

## AP Macroeconomics – Monetary Policy

1. Under a fractional reserve banking system, banks are required to
  - a. keep part of their demand deposits as reserves
  - b. expand the money supply when requested by the central bank
  - c. insure their deposits against losses and bank runs
  - d. pay a fraction of their interest income in taxes
  - e. charge the same interest rate on all their loans
2. When the Federal Reserve buys government securities on the open market, which of the following will decrease in the short run?
  - a. Interest rates
  - b. Taxes
  - c. Investment
  - d. The amount of money loaned by banks
  - e. The money supply
3. If a commercial bank has no excess reserves and the reserve requirement is 10 percent, what is the value of new loans this single bank can issue if a new customer deposits \$10,000?
  - a. \$100,000
  - b. \$90,333
  - c. \$10,000
  - d. \$9,000
  - e. \$1,000
4. When a central bank sells securities in the open market, which of the following set of events is most likely to follow?
  - a. An increase in the money supply, a decrease in interest rates, and an increase in aggregate demand
  - b. An increase in the money supply, an increase in interest rates, and a decrease in aggregate demand
  - c. An increase in interest rates, an increase in the government budget deficit, and a movement toward trade surplus
  - d. A decrease in the money supply, an increase in interest rates, and a decrease in aggregate demand
  - e. A decrease in the money supply, a decrease in interest rates, and a decrease in aggregate demand
5. The federal funds rate is the interest rate that
  - a. The Federal Reserve charges the federal government on its loans
  - b. Banks charge one another for short-term loans
  - c. Banks charge their best customers
  - d. Equalizes the yield on government bonds and corporate bonds
  - e. Is equal to the inflation rate

6. In the country Agronomia, banks charge 10 percent interest on all loans. If the general price level has been increasing at the rate of 4 percent per year, the real rate of interest in Agronomia is
- 14%
  - 10%
  - 6%
  - 4%
  - 2.5%

Assets

Total Reserves: \$15,000  
Securities: 70,000  
Loan: 15,000

Liabilities

Demand Deposits \$100,000

7. A commercial bank is facing the conditions given above. If the reserve requirement is 12 percent and the bank does not sell any of its securities, the maximum amount of additional lending this bank can undertake is
- \$15,000
  - \$12,000
  - \$3,000
  - \$1,800
  - 0
8. If the Federal Reserve institutes a policy to reduce inflation, which of the following is most likely to increase?
- Tax rates
  - Investment
  - Government spending
  - Interest rates
  - Gross domestic product
9. Assume that the reserve requirement is 20 percent, but banks voluntarily keep some excess reserves. A \$1 million increase in new reserves will result in
- An increase in the money supply of \$5 million
  - An increase in the money supply of less than \$5 million
  - A decrease in the money supply of \$1 million
  - A decrease in the money supply of \$5 million
  - A decrease in the money supply of more than \$5 million
10. If the economy is operating at full employment and there is a substantial increase in the money supply, the quantity theory of money predicts an increase in
- The velocity of money
  - Real output
  - Interest rates
  - Unemployment
  - The price level

11. Which of the following will most likely occur in an economy if more money is demanded than is supplied?
- a. The amount of investment will increase
  - b. Interest rates will decrease
  - c. Interest rates will increase
  - d. The demand curve for money will shift to the left
  - e. The demand curve for money will shift to the right
12. If on receiving a checking deposit of \$300 a bank's excess reserves increased by \$255, the required reserve ratio must be
- a. 5%
  - b. 15%
  - c. 25%
  - d. 35%
  - e. 45%
13. The Federal Reserve can increase the money supply by
- a. Selling gold reserves to the banks
  - b. Selling foreign currency holdings
  - c. Buying government bonds on the open market
  - d. Buying gold from foreign central banks
  - e. Borrowing reserves from foreign governments
14. When consumers hold money rather than bonds because they expect the interest rate to increase in the future, they are holding money for which of the following purposes?
- a. Transactions
  - b. Unforeseen expenditures
  - c. Speculation
  - d. Illiquidity
  - e. Exchange
15. An increase in the money supply is most likely to have which of the following short-run effects on real interest rates and real output?

	<u>Real Interest Rates</u>	<u>Real Output</u>
a.	Decrease	Decrease
b.	Decrease	Increase
c.	Increase	Decrease
d.	Increase	No change
e.	No change	increase

16. In the Keynesian model, an expansionary monetary policy will lead to
- Lower real interest rates and more investment
  - Lower real interest rates and lower prices
  - Higher real interest rates and lower prices
  - Higher real interest rates and higher real income
  - Higher nominal interest rates and more investment
17. The money-creating ability of the banking system will be less than the maximum amount indicated by the money multiplier when
- Interest rates are high
  - The velocity of money is rising
  - People hold a portion of their money in the form of currency
  - The unemployment rate is low
  - The government's budget is in deficit
18. Which of the following constitutes the largest component of the United States money supply (M1)?
- Silver certificates
  - Checkable deposits (demand deposits)
  - Currency (paper money)
  - Coins
  - Large certificates of deposit
19. Under which of the following conditions would a restrictive monetary policy be most appropriate?
- High inflation
  - High unemployment
  - Full employment with stable prices
  - Low interest rates
  - A budget deficit
20. One way in which the Federal Reserve works to change the United States money supply is by changing the
- Number of banks in operation
  - Velocity of money
  - Price level
  - Prime rate
  - Discount rate
21. Assume that the reserve requirement is 20 percent. If a bank initially has no excess reserves and \$10,000 cash is deposited in the bank, the maximum amount by which this bank may increase its loans is
- \$2,000
  - \$8,000
  - \$10,000
  - \$20,000
  - \$50,000

22. If the money stock decreases but nominal gross domestic product remains constant, which of the following has occurred?
- Income velocity of money has increased.
  - Income velocity of money has decreased.
  - Price level has increased.
  - Price level has decreased.
  - Real output has decreased.

23. Assume that the reserve requirement is 15 percent and that a bank receives a new checking deposit of \$200. Which of the following will most likely occur in the bank's balance sheet?

	<u>Liabilities</u>	<u>Required Reserves</u>
a.	Increase by \$200	Increase by \$170
b.	Increase by \$200	Increase by \$30
c.	Increase by \$200	Not change
d.	Decrease by \$200	Decrease by \$30
e.	Decrease by \$200	Decrease by \$170

24. Open market operations refer to which of the following activities?
- The buying and selling of stocks in the New York stock market
  - The loans made by the Federal Reserve to member commercial banks
  - The buying and selling of government securities by the Federal Reserve
  - The government's purchase and sales of municipal bonds
  - The government's contribution to net exports

25. In a flexible system of exchange rates, an open market sale of bonds by the Federal Reserve will most likely change the money supply, the interest rate, and the value of the United States dollar which of the following ways?

	<u>Money Supply</u>	<u>Interest Rate</u>	<u>Value of the Dollar</u>
a.	Increase	Decrease	Decrease
b.	Increase	Decrease	Increase
c.	Decrease	Decrease	Decrease
d.	Decrease	Increase	Increase
e.	Decrease	Increase	Decrease

### Answers to Multiple Choice Questions

1. A
2. A
3. D
4. D
5. B
6. C
7. C
8. D
9. B
10. E
11. C
12. B
13. C
14. C
15. B
16. A
17. C
18. B
19. A
20. E
21. B
22. A
23. B
24. C
25. D