Chapter 16 The Monetary System

MULTIPLE CHOICE

1. Mia puts money into a piggy bank so she can spend it later. What function of money does this illustrate?
   a. store of value
   b. medium of exchange
   c. unit of account
   d. None of the above is correct.

   ANS: A

2. Which of the following best illustrates the medium of exchange function of money?
   a. You keep some money hidden in your shoe.
   b. You keep track of the value of your assets in terms of currency.
   c. You pay for your double latte using currency.
   d. None of the above is correct.

   ANS: C

3. Fiat money
   a. is worthless.
   b. has no intrinsic value.
   c. may be used as a medium of exchange, but is not legal tender.
   d. performs all the functions of money except providing a unit of account.

   ANS: B

4. Which type of currency has intrinsic value?
   a. commodity money
   b. fiat money
   c. both commodity money and fiat money
   d. neither commodity money nor fiat money

   ANS: A

5. Which of the following is not included in M1?
   a. currency
   b. demand deposits
   c. savings deposits
   d. travelers' checks

   ANS: C

6. Which of the following is included in M2 but not in M1?
   a. currency
   b. demand deposits
   c. savings deposits
   d. All of the above are included in both M1 and M2

   ANS: C

7. Which of the following is included in the M2 definition of the money supply?
    a. credit cards
    b. money market mutual funds
    c. corporate bonds
    d. large time deposits

    ANS: B

8. Which of the following pairs correctly lists a function of the Fed and the part of the Fed directly responsible for that action?
    a. income tax policy-Board of Governors
    b. conduct open market operations-New York Federal Reserve Bank
    c. lender of last resort-The FOMC
    d. None of the above is correct.

    ANS: B

9. Which of the following statements about the Federal Reserve is incorrect?
    a. The members of the Board of Governors are also presidents of the Federal Reserve's regional banks.
    b. The Federal Open Market Committee makes monetary policy.
    c. All members of the Board of Governors sit on the Federal Open Market Committee.
    d. The Federal Reserve regulates banks.

    ANS: A

10. The 12 regional Federal Reserve Banks
    a. may not make loans to banks in their districts.
    b. regulate banks in their districts.
    c. send representatives to the FOMC and have a majority vote.
    d. all vote on policy directives.

    ANS: B

11. The Federal Open Market Committee is made up of
    a. 5 of the 12 presidents of the Federal Reserve Regional banks, and the 7 members of the Board of Governors.
    b. 7 of the 12 presidents of the Federal Reserve Regional banks, and the 5 members of the Board of Governors.
    c. the 12 presidents of the Federal Reserve Regional banks, and the Chair of the Board of Governors.
    d. the 12 presidents of the Federal Reserve Regional banks, and the 7 members of the Board of Governors.

    ANS: A

12. Which of the following is not always a voting member of the FOMC?
    a. the president of the New York Federal Reserve District Bank
    b. the Chairman of the Board of Governors
    c. the newest member of the Board of Governors
    d. the president of the Boston Federal Reserve District Bank.

    ANS: D

13. When the Fed wants to change the money supply, it most frequently
    a. changes the discount rate.
    b. changes the reserve requirement.
    c. conducts open market operations.
    d. issues Federal Reserve notes.

    ANS: C

14. When the Fed conducts open market purchases,
    a. it buys Treasury securities, which increases the money supply.
    b. it buys Treasury securities, which decreases the money supply.
    c. it borrows from member banks, which increases the money supply.
    d. it lends money to member banks, which decreases the money supply.

    ANS: A

15. When the Fed conducts open market sales,
    a. it sells Treasury securities, which increases the money supply.
    b. it sells Treasury securities, which decreases the money supply.
    c. it borrows from member banks, which increases the money supply.
    d. it lends money to member banks, which decreases the money supply.

    ANS: B

16. On a bank's T-account,
    a. both deposits and reserves are assets.
    b. both deposits and reserves are liabilities.
    c. deposits are assets, reserves are liabilities.
    d. reserves are assets, deposits are liabilities.

    ANS: D

17. Suppose that the reserve ratio is 5 percent and that a bank has $1,000 in deposits. Its required reserves are
    a. $5.
    b. $50.
    c. $95.
    d. $950.

    ANS: B

18. Suppose that the reserve ratio is 10 percent and that a bank has $2,000 in deposits. Its required reserves are
    a. $20.
    b. $200.
    c. $1,880.
    d. $1,800.

    ANS: B

19. Suppose a bank has a 10 percent reserve ratio, $5,000 in deposits, and it loans out all it can given the reserve ratio.
    a. It has $50 in reserves and $4,950 in loans.
    b. It has $500 in reserves and $4,500 in loans.
    c. It has $555 in reserves and $4,445 in loans.
    d. None of the above is correct.

    ANS: B

20. Suppose a bank has a 10 percent reserve ratio, $4,000 in deposits, and it loans out all it can given the reserve ratio.
    a. It has $40 in reserves and $3,960 in loans.
    b. It has $400 in reserves and $3,600 in loans.
    c. It has $444 in reserves and $3,556 in loans.
    d. None of the above is correct.

    ANS: B

21. Suppose a bank has $10,000 in deposits and $8,000 in loans. It has a reserve ratio of
    a. 2 percent.
    b. 12.5 percent.
    c. 20 percent.
    d. 80 percent.

    ANS: C

22. If the reserve ratio is 5 percent and a bank receives a new deposit of $500, this bank
    a. must increase its required reserves by $25.
    b. will initially see its total reserves increase by $500.
    c. will be able to make a new loan of $475.
    d. All of the above are true.

    ANS: D

23. If the reserve ratio is 10 percent and a bank receives a new deposit of $10, this bank
    a. must increase required reserves by $1.
    b. will initially see its total reserves increase by $1.
    c. will be able to make new loans up to a maximum of $1.
    d. All of the above are true.

    ANS: A

24. If the reserve ratio is 5 percent and a bank receives a new deposit of $200, it
    a. must increase required reserves by $190.
    b. will initially see reserves increase by $190.
    c. will be able to make new loans up to a maximum of $190.
    d. None of the above is true.

    ANS: C

25. In 1991 the Federal Reserve lowered the reserve requirement ratio from 12 percent to 10 percent. Other things the same this should have
    a. increased both the money multiplier and the money supply.
    b. decreased both the money multiplier and the money supply.
    c. increased the money multiplier and decreased the money supply.
    d. decreased the money multiplier and increased the money supply.

    ANS: A

Use the balance sheet for the following questions.

Table 16-2

First Bank of Mason City

Assets		Liabilities	
Required Reserves	$20.00	Deposits	$100.00
Loans	$80.00		

26. Refer to Table 16-2. The reserve ratio is
    a. 0 percent.
    b. 20 percent.
    c. 80 percent.
    d. 100 percent.

    ANS: B

27. Refer to Table 16-2. If $1,000 is deposited into the First Bank of Mason City,
    a. total reserves will initially increase by $200.
    b. liabilities will decrease by $1,000.
    c. assets will increase by $1,000.
    d. required reserves will increase by $800.

    ANS: C

28. Refer to Table 16-2. If $400 is deposited into the First Bank of Mason City,
    a. the bank will be able to make additional loans totaling $320.
    b. excess reserves initially increase by $320.
    c. required reserves initially increase by $80.
    d. All of the above are true.

    ANS: D

Use the balance sheet for the following questions.

Table 16-3

Last Bank of Cedar Bend

Assets		Liabilities	
Reserves	$25,000	Deposits	$150,000
Loans	$125,000		

29. Refer to Table 16-3. If the reserve requirement is 10 percent, this bank
    a. is in a position to make a new loan of $15,000.
    b. has less reserves than required.
    c. has excess reserves of less than $15,000.
    d. None of the above are correct.

    ANS: C

30. Refer to Table 16-3. If the reserve requirement is 10 percent and then someone deposits $50,000 into the bank, it will
    a. have $65,000 in excess reserves.
    b. have $55,000 in excess reserves.
    c. need to raise reserves by $5,000.
    d. None of the above are correct.

    ANS: B

31. Refer to Table 16-3. If the reserve requirement is 20 percent, this bank
    a. has $10,000 of excess reserves.
    b. needs $10,000 more of reserves to meet its reserve requirements.
    c. needs $5,000 more of reserves to meet its reserve requirements.
    d. just meets its reserve requirement.

    ANS: C

32. Refer to Table 16-3. If the Last Bank of Cedar Bend is holding $10,000 in excess reserves, the reserve requirement is
    a. 2 percent.
    b. 5 percent.
    c. 7 percent.
    d. 10 percent.

    ANS: D

33. If the reserve ratio is 10 percent, the money multiplier is
    a. 100.
    b. 10.
    c. 9/10.
    d. 1/10.

    ANS: B

34. If the reserve ratio is 20 percent, the money multiplier is
    a. 2.
    b. 4.
    c. 5.
    d. 8.

    ANS: C

35. If the reserve ratio increased from 10 percent to 20 percent, the money multiplier would
    a. rise from10 to 20.
    b. rise from 5 to 10.
    c. fall from 10 to 5.
    d. not change.

    ANS: C

36. If the reserve ratio is 10 percent, $1,000 of excess reserves can create
    a. $100 of new money.
    b. $1,000 of new money.
    c. $10,000 of new money.
    d. None of the above are correct.

    ANS: C

37. If the reserve ratio is 15 percent, an additional $1,000 of reserves will increase the money supply, to the nearest dollar, by
    a. $1176.
    b. $1275.
    c. $5667.
    d. $6667.

    ANS: D

38. In Wellville, the money supply is $80,000 and reserves are $18,000. Assuming that people hold only deposits and no currency, and that banks hold only required reserves, the required reserve ratio is
    a. 29 percent.
    b. 22.5 percent.
    c. 16 percent.
    d. None of the above are correct.

    ANS: B

39. If the reserve ratio is 100 percent, depositing $500 of paper money in a bank will eventually increase the money supply by
    a. $5,000.
    b. $1,000.
    c. $500.
    d. $0.

    ANS: D

40. Which list contains only actions that increase the money supply?
    a. lower the discount rate, raise the reserve requirement ratio
    b. lower the discount rate, lower the reserve requirement ratio
    c. raise the discount rate, raise the reserve requirement ratio
    d. raise the discount rate, lower the reserve requirement ratio

    ANS: B

41. Which list contains only actions that decrease the money supply?
    a. raise the discount rate, make open market purchases
    b. raise the discount rate, make open market sales
    c. lower the discount rate, make open market purchases
    d. lower the discount rate, make open market sales

    ANS: B

42. To increase the money supply, the Fed could
    a. sell government bonds.
    b. increase the discount rate.
    c. decrease the reserve requirement.
    d. None of the above is correct.

    ANS: C

43. To increase the money supply, the Fed could
    a. sell government bonds.
    b. decrease the discount rate.
    c. increase the reserve requirement.
    d. None of the above is correct.

    ANS: B

44. To decrease the money supply, the Fed could
    a. sell government bonds.
    b. increase the discount rate.
    c. increase the reserve requirement.
    d. All of the above are correct.

    ANS: D

45. When the Fed conducts open market purchases, bank reserves
    a. increase and banks can increase lending.
    b. increase and banks must decrease lending.
    c. decrease and banks can increase lending.
    d. decrease and banks must decrease lending.

    ANS: A

46. If the Fed sells government bonds to the public, bank reserves tend to
    a. increase and the money supply increases.
    b. increase and the money supply decreases.
    c. decrease and the money supply increases.
    d. decrease and the money supply decreases.

    ANS: D

47. In a fractional reserve banking system, an increase in reserve requirements
    a. increases both the money multiplier and the money supply.
    b. decreases both the money multiplier and the money supply.
    c. increases the money multiplier, but decreases the money supply.
    d. decreases the money multiplier, but increases the money supply.

    ANS: B

48. In a fractional reserve banking system, a decrease in reserve requirements
    a. increases both the money multiplier and the money supply.
    b. decreases both the money multiplier and the money supply.
    c. increases the money multiplier, but decreases the money supply.
    d. decreases the money multiplier, but increases the money supply.

    ANS: A

49. If the discount rate is lowered, banks choose to borrow
    a. less from the Fed so reserves increase.
    b. less from the Fed so reserves decrease.
    c. more from the Fed so reserves increase.
    d. more from the Fed so reserves decrease.

    ANS: C

50. When the Fed decreases the discount rate, banks will borrow more from the Fed, lend
    a. more to the public, and so the money supply will decrease.
    b. less to the public, and so the money supply will decrease.
    c. more to the public, and so the money supply will increase.
    d. less to the public, and so the money supply will increase.

    ANS: C

51. If the reserve ratio is 10 percent, banks do not hold excess reserves, and people do not hold currency, then when the Fed purchases $20 million of government bonds, bank reserves
    a. increase by $20 million and the money supply eventually increases by $200 million.
    b. decrease by $20 million and the money supply eventually increases by $200 million.
    c. increase by $20 million and the money supply eventually decreases by $200 million.
    d. decrease by $20 million and the money supply eventually decreases by $200 million.

    ANS: A

52. If the reserve ratio is 10 percent, and banks do not hold excess reserves, when the Fed sells $10 million dollars of bonds to the public, bank reserves
    a. increase by $1 million and the money supply eventually increases by $10 million.
    b. increase by $10 million and the money supply eventually increases by $100 million.
    c. decrease by $1 million and the money supply eventually increases by $10 million.
    d. decrease by $10 million and the money supply eventually decreases by $100 million.

    ANS: D

53. If the public decides to hold more currency and fewer deposits in banks, bank reserves
    a. decrease and the money supply eventually decreases.
    b. decrease but the money supply does not change.
    c. increase and the money supply eventually increases.
    d. increase but the money supply does not change.

    ANS: A

54. During recessions, banks typically choose to hold more excess reserves relative to their deposits. This action
    a. increases the money multiplier and increases the money supply.
    b. decreases the money multiplier and decreases the money supply.
    c. does not change the money multiplier, but increases the money supply.
    d. does not change the money multiplier, but decreases the money supply.

    ANS: B

55. In the nineteenth century when there were often bank runs caused by crop failures, banks would make relatively fewer loans and hold relatively more excess reserves. By itself, these actions by the banks should have
    a. increased the money multiplier and the money supply.
    b. decreased the money multiplier and increased the money supply.
    c. increased the money multiplier and decreased the money supply.
    d. decreased both the money multiplier and the money supply.

    ANS: D

56. At one time, the country of Aquilonia had no banks, but had currency of $10 million. Then a banking system was established with a reserve requirement of 20 percent. The people of Aquilonia deposited half of their currency into the banking system. If banks do not hold excess reserves, what is Aquilonia's money supply now?
    a. $10 million
    b. $12 million
    c. $25 million
    d. $30 million

    ANS: D