15 MONETARY POLICY

1. Assume the U.S. economy is undergoing a recession. In its efforts to stimulate the economy by trying to influence short-term interest rates the Fed is most likely to take which two actions?
   (A) Buy Treasury securities and decrease bank reserve requirements.
   (B) Sell Treasury securities and decrease bank reserve requirements.
   (C) Sell Treasury securities and increase bank reserve requirements.

2. Which of the following policy tools is the least likely to be available to the U.S. Federal Reserve Board?
   (A) Setting the discount rate at which banks can borrow from the Federal Reserve.
   (B) Requiring the banking system to tighten or loosen its credit policies.
   (C) Buying and selling Treasury securities in the open market.

3. Which of the following statements regarding U.S. Federal Reserve open market operations is least accurate?
   (A) If the Fed wants to stimulate the economy, it will sell Treasury securities to banks.
   (B) When the Fed buys Treasury securities, short-term interest rates will generally decrease.
   (C) When the Fed sells Treasury securities, excess reserves decrease.

4. A central bank follows an inflation targeting monetary policy. If the permissible band is plusor-minus 2% around the target inflation rate, the central bank is most likely to choose a target inflation rate of:
   (A) 0%.
   (B) 1%.
   (C) 3%.

5. A country is experiencing a core inflation rate of 7% during a recessionary period of real GDP growth. If the central bank has a single mandate to achieve price stability and uses inflation targeting with an acceptable range of zero to 4%, its monetary policy response is most likely to decrease:
   (A) GDP growth in the short run.
   (B) short-term interest rates.
   (C) the foreign exchange value of the country's currency.

6. Silvano Jimenez, an analyst at Banco del Rey, is reviewing recent actions taken by the U.S. Federal Reserve (the Fed) in setting monetary policy. Recently, the Fed decided to increase the money supply, which has resulted in a decrease in real interest rates. At a staff meeting, Jimenez brings this matter to the attention of his colleagues and makes the following statements:

   Statement 1: Although the money supply increase has led to a decrease in real interest

   rates, we should begin to see U.S. investors decrease their investments abroad and the U.S.

   dollar will appreciate in the foreign exchange market.

   Statement 2: The Fed's increase in the money supply will increase the amount of imports into the U.S.

   Are Statement 1 and Statement 2 as made by Jimenez CORRECT?

	Statement 1	Statement 2
(A)	Correct	Incorrect
(B)	Incorrect	Correct
(C)	Incorrect	Incorrect

7. Central banks that are able to define how inflation is computed and determine its desired level are best described as having:
   (A) operational independence.
   (B) target independence.
   (C) transparency.

8. If a country's economy is growing at an unsustainably rapid rate and the central bank decreases its target overnight interest rate, the country's:
   (A) expected rate of inflation is likely to decline.
   (B) inflation rate is likely to increase.
   (C) long-term rate of economic growth will increase.

9. Central banks are most likely to pursue a target inflation rate:
   (A) between 0% and 2%.
   (B) equal to 0%.
   (C) between 2% and 3%.

10. Which of the following is least likely a function or objective of a central bank?
    (A) Issuing currency.
    (B) Keeping inflation within an acceptable range.
    (C) Lending money to government agencies.

11. Central banks pursuing expansionary policies may:
    (A) decrease the policy rate and make open market purchases of securities.
    (B) decrease the policy rate and make open market sales of securities.
    (C) increase the policy rate and make open market purchases of securities.

12. Which of the following policy combinations would most likely lead to private sector growth and a decreasing government share of GDP?
    (A) Contractionary fiscal policy and expansionary monetary policy.
    (B) Contractionary fiscal policy and contractionary monetary policy.
    (C) Expansionary fiscal policy and contractionary monetary policy.

13. Which one of the following Federal Reserve monetary policies, when pursued in line with the U.S. government's fiscal policies, would help increase aggregate demand during a period of high unemployment?
    (A) An increase in the reserve requirements for financial institutions.
    (B) A decrease in the discount rate.
    (C) The sale of bonds by the Fed.

14. To determine whether monetary policy is expansionary or contractionary, an analyst should compare the central bank's policy rate to the:
    (A) neutral interest rate.
    (B) target inflation rate.
    (C) trend rate of real growth.

15. When the Federal Reserve sells government securities on the open market, bank reserves are:
    (A) decreased, which reduces the amount of money banks are able to lend, causing a decrease in the federal funds rate.

(B) decreased, which reduces the amount of money banks are able to lend, causing an increase in the federal funds rate.

(C) increased, which increases the amount of money banks are able to lend, causing a decrease in the federal funds rate.

16. Which of the following conditions is difficult for monetary policy to address because a central bank cannot reduce its nominal policy rate much below zero?

(A) Deflation.

(B) Inflation.

(C) Stagflation.

17. A central bank has operational independence if it can independently determine:

(A) the horizon over which to achieve its inflation target.

(B) the policy rate.

(C) how inflation is calculated.

18. If the Federal Reserve wishes to lower market interest rates without changing the discount rate, it can:

(A) buy Treasury securities.

(B) increase bank reserve requirements.

(C) raise the yield on Treasury securities.

19. A central bank is said to have credibility if:

(A) economic actors base decisions on the central bank's stated inflation targets.

(B) it issues inflation reports monthly.

(C) it determines both the policy rate and the method for computing the inflation rate.

20. If a monetary policy is focused on combating inflation, which open market actions by the Federal Reserve will most effectively accomplish this?

(A) Sell Treasury securities, causing aggregate demand to decrease.

(B) Sell Treasury securities, causing aggregate demand to increase.

(C) Purchase Treasury securities, causing aggregate demand to decrease.

21. The most likely reason for deflation to persist despite expansionary monetary policy is:

(A) a liquidity trap.

(B) bond market vigilantes.

(C) inelastic demand for money.

22. Which of the following is the most likely result of a central bank's shift to an expansionary monetary policy?
    (A) Domestic currency appreciates.
    (B) Exports increase.
    (C) Interest rates increase.

23. An analyst has determined the projected trend rate of real GDP growth is 2.5% and the central bank's inflation target is 2.5%. If the central bank policy rate is 5.0%, monetary policy is most likely:
    (A) neutral.
    (B) expansionary.
    (C) contractionary.

24. An economy's long-term trend rate of real GDP growth is 3% and the central bank's target inflation rate is 2%. If the policy rate is 6%, monetary policy is:
    (A) contractionary.
    (B) expansionary.
    (C) neutral.

25. The velocity of transactions in an economy has been increasing rapidly for the past seven years. Over the same time period, the economy has experienced minimal growth in real output. According to the equation of exchange, inflation over the last seven years has:
    (A) been minimal, consistent with the slow growth in real output.
    (B) increased at a rate similar to the growth rate in the money supply.
    (C) increased more than the growth in the money supply.

26. What are the three essential qualities an effective central bank should possess?
    (A) Transparency, independence, and consistency.
    (B) Independence, credibility, and transparency.
    (C) Credibility, relevance, and reliability.

27. Contractionary monetary policy is least likely to decrease consumption spending by decreasing:
    (A) expectations for economic growth.
    (B) securities prices.
    (C) the foreign exchange value of the currency.

28. Which of the following statements regarding the monetary policy transmission mechanism is most accurate?
    (A) Central banks can control short-term interest rates directly, but long-term interest rates are beyond their control.
    (B) Central banks can control long-term interest rates directly because decisions by consumers and businesses are based on these rates.
    (C) Central banks can control short-term interest rates by increasing the money supply to increase interest rates or by decreasing the money supply to decrease interest rates.

29. The government is reducing its spending to balance the budget, while the central bank is lowering its official policy rate. What will most likely be the combined effect on the economy?
    (A) The private sector as a percentage of GDP will increase.
    (B) The public and private sectors as a percentage of GDP will neither decrease nor increase.
    (C) The public sector as a percentage of GDP will increase.

30. A central bank that wants to increase short-term interest rates is most likely to:
    (A) issue long-term bonds.
    (B) decrease bank reserve requirements.
    (C) sell government securities.

31. Which of the following is currently the most-used target for central banks?
    (A) Interest rate targeting.
    (B) Money supply targeting.
    (C) Inflation targeting.

32. If a bank needs to borrow funds from the Federal Reserve to fund a temporary shortage in reserves, it would borrow funds at the:
    (A) discount rate.
    (B) prime rate.
    (C) federal funds rate.

33. Which of the following is least likely to be a function of the central bank?
    (A) Collect tax payments.
    (B) Issue currency.
    (C) Regulate the banking system.

34. The open market sale of Treasury securities by the Federal Reserve is least likely to result in:
    (A) increased exports of U.S. goods.
    (B) increased longer-term interest rates.
    (C) a decreased rate of inflation.

35. Xanadu attempts to decrease its inflation rate by implementing contractionary monetary policy. Which of the following is most likely to be the long-run effect on Xanadu's trade balance as a result of the monetary policy change?
    (A) Worsen.
    (B) Remain the same.
    (C) Improve.

36. If a central bank implements an exchange rate targeting policy successfully, the country's inflation rate is most likely to be:
    (A) less than that of the target currency.
    (B) the same as that of the target currency.
    (C) greater than that of the target currency.

37. The primary objective of a central bank is typically to:
    (A) control inflation.
    (B) stabilize exchange rates.
    (C) achieve full employment.

38. The Federal Reserve has decided to increase the federal funds rate (the interest rate that banks charge each other for overnight loans). To implement this policy, the Federal Reserve will most likely:
    (A) sell government securities in the open market.
    (B) increase currency exchange rates (cause domestic currency to appreciate).
    (C) set a lower price on Treasury bills and notes that it is auctioning.

39. If a central bank's targeted inflation rate is above the current rate, the central bank is most likely to:
    (A) increase the overnight lending rate.
    (B) buy government securities.
    (C) increase the reserve requirement.

40. If the U.S. Federal Reserve decides to decrease the money supply, which of the following is most likely to occur in the short run?
    (A) An increase in the real rate of interest.
    (B) A decrease in the unemployment rate.
    (C) An increase in the velocity of money similar to decrease in the money supply.

41. Which of the following fiscal and monetary policy scenarios is most likely to increase the size of the public sector relative to the private sector?
    (A) Contractionary fiscal and monetary policy.
    (B) Expansionary fiscal policy and contractionary monetary policy.
    (C) Expansionary monetary policy and contractionary fiscal policy.