserve ratio.
 - B) be unaffected.
 - C) increase.
 - D) decrease.
- 63. The basic reason why the commercial banking system can increase its checkable deposits by a multiple of its excess reserves is that:
 - A) reserves lost by any particular bank will be gained by some other bank.
 - B) the central banks follow policies that prevent reserves from falling below the level required by law.
 - C) the MPC of borrowers is greater than zero, but less than 1.
 - D) the banking system must keep reserves equal to 100 percent of its checkable-deposit liabilities.

Use the following to answer questions 64-66:

Answer the next question(s) on the basis of the following consolidated balance sheet for the commercial banking system. Assume the required reserve ratio is 30 percent. All figures are in billions.

Assets		Liabilities and net worth	
Reserves	\$ 51	Checkable Deposits	\$140
Securities	100	Capital Stock	130
Loans	109	_	
Property	10		

- 64. Refer to the above data. The commercial banking system has excess reserves of:
 - A) \$9 billion.
 - B) \$7 billion.

- C) \$6.1 billion.
- D) \$5 billion.
- 65. Refer to the above data. The maximum amount by which the commercial banking system can expand the supply of money by lending is:
 - A) \$30 billion.
 - B) \$23.1 billion.
 - C) \$27 billion.
 - D) \$15 billion.
- 66. Refer to the above data. If the commercial banking system actually loans the maximum amount it is able to lend:
 - A) reserves and deposits equal to that amount will be gained.
 - B) excess reserves will be \$2.6 billion.
 - C) excess reserves will fall to \$1.7 billion.
 - D) excess reserves will be reduced to zero.
- 67. If borrowers take a portion of their loans as currency rather than checkable deposits, the maximum amount by which the commercial banking system can increase the money supply by lending will:
 - A) decrease because the legal reserve ratio varies directly with the amount of currency in circulation.
 - B) increase because currency is the basis for all checkable-deposit creation.
 - C) decrease because the amount of reserves transferred to other banks will diminish.
 - D) increase because commercial banks can lend by the reciprocal of the amount of currency in circulation.
- 68. Given a 25 percent reserve ratio, assume the commercial banking system is loaned up. Now assume the reserve ratio is reduced to 20 percent. As a result of this reduction:
 - A) we can expect bank lending and bank profits to decline.
 - B) each dollar of bank reserves will now support a maximum of \$5 of checkable deposits.
 - C) the banking system must now reduce outstanding loans by 5 percent.
 - D) the banking system can now increase lending by 5 percent.
- 69. When commercial banks use excess reserves to buy government securities from the public:
 - A) new money is created.
 - B) commercial bank reserves increase.
 - C) the money supply falls.
 - D) checkable deposits decline.
- 70. Which of the following would reduce the money supply?
 - A) Commercial banks use excess reserves to buy government bonds from the public.
 - B) Commercial banks loan out excess reserves.
 - C) Commercial banks sell government bonds to the public.
 - D) A check clears from Bank A to Bank B.
- 71. In an unregulated banking system there will be a tendency for:
 - A) interest rates to vary directly with the rate of increase in the money supply.
 - B) the money supply to grow at a constant rate through time.
 - C) the money supply to decrease during recession.

D) the money supply to increase during recession.

Use the following to answer questions 72-74:

Answer the next question(s) on the basis of the following consolidated balance sheet for the commercial banking system. Assume the required reserve ratio is 10 percent. All figures are in billions.

Assets		Liabilities and net worth	
Reserves	\$ 30	Checkable Deposits	\$300
Securities	70	Capital Stock	130
Loans	130		
Property	200		

- 72. Refer to the above data. The commercial banking system has excess reserves of:
 - A) \$0 billion.
 - B) \$30 billion.
 - C) \$60 billion.
 - D) \$70 billion.

73. Refer to the above data. After a deposit of \$10 billion of new currency into a checking account in the banking system, excess reserves will increase by:

- A) \$0 billion.
- B) \$7 billion.
- C) \$9 billion.
- D) \$10 billion.
- 74. Refer to the above data. After the deposit, the maximum amount by which this commercial banking system can expand the supply of money by lending is:
 - A) \$9 billion.
 - B) \$45 billion.
 - C) \$36 billion.
 - D) \$90 billion.

Use the following to answer questions 75-78:

Answer the next question(s) on the basis of the following information about a banking system: new currency deposited in the system = 40 billion; legal reserve ratio = 0.20; excess reserves prior to the currency deposit = 0.20;

- 75. Refer to the above information. The \$40 billion deposit of currency into checking accounts will initially create:
 - A) \$8 billion of new checkable deposits.
 - B) \$10 billion of new checkable deposits.
 - C) \$40 billion of new checkable deposits.
 - D) \$160 billion of new checkable deposits.
- 76. Refer to the above information. The \$40 billion deposit of currency into checking accounts will create excess reserves of:

- A) \$20 billion.
- B) \$32 billion.
- C) \$40 billion.
- D) \$0.
- 77. Refer to the above information. The banking system will be able to expand the money supply through loans by:
 - A) \$160 billion.
 - B) \$200 billion.
 - C) \$40 billion.
 - D) \$128 billion.
- 78. Refer to the above information. The \$40 billion deposit of new currency will support total checkable deposits of:
 - A) \$160 billion.
 - B) \$200 billion.
 - C) \$40 billion.
 - D) \$128 billion.

Use the following to answer questions 79-83:

Answer the next question(s) on the basis of the following table for a commercial bank or thrift:

(1)	(2)	(3)
Legal reserve ratio,	Checkable	Actual
percent	deposits	reserves
10	\$40,000	\$10,000
20	40,000	10,000
25	40,000	10,000
30	40,000	10,000

- 79. Refer to the above table. When the legal reserve ratio is 25 percent, the excess reserves of this single bank are: A) \$0.
 - B) \$1,000.
 - C) \$5,000.
 - D) \$30,000.
- 80. Refer to the above table. When the legal reserve ratio is 10 percent, the money creating potential of this single bank is:
 - A) \$0.
 - B) \$6,000.
 - C) \$30,000.
 - D) \$60,000.
- 81. Refer to the above table. When the legal reserve ratio is 20 percent, the money creating potential of the entire banking system is:
 - A) \$4,000.
 - B) \$6,000.

- C) \$8,000.
- D) \$10,000.
- 82. Refer to the above table. When the legal reserve ratio is 30 percent, the monetary multiplier is:
 - A) 5.
 - B) 4.
 - C) 3.33.
 - D) 2.5.
- 83. Refer to the above table. If the legal reserve ratio falls from 25 percent to 10 percent, excess reserves of this single bank will:
 - A) rise by \$6,000 and the monetary multiplier will increase from 4 to 10.
 - B) rise by \$60,000 and the monetary multiplier will increase from 4 to 10.
 - C) fall by \$6,000 and the monetary multiplier will decline from 30 to 10.
 - D) fall by \$2,000 and the monetary multiplier will decline from 10 to 4.
- 84. If excess reserves in the banking system are \$4,000, checkable deposits are \$40,000, and the legal reserve ratio is 10 percent, then actual reserves are:
 - A) \$4,000.
 - B) \$6,000.
 - C) \$8,000.
 - D) \$5,000.
- 85. If actual reserves in the banking system are \$8,000, checkable deposits are \$70,000, and the legal reserve ratio is 10 percent, then excess reserves are:
 - A) zero.
 - B) \$1,000.
 - C) \$2,000.
 - D) \$500.
- 86. If actual reserves in the banking system are \$40,000, excess reserves are \$10,000, and checkable deposits are \$240,000, then the legal reserve requirement is:
 - A) 10 percent.
 - B) 12.5 percent.
 - C) 20 percent.
 - D) 5 percent.
- 87. If actual reserves in the banking system are \$50,000, excess reserves are \$5,000, and checkable deposits are \$225,000, then the monetary multiplier is:
 - A) 10.
 - B) 4.
 - C) 5.
 - D) 10.
- 88. Overnight loans from one bank to another for reserve purposes entail an interest rate called the:
 - A) prime rate.
 - B) discount rate.

- C) Federal funds rate.
- D) treasury bill rate.
- 89. A bank temporarily short of required reserves may be able to remedy this situation by:
 - A) borrowing funds in the Federal funds market.
 - B) granting new loans.
 - C) shifting some of its vault cash to its reserve account at the Federal Reserve.
 - D) buying bonds from the public.
- 90. The market for immediately available reserve balances at the Federal Reserve is known as the:
 - A) money market.
 - B) long-term bond market.
 - C) short-term bond market.
 - D) Federal funds market.
- 91. The Federal funds market is the market in which:
 - A) banks borrow from the Federal Reserve Banks.
 - B) U.S. securities are bought and sold.
 - C) banks borrow reserves from one another on an overnight basis.
 - D) Federal Reserve Banks borrow from one another.

Monetary multiplier

- 92. The multiple by which the commercial banking system can expand the supply of money is equal to the reciprocal of:
 - A) the MPS.
 - B) its actual reserves.
 - C) its excess reserves.
 - D) the reserve ratio.
- 93. The multiple by which the commercial banking system can expand the supply of money on the basis of excess reserves:
 - A) is larger the smaller the legal reserve ratio.
 - B) is the reciprocal of the bank's actual reserves.
 - C) is directly or positively related to the size of the required reserve ratio.
 - D) will be zero when the required reserve ratio is 100 percent.
- 94. The multiple by which the commercial banking system can increase the supply of money on the basis of each dollar of excess reserves is equal to:
 - A) the reciprocal of the legal reserve ratio.
 - B) 1 minus the legal reserve ratio.
 - C) the reciprocal of the income velocity of money.
 - D) 1/MPS.
- 95. If *m* equals the maximum number of new dollars that can be created for a single dollar of excess reserves and *R* equals the required reserve ratio, then for the banking system:

A) m = R - 1. B) R = m/1.

- C) R = m 1.
- D) m = 1/R.
- 96. If D equals the maximum amount of a new demand-deposit money that can be created by the banking system on the basis of any given amount of excess reserves; E equals the amount of excess reserves; and m is the monetary multiplier, then:
 - A) m = E/D.
 - B) $D = E \times m$.
 - C) D = E 1/m.
 - D) D = m/E.
- 97. If the reserve ratio is 15 percent and commercial bankers decide to hold additional excess reserves equal to 5 percent of any newly acquired checkable deposits, then the relevant monetary multiplier for the banking system will be:
 - A) $3^{1/2}$.
 - B) 4.
 - C) 5.
 - D) 10.

98. Other things equal, if the required reserve ratio was lowered:

- A) banks would have to reduce their lending.
- B) the size of the monetary multiplier would increase.
- C) the actual reserves of banks would increase.
- D) the Federal funds interest rate would rise.
- 99. If the monetary authorities want to reduce the monetary multiplier, they should:
 - A) lower the legal reserve ratio.
 - B) raise the legal reserve ratio.
 - C) increase bank reserves.
 - D) lower interest rates.
- 100. If the reserve ratio is 100 percent, the value of the monetary multiplier is:
 - A) 0.
 - B) 1.
 - C) 10.
 - D) 100.
- 101. The value of the monetary multiplier is:
 - A) 1/MPS.
 - B) 1/Excess Reserves.
 - C) 1/MPC.
 - D) 1/Required Reserve Ratio.
- 102. The greater the legal reserve ratio, the:A) higher is the income multiplier.

- B) lower is the income multiplier.
- C) lower is the monetary multiplier.
- D) higher is the monetary multiplier.

Combined topics

Use the following to answer questions 103-109:

Answer the next question(s) on the basis of the following information for the Moola Bank.

Reserves	\$ 100
Checkable deposits	1000
Loans (to customers)	300
Property	400
Securities (owned)	300
Capital stock	0

- 103. Assume that the listed amounts constitute this bank's complete set of accounts. Moola's:A) assets are \$1000.
 - B) liabilities are \$1000.
 - C) net worth is zero.
 - D) profit is \$1000.
- 104. Assume that the listed amounts constitute this bank's complete set of accounts. Moola's:
 - A) assets are \$1100.
 - B) liabilities are \$1100.
 - C) net worth is \$300.
 - D) profit is \$1000.
- 105. Assume that the listed amounts constitute this bank's complete set of accounts. Moola's:
 - A) assets are \$1000.
 - B) liabilities are \$300.
 - C) net worth is \$100.
 - D) annual profit is \$200.
- 106. Refer to the above information. If Moola Bank is legally "loaned up," the reserve requirement must be:A) 10 percent.
 - B) 15 percent.
 - C) 20 percent.
 - D) 25 percent.
- 107. Refer to the above information. If Moola Bank is legally "loaned up," the banking system's monetary multiplier must be:
 - A) 5.
 - B) 8.
 - C) 10.
 - D) 20.

- 108. Refer to the above information and assumed that Moola bank is "loaned up." If it receives a \$100 deposit of currency, it could safely expand its loans by:
 - A) \$100.
 - B) \$90.
 - C) \$900.
 - D) \$1000.
- 109. Refer to the above information and assume that Moola Bank is "loaned up." If it receives a \$100 deposit of currency, the banking system of which Moola is a part could expand loans by:
 - A) \$100.
 - B) \$90.
 - C) \$900.
 - D) \$1000.

Last Word Questions

- 110. (Last Word) The bank panics of 1930-1933:
 - A) resulted in the passage of the Smoot-Hawley Act.
 - B) boosted the nation's money supply, causing inflation.
 - C) directly resulted in the Federal insured deposit program.
 - D) caused a significant outflow of gold from the United States.
- 111. (Last Word) A "national bank holiday" that closed all banks for a week and resulted in Federal deposit insurance occurred in the United States in:
 - A) 1903, following the "Louisiana stampede."
 - B) 1987, following the collapse of numerous savings and loan associations.
 - C) 1945, following the end of the Second World War.
 - D) 1933, following the bank panics of 1930-1933.
- 112. (Last Word) Which of the following represents a change in today's banking policies that should prevent a recurrence of the bank panics of 1930-1933?
 - A) banks are more cautious lenders
 - B) banks keep large amounts of excess reserves on hand
 - C) the FDIC insures bank deposits and therefore depositors do not panic and rush to withdraw money when individual banks have financial problems
 - D) the President now has the authority to close banks whenever panics occur
- 113. (Last Word) The bank panics of 1930-1933 and the resulting failures of many banks were caused by:
 - A) the widespread conversion of checkable deposits to cash by the public.
 - B) the raising of the reserve requirement by the Board of Governors.
 - C) a massive inflow of gold bullion to the United States.
 - D) a massive inflow of cash into bank deposits by citizens who feared their money was losing its value.

True/False Questions

- 114. Excess reserves are the amount by which required reserves exceed actual reserves.
- 115. The supply of money increases when the public buys government securities from commercial banks.
- 116. Commercial bank reserves are an asset to commercial banks but a liability to the Federal Reserve Bank holding them.
- 117. Commercial banks increase the supply of money when they purchase either personal IOU's or government bonds from businesses and households.
- 118. Balance sheets always balance because reserves must always equal liabilities plus net worth
- 119. When commercial banks retire outstanding loans, the supply of money is increased.
- 120. Commercial banks monetize claims when they sell securities to Federal Reserve Banks.
- 121. Actual reserves equal required reserves plus excess reserves.
- 122. The banking system can lend by a multiple of its excess reserves because lending does not result in a loss of reserves to the banking system as a whole.
- 123. The monetary multiplier and the income multiplier are two ways of referring to the same concept.
- 124. In an uncontrolled or unregulated system commercial bank lending will tend to intensify the business cycle.