天津外国语大学(天外)
Tianjin Foreign Studies University (TFSU)

Correct answers and the glossary for the Monetary policy topic.

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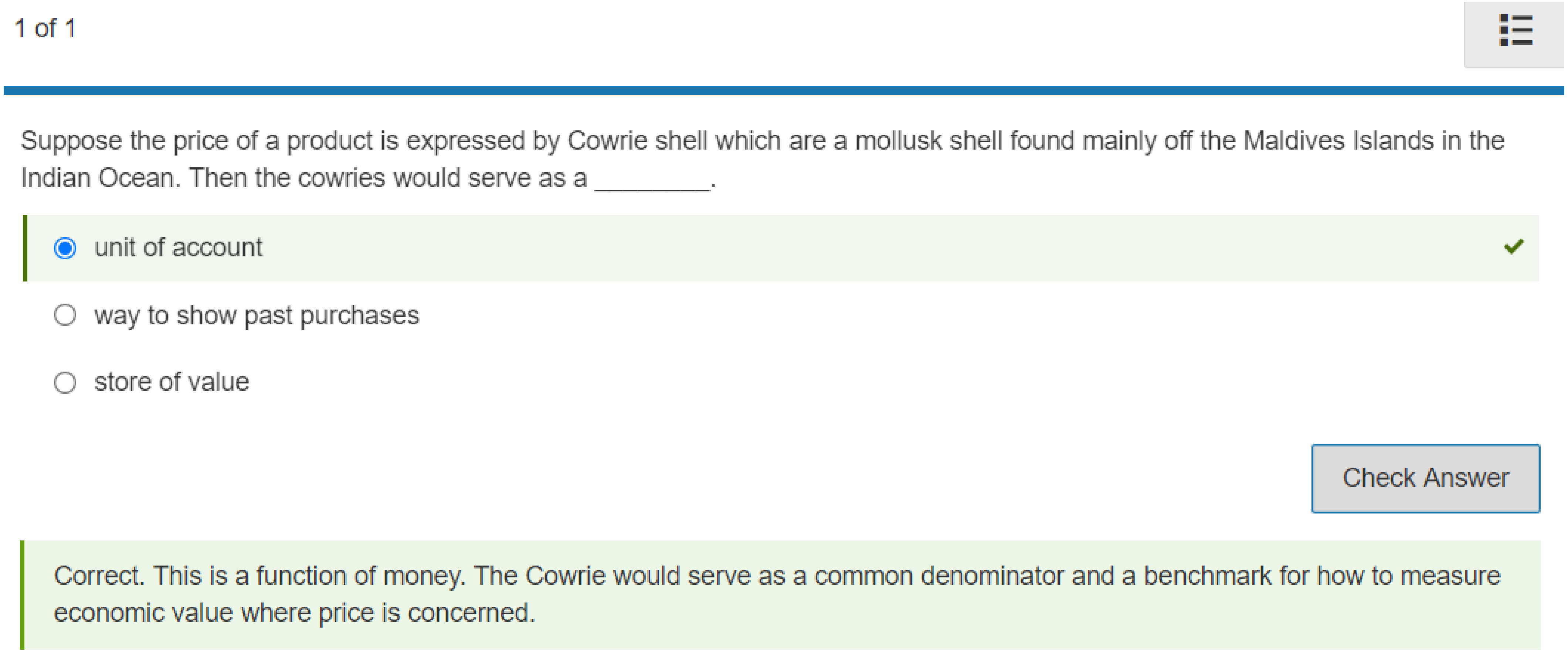
Tianjin, 2023

Q Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



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Suppose the price of a product is expressed by Cowrie shell which are a mollusk shell found mainly off the Maldives Islands in the Indian Ocean. Then the cowries would serve as a ________.

● unit of account ✓

○ way to show past purchases

○ store of value

Correct. This is a function of money. The Cowrie would serve as a common denominator and a benchmark for how to measure economic value where price is concerned.

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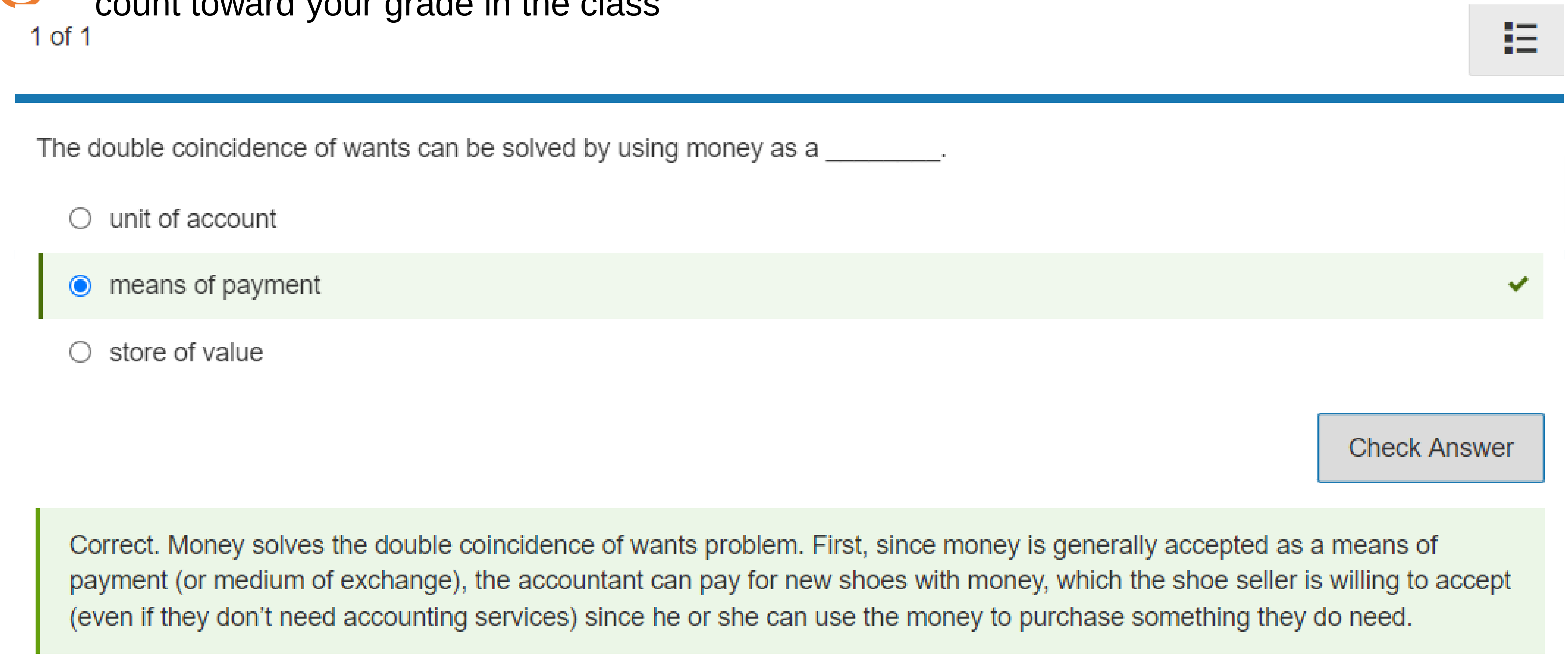

1 of 1

The double coincidence of wants can be solved by using money as a ________.

○ unit of account

● means of payment ✓

○ store of value

Correct. Money solves the double coincidence of wants problem. First, since money is generally accepted as a means of payment (or medium of exchange), the accountant can pay for new shoes with money, which the shoe seller is willing to accept (even if they don’t need accounting services) since he or she can use the money to purchase something they do need.

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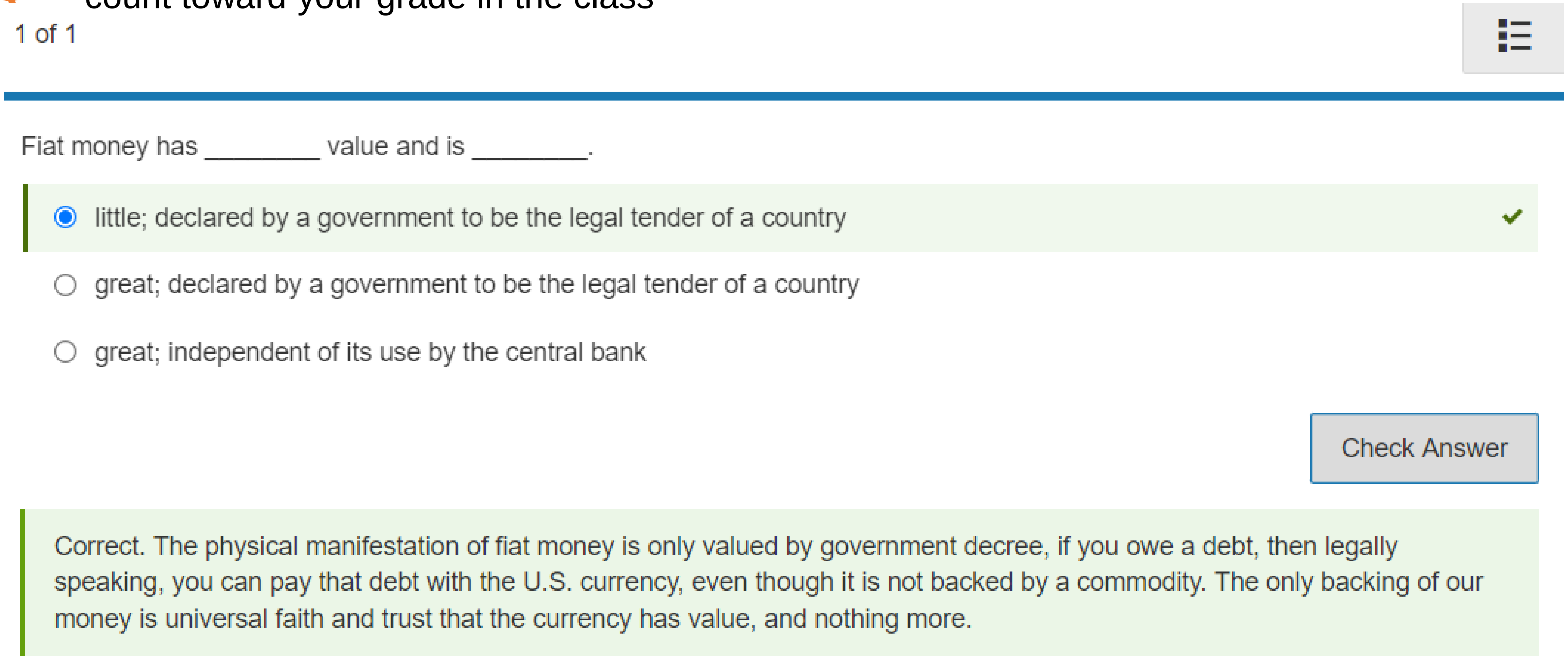

Fiat money has ________ value and is ________.

- ● little; declared by a government to be the legal tender of a country ✓
- ○ great; declared by a government to be the legal tender of a country
- ○ great; independent of its use by the central bank

Correct. The physical manifestation of fiat money is only valued by government decree, if you owe a debt, then legally speaking, you can pay that debt with the U.S. currency, even though it is not backed by a commodity. The only backing of our money is universal faith and trust that the currency has value, and nothing more.

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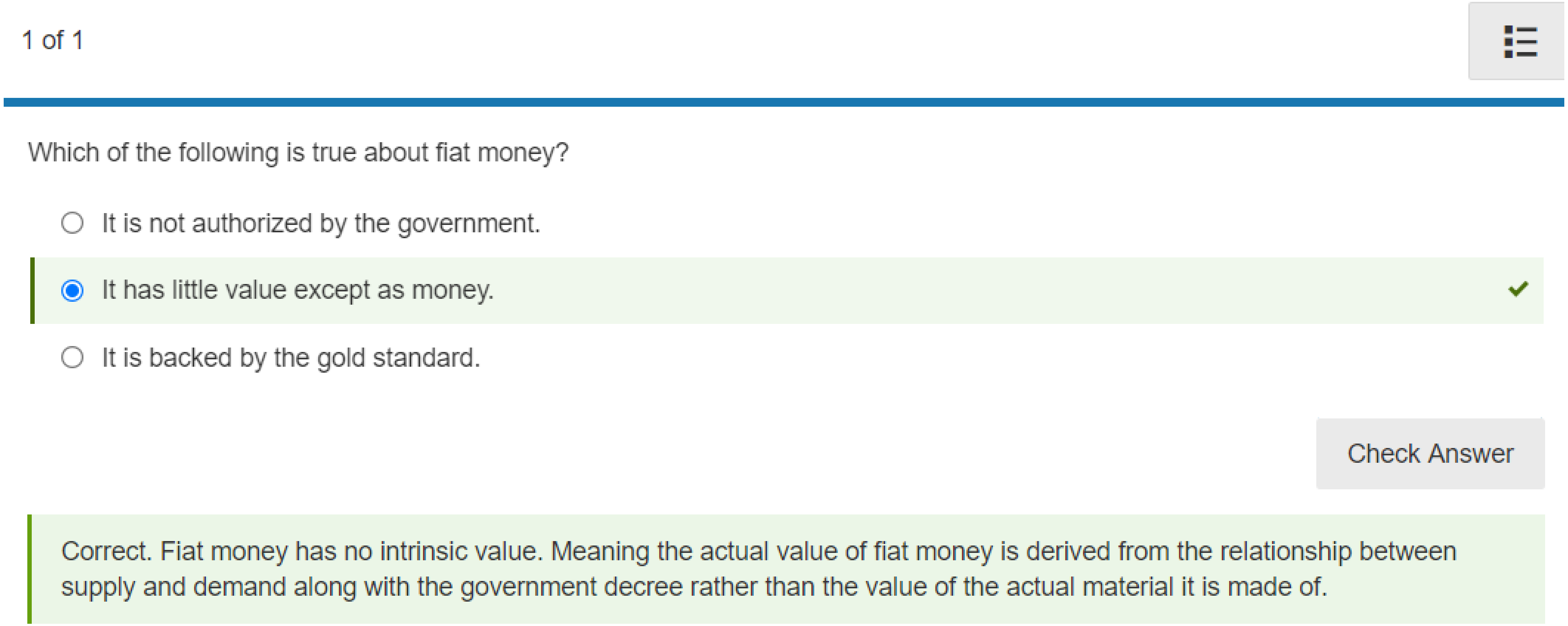

1 of 1

Which of the following is true about fiat money?

○ It is not authorized by the government.

● It has little value except as money. ✓

○ It is backed by the gold standard.

Correct. Fiat money has no intrinsic value. Meaning the actual value of fiat money is derived from the relationship between supply and demand along with the government decree rather than the value of the actual material it is made of.

GLOSSARY

barter: literally, trading one good or service for another, without using money

commodity money: an item that is used as money, but which also has value from its use as something other than money

commodity-backed currencies: dollar bills or other currencies with values backed up by gold or another commodity

double coincidence of wants: a situation in which two people each want some good or service that the other person can provide

fiat money: something used as money, but which has no intrinsic value besides that

medium of exchange: whatever is widely accepted as a method of payment

money: whatever serves society in four functions: as a medium of exchange, a store of value, a unit of account, and a standard of deferred payment.

standard of deferred payment: money must also be acceptable to make purchases today that will be paid in the future

store of value: something that serves as a way of preserving economic value that one can spend or consume in the future

unit of account: the common way in which we measure market values in an economy

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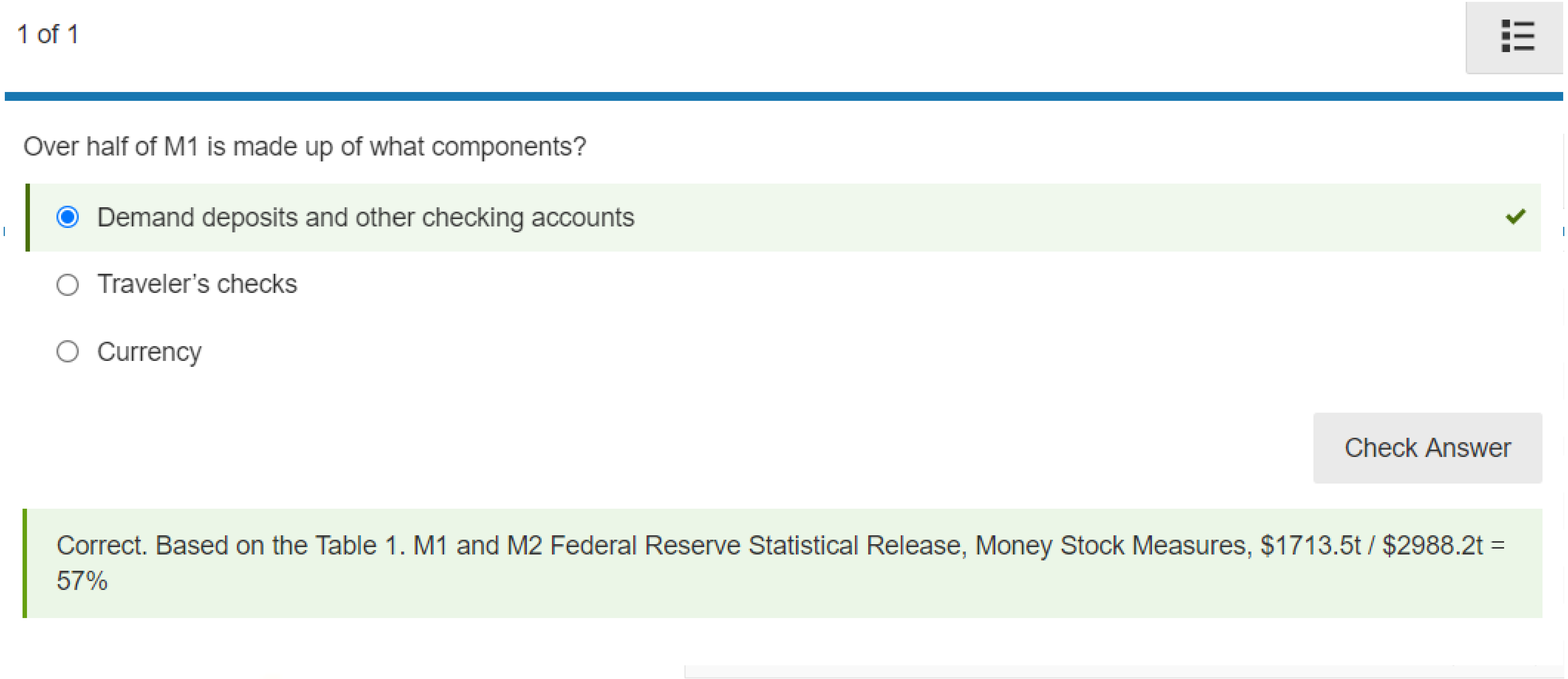

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Over half of M1 is made up of what components?

- ● Demand deposits and other checking accounts ✓
- ○ Traveler’s checks
- ○ Currency

Correct. Based on the Table 1. M1 and M2 Federal Reserve Statistical Release, Money Stock Measures, $1713.5t / $2988.2t = 57%

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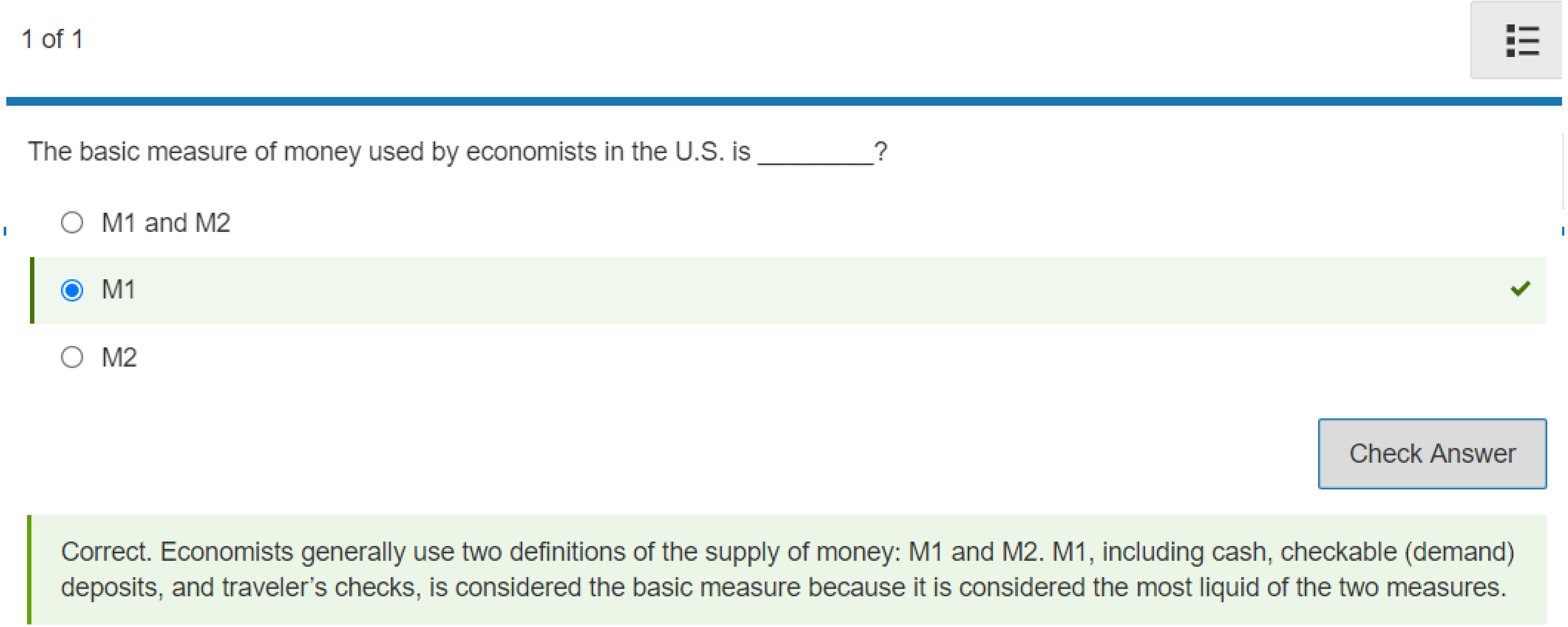

1 of 1

The basic measure of money used by economists in the U.S. is ________?

○ M1 and M2

● M1 ✓

○ M2

Correct. Economists generally use two definitions of the supply of money: M1 and M2. M1, including cash, checkable (demand) deposits, and traveler’s checks, is considered the basic measure because it is considered the most liquid of the two measures.

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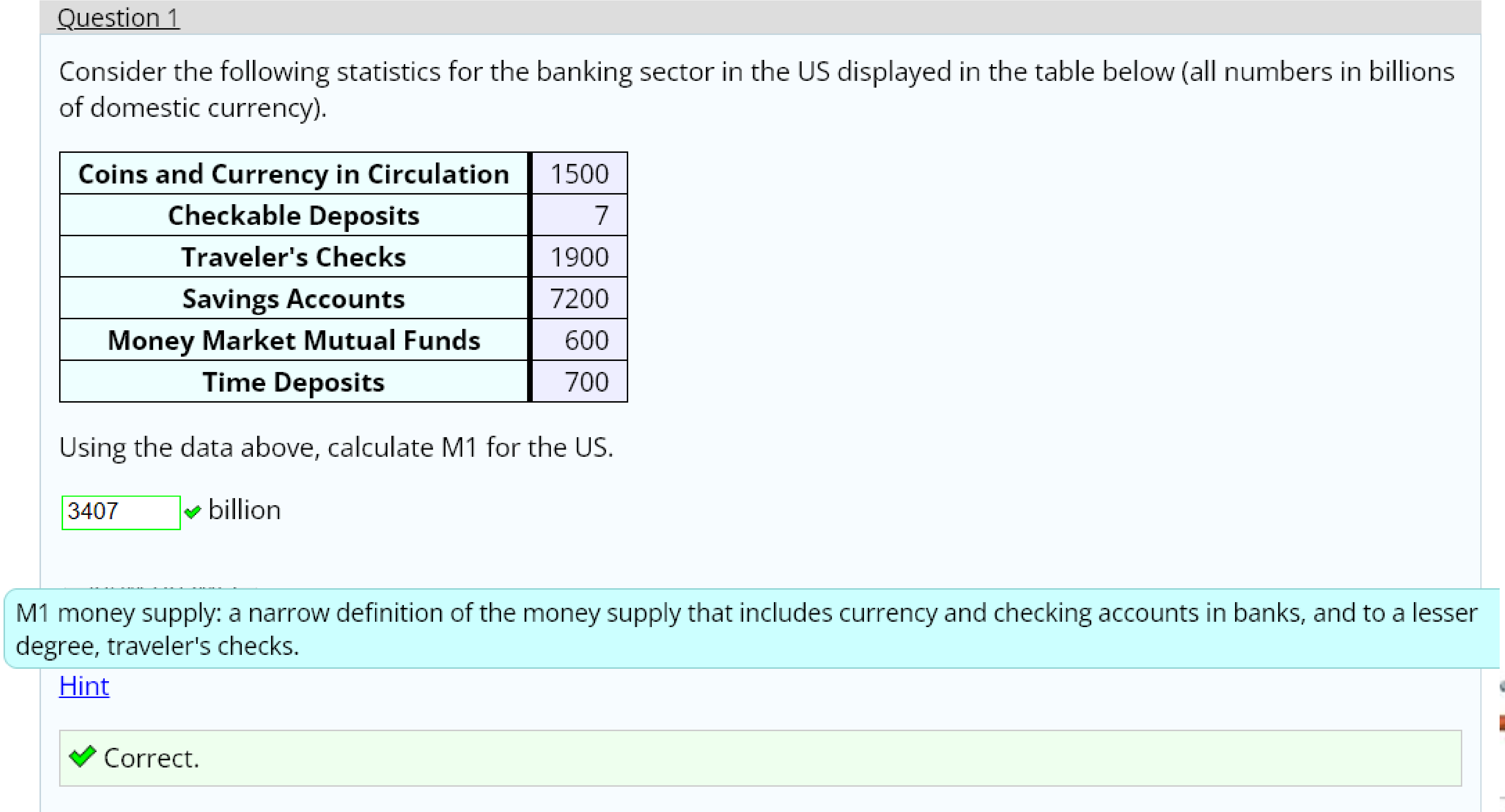

Question 1

Consider the following statistics for the banking sector in the US displayed in the table below (all numbers in billions of domestic currency).

Coins and Currency in Circulation	1500
Checkable Deposits	7
Traveler's Checks	1900
Savings Accounts	7200
Money Market Mutual Funds	600
Time Deposits	700

Using the data above, calculate M1 for the US.

3407 ✓ billion

M1 money supply: a narrow definition of the money supply that includes currency and checking accounts in banks, and to a lesser degree, traveler's checks.

Hint

✓ Correct.

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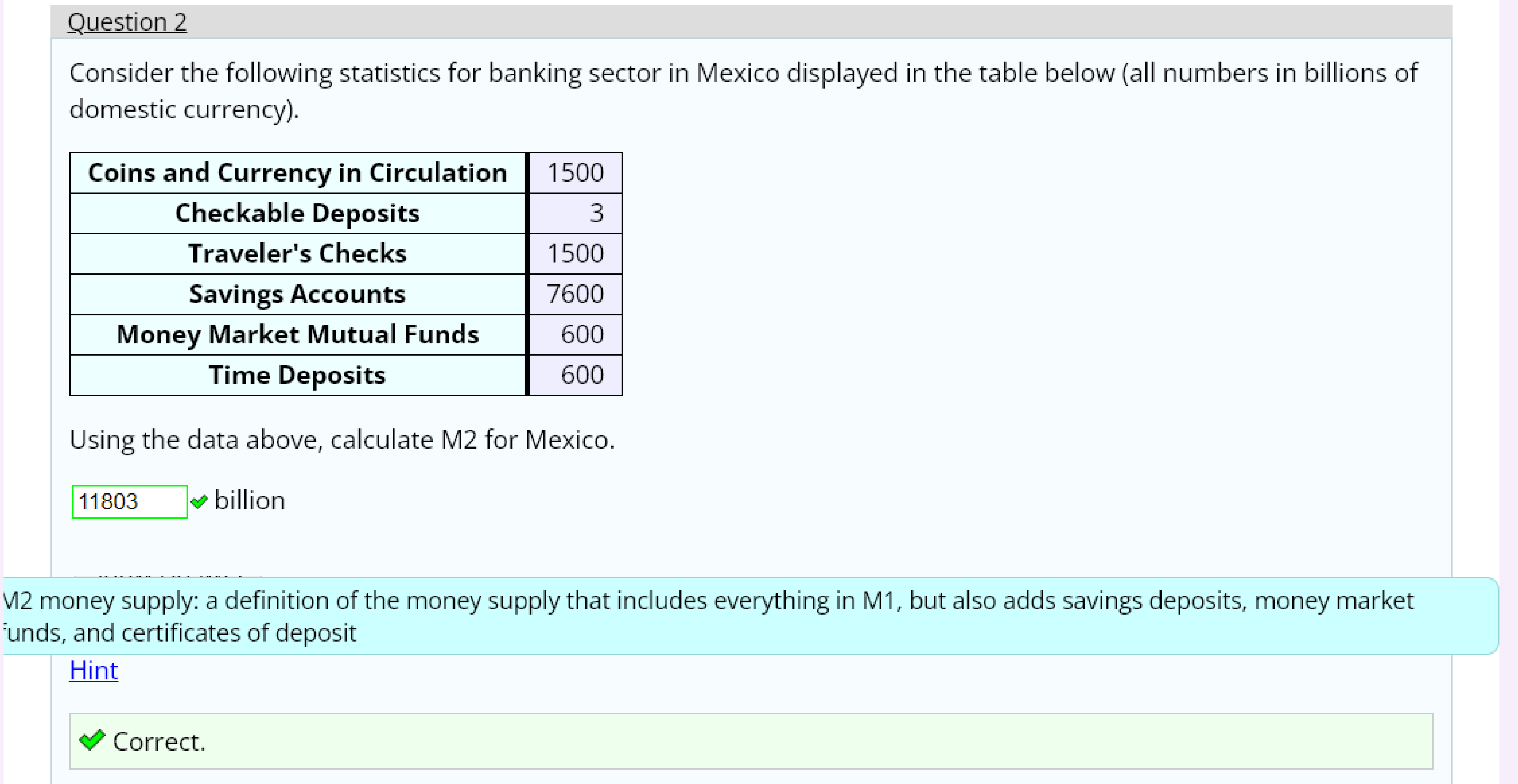

Question 2

Consider the following statistics for banking sector in Mexico displayed in the table below (all numbers in billions of domestic currency).

Coins and Currency in Circulation	1500
Checkable Deposits	3
Traveler's Checks	1500
Savings Accounts	7600
Money Market Mutual Funds	600
Time Deposits	600

Using the data above, calculate M2 for Mexico.

11803 ✓ billion

M2 money supply: a definition of the money supply that includes everything in M1, but also adds savings deposits, money market funds, and certificates of deposit

Hint

✓ Correct.

GLOSSARY

coins and currency in circulation: the coins and bills that circulate in an economy that are not held by the U.S Treasury, at the Federal Reserve Bank, or in bank vaults

credit card: immediately transfers money from the credit card company’s checking account to the seller, and at the end of the month the user owes the money to the credit card company; a credit card is a short-term loan

debit card:like a check, is an instruction to the user’s bank to transfer money directly and immediately from your bank account to the seller

demand deposit:checkable deposit in banks that is available by making a cash withdrawal or writing a check

liquidity: how quickly and easily an asset can be converted to a means of payment to make a purchase

M1 money supply: a narrow definition of the money supply that includes currency and checking accounts in banks, and to a lesser degree, traveler’s checks.

M2 money supply: a definition of the money supply that includes everything in M1, but also adds savings deposits, money market funds, and certificates of deposit

money market fund: the deposits of many investors are pooled together and invested in a safe way like short-term government bonds

savings deposit:bank account where you cannot withdraw money by writing a check, but can withdraw the money at a bank—or can transfer it easily to a checking account

smart card: stores a certain value of money on a card and then one can use the card to make purchases

time deposit: account that the depositor has committed to leaving in the bank for a certain period of time, in exchange for a higher rate of interest; also called certificate of deposit

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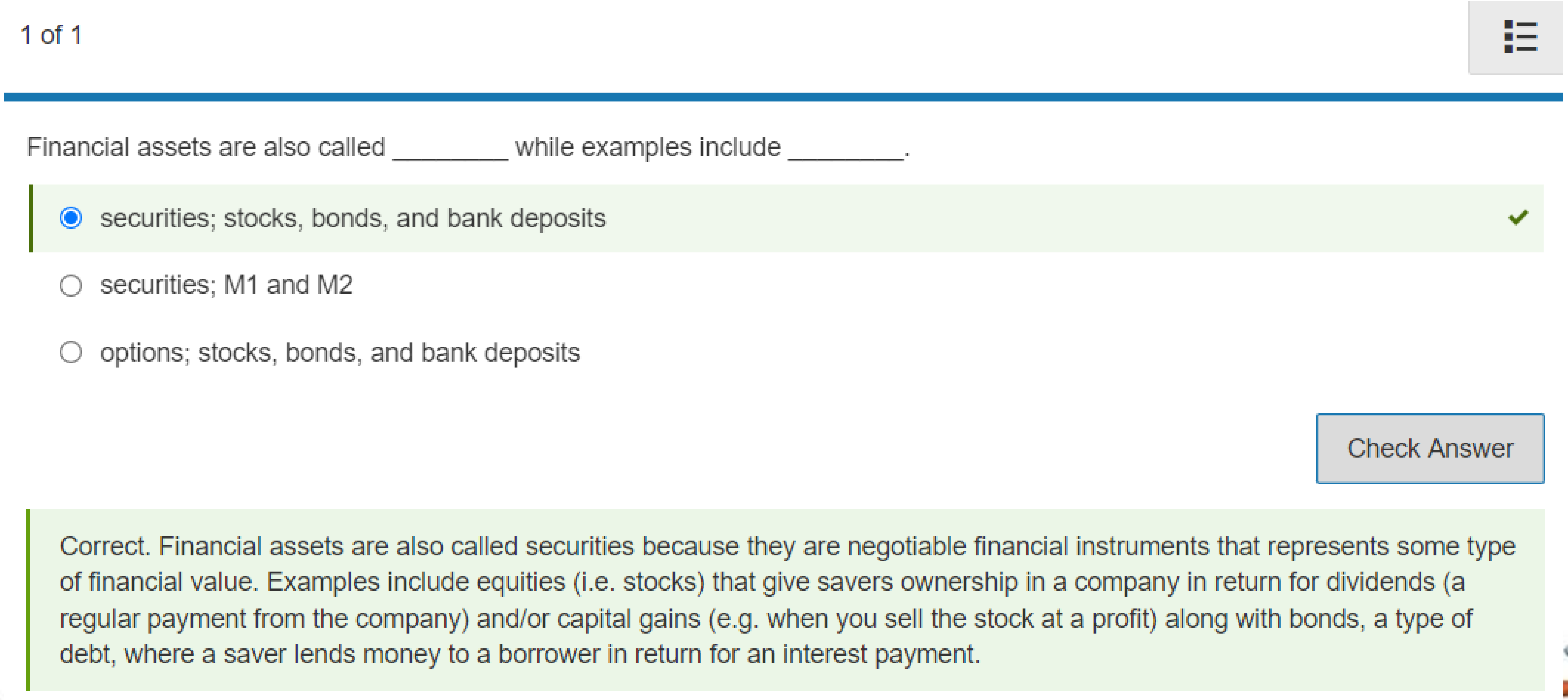

Financial assets are also called ________ while examples include ________.

● securities; stocks, bonds, and bank deposits ✓

○ securities; M1 and M2

○ options; stocks, bonds, and bank deposits

Correct. Financial assets are also called securities because they are negotiable financial instruments that represents some type of financial value. Examples include equities (i.e. stocks) that give savers ownership in a company in return for dividends (a regular payment from the company) and/or capital gains (e.g. when you sell the stock at a profit) along with bonds, a type of debt, where a saver lends money to a borrower in return for an interest payment.

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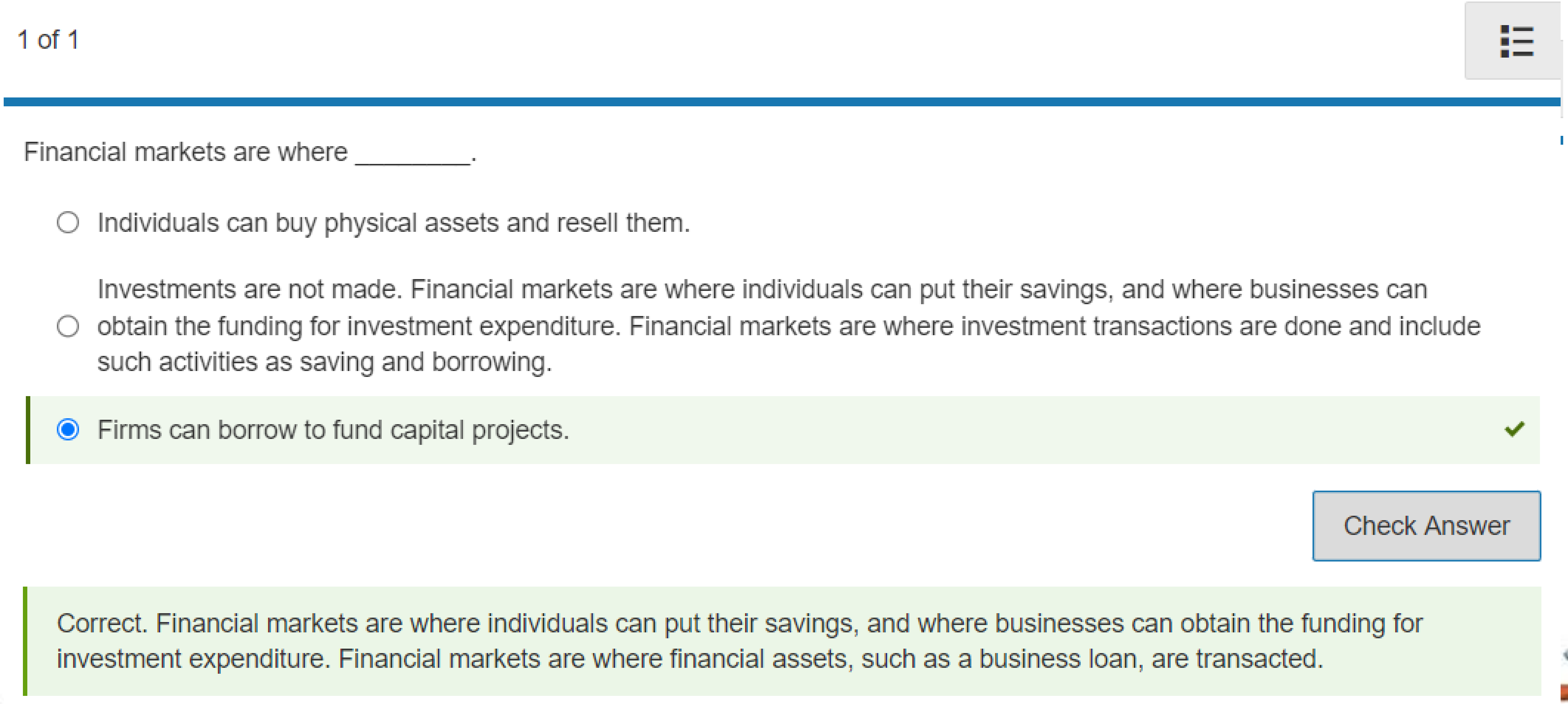

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Financial markets are where ________.

○ Individuals can buy physical assets and resell them.

○ Investments are not made. Financial markets are where individuals can put their savings, and where businesses can obtain the funding for investment expenditure. Financial markets are where investment transactions are done and include such activities as saving and borrowing.

● Firms can borrow to fund capital projects. ✓

Correct. Financial markets are where individuals can put their savings, and where businesses can obtain the funding for investment expenditure. Financial markets are where financial assets, such as a business loan, are transacted.

GLOSSARY

bills: short term (less than one year) debt instruments

bond: a financial contract through which a borrower like a corporation, a city or state, or the federal government agrees to repay the amount that it borrowed and also a rate of interest over a period of time in the future; usually long-term (greater than 10 year) debt instruments

bondholder: someone who owns bonds and receives the interest payments

capital gain: a financial gain from buying an asset, like a share of stock or a house, and later selling it at a higher price

corporation: a business owned by shareholders who have limited liability for the company's debt yet a share of the company's profits; may be private or public and may or may not have publicly-traded stock

dividend: a direct payment from a firm to its shareholders

equities or stocks: ownership in a private company (unlike debt which conveys no ownership)

financial markets: marketplace where money is invested and borrowed, or in other words, where securities are traded

initial public offering (IPO): original sale of stock by a corporation

mutual funds: funds that buy a range of stocks or bonds from different companies, thus allowing an investor an easy way to diversify

notes: intermediate term (1-10 year) debt instruments

private company: a firm owned by the people who run it on a day-to-day basis

public company: a firm that has sold stock to the public, which in turn investors then can buy and sell

securities: synonym for financial assets, or a certificate or other financial instrument that has monetary value and can be traded. These can be debt securities like bonds or equity securities like stocks.

shareholders: people who own at least some shares of stock in a firm

shares: a firm's stock, divided into individual portions

sole proprietorship: a company run by an individual as opposed to a group

stock: a specific firm's claim on partial ownership

Treasury bond: a bond issued by the federal government through the U.S. Department of the Treasury

venture capital: financial investments in new companies that are still relatively small in size, but that have potential to grow substantially

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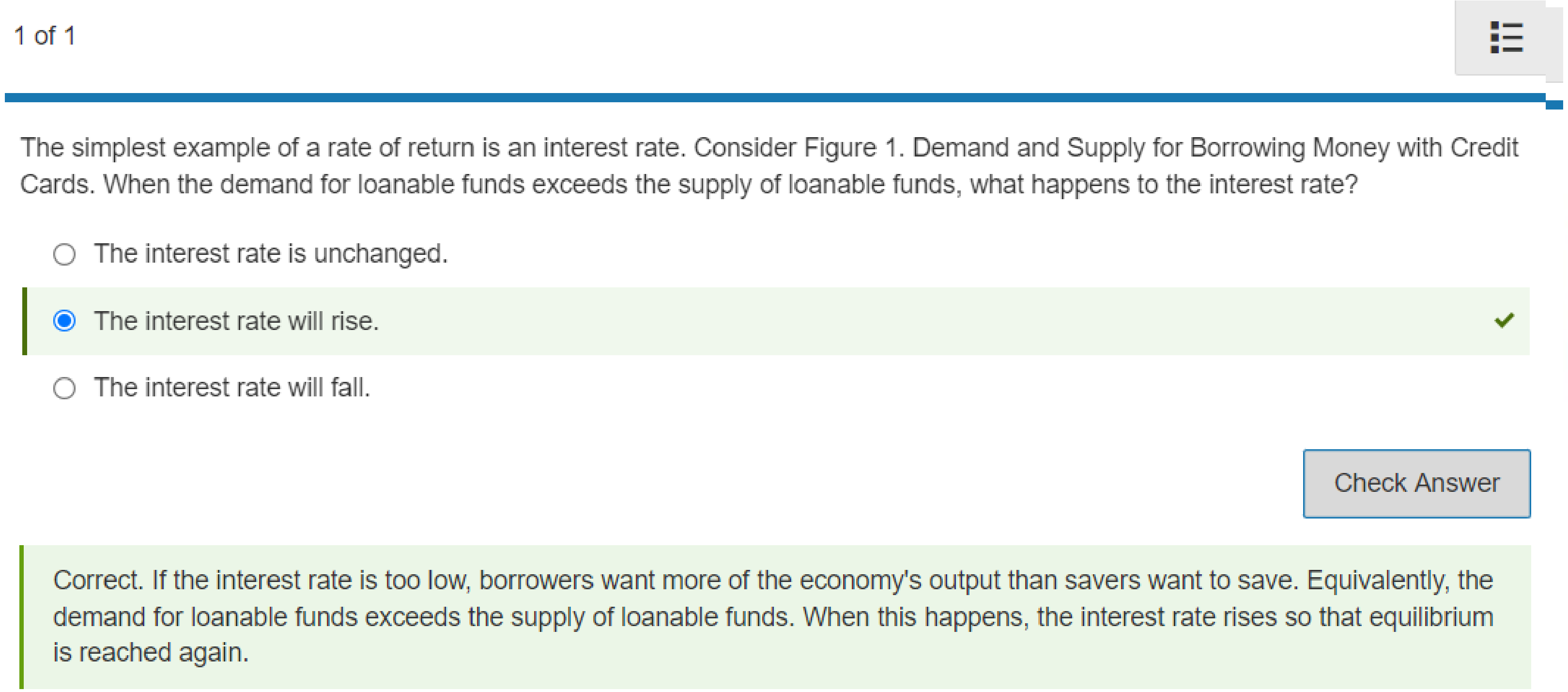
Equilibrium in Financial Markets



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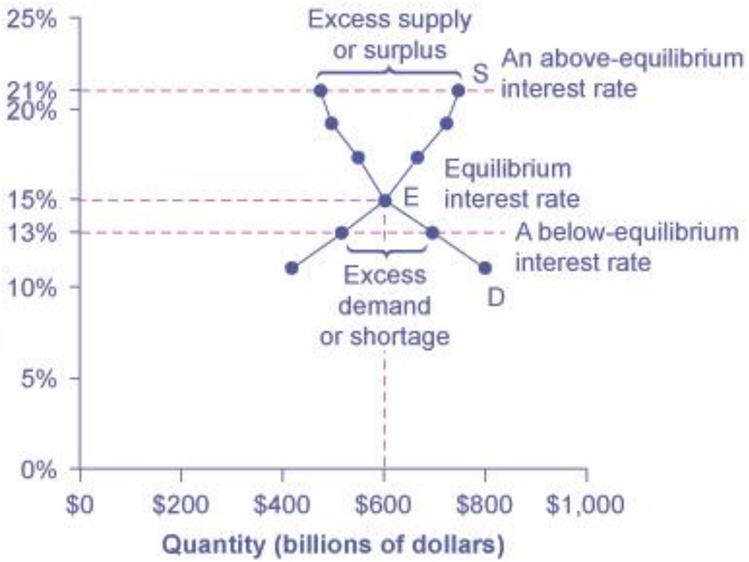
The simplest example of a rate of return is an interest rate. Consider Figure 1. Demand and Supply for Borrowing Money with Credit Cards. When the demand for loanable funds exceeds the supply of loanable funds, what happens to the interest rate?

- ○ The interest rate is unchanged.
- ● The interest rate will rise. ✓
- ○ The interest rate will fall.

Correct. If the interest rate is too low, borrowers want more of the economy's output than savers want to save. Equivalently, the demand for loanable funds exceeds the supply of loanable funds. When this happens, the interest rate rises so that equilibrium is reached again.



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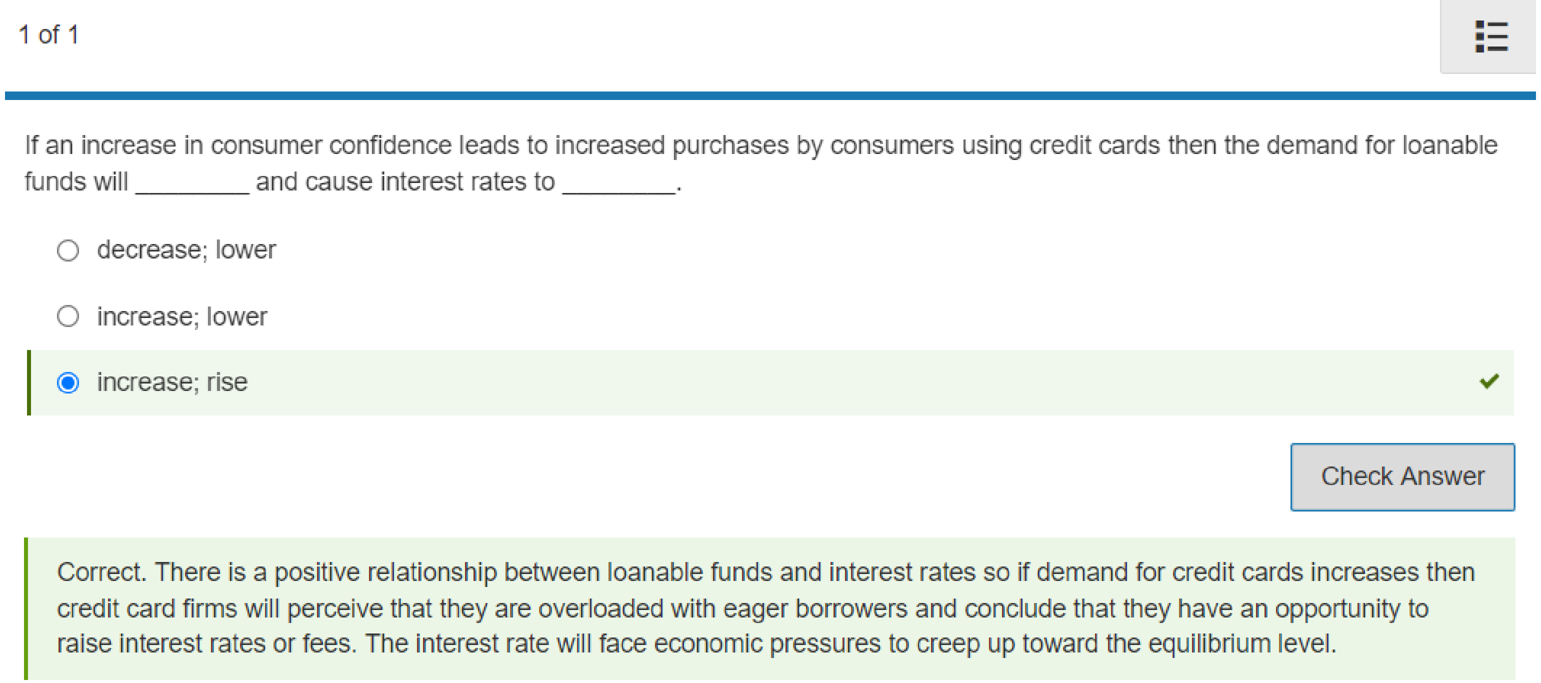
Equilibrium in Financial Markets



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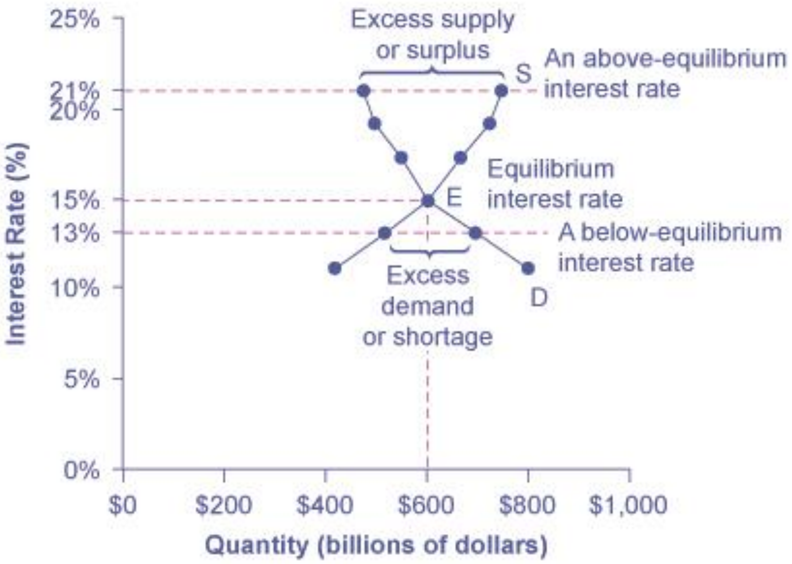
If an increase in consumer confidence leads to increased purchases by consumers using credit cards then the demand for loanable funds will ________ and cause interest rates to ________.

○ decrease; lower

○ increase; lower

● increase; rise ✓

Correct. There is a positive relationship between loanable funds and interest rates so if demand for credit cards increases then credit card firms will perceive that they are overloaded with eager borrowers and conclude that they have an opportunity to raise interest rates or fees. The interest rate will face economic pressures to creep up toward the equilibrium level.



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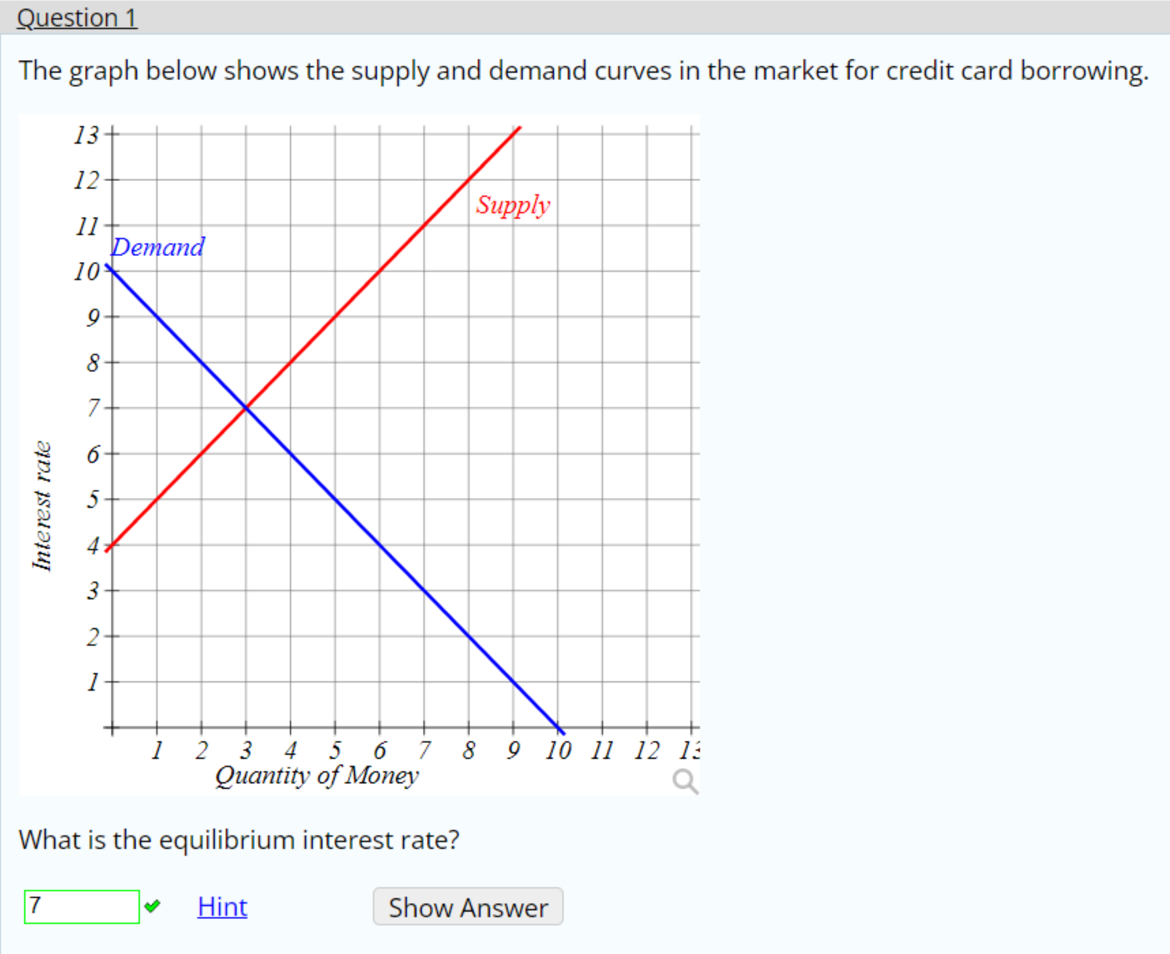
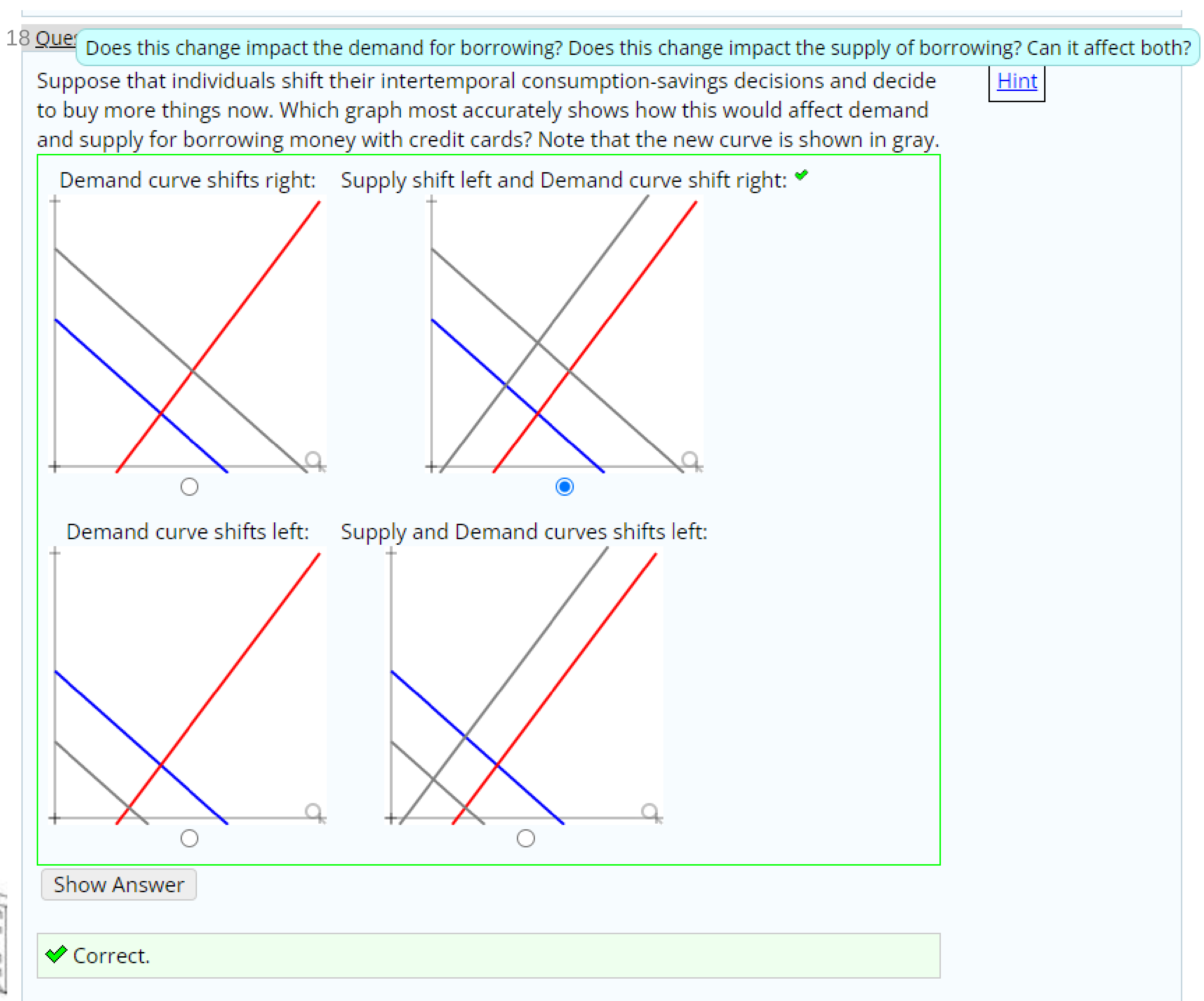


Question 1

The graph below shows the supply and demand curves in the market for credit card borrowing.

What is the equilibrium interest rate?

7 ✓



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Does this change impact the demand for borrowing? Does this change impact the supply of borrowing? Can it affect both?

Suppose that individuals shift their intertemporal consumption-savings decisions and decide to buy more things now. Which graph most accurately shows how this would affect demand and supply for borrowing money with credit cards? Note that the new curve is shown in gray.

Hint

Demand curve shifts right: ○

Supply shift left and Demand curve shift right: ✓ ●

Demand curve shifts left: ○

Supply and Demand curves shifts left: ○

Show Answer

✓ Correct.

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GLOSSARY

interest rate: the “price” of borrowing in the financial market; a rate of return on an investment

intertemporal decision making: the study of how people make choices about what and how much to do at various points in time; when choices at one time influence the possibilities available at other points in time

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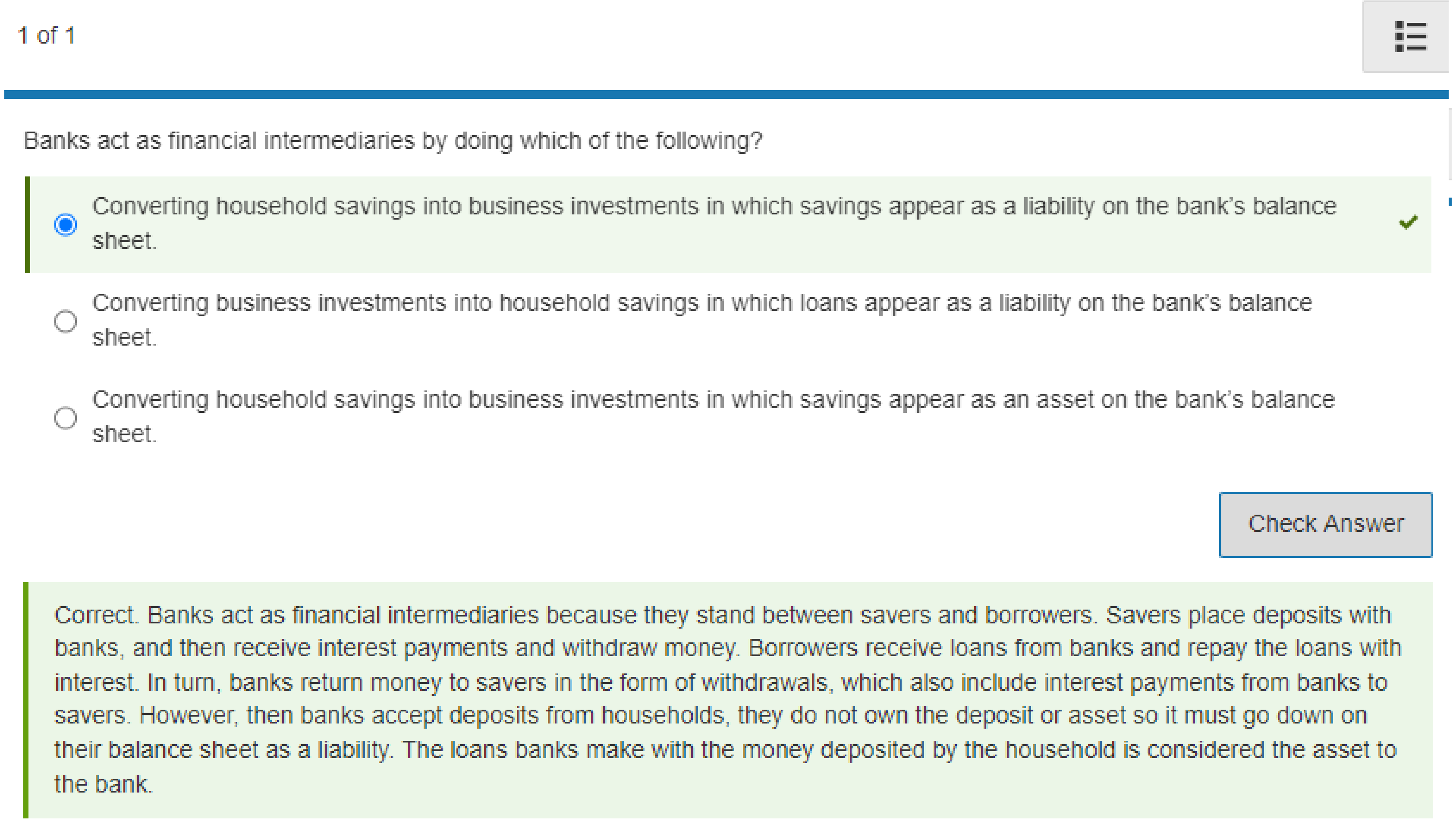

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Banks act as financial intermediaries by doing which of the following?

- ● Converting household savings into business investments in which savings appear as a liability on the bank's balance sheet. ✓
- ○ Converting business investments into household savings in which loans appear as a liability on the bank's balance sheet.
- ○ Converting household savings into business investments in which savings appear as an asset on the bank's balance sheet.

Correct. Banks act as financial intermediaries because they stand between savers and borrowers. Savers place deposits with banks, and then receive interest payments and withdraw money. Borrowers receive loans from banks and repay the loans with interest. In turn, banks return money to savers in the form of withdrawals, which also include interest payments from banks to savers. However, then banks accept deposits from households, they do not own the deposit or asset so it must go down on their balance sheet as a liability. The loans banks make with the money deposited by the household is considered the asset to the bank.

GLOSSARY

checking account: a bank account that typically pays little or no interest, but that gives easy access to money, either by writing a check or by using a “debit card”

credit union: a nonprofit financial institution that its members own and run

debit card: a card that lets the person make purchases, and the financial institution immediately deducts cost from that person’s checking account

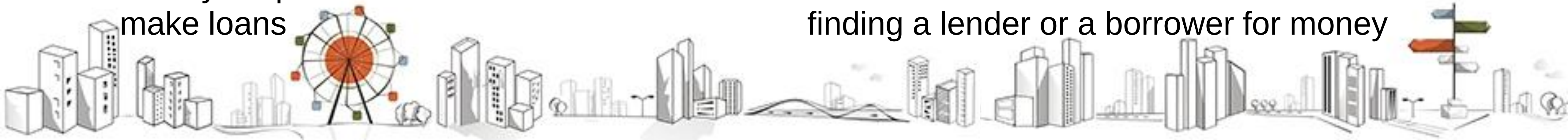
depository institution: institution that accepts money deposits and then uses these to make loans

financial intermediary: an institution that operates between a saver with financial assets to invest and an entity who will borrow those assets and pay a rate of return

payments system: system by which buyers and sellers exchange money for goods, services and financial capital.

savings account: a bank account that pays an interest rate, but withdrawing money typically requires a trip to the bank or an automatic teller machine

transaction costs: the costs associated with finding a lender or a borrower for money



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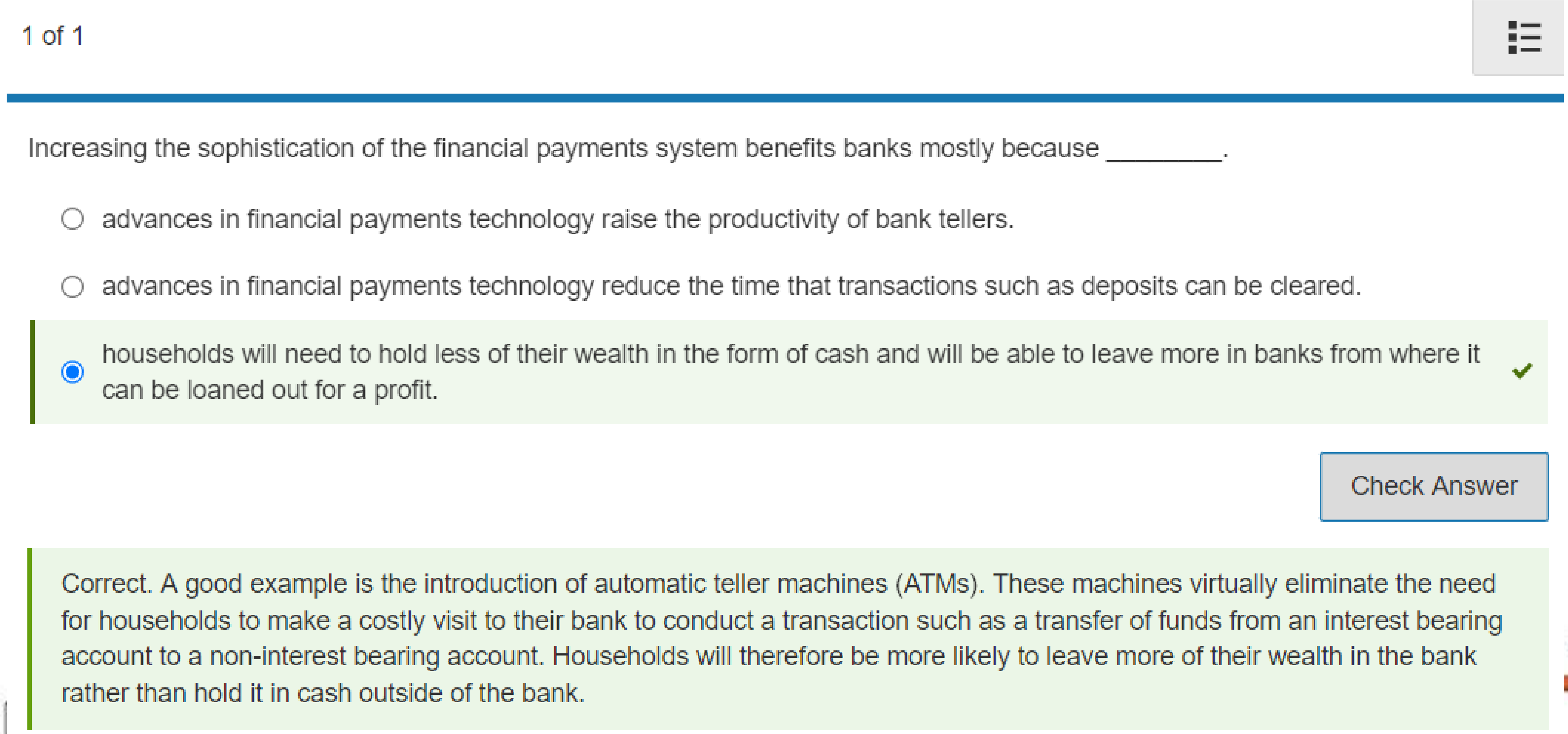

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Increasing the sophistication of the financial payments system benefits banks mostly because ________.

○ advances in financial payments technology raise the productivity of bank tellers.

○ advances in financial payments technology reduce the time that transactions such as deposits can be cleared.

● households will need to hold less of their wealth in the form of cash and will be able to leave more in banks from where it can be loaned out for a profit. ✓

Correct. A good example is the introduction of automatic teller machines (ATMs). These machines virtually eliminate the need for households to make a costly visit to their bank to conduct a transaction such as a transfer of funds from an interest bearing account to a non-interest bearing account. Households will therefore be more likely to leave more of their wealth in the bank rather than hold it in cash outside of the bank.

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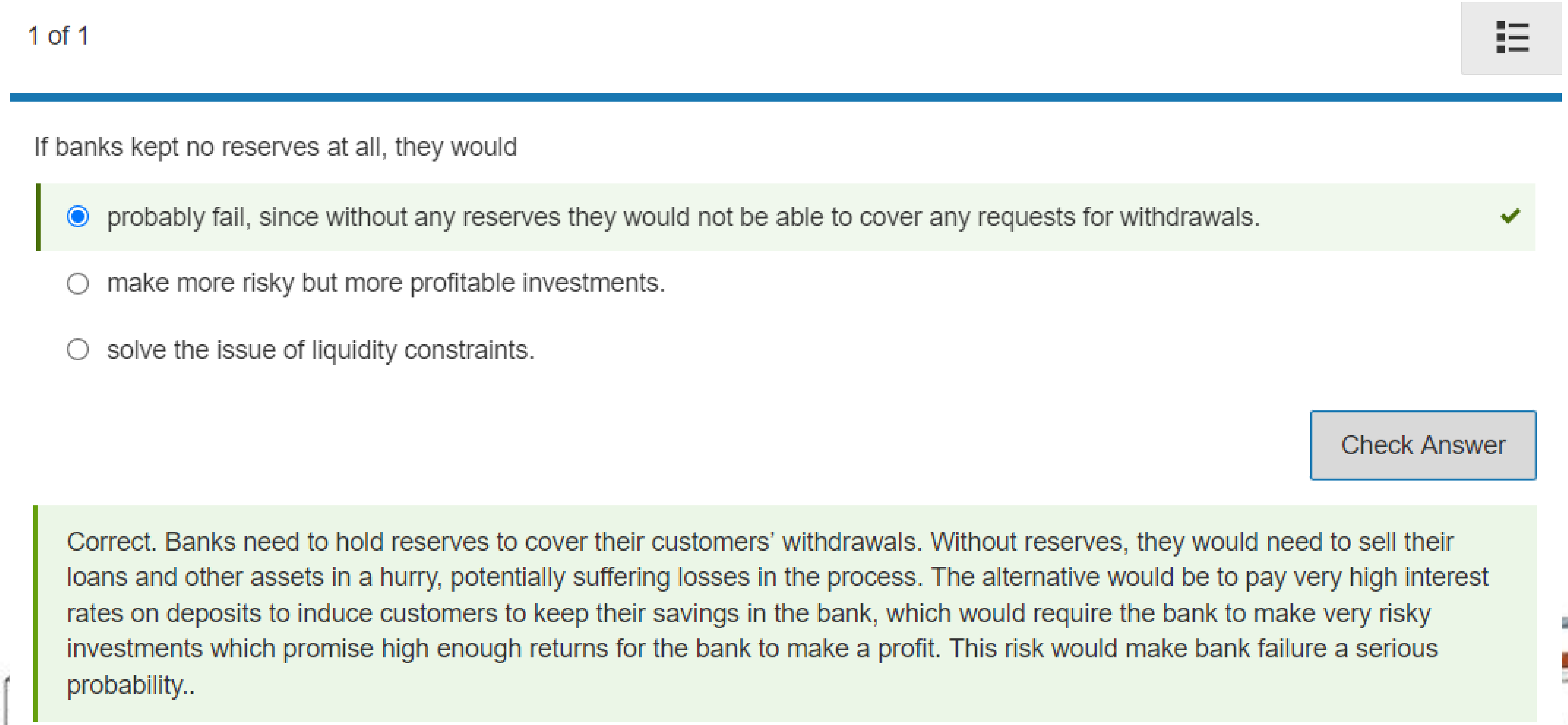

If banks kept no reserves at all, they would

● probably fail, since without any reserves they would not be able to cover any requests for withdrawals. ✓

○ make more risky but more profitable investments.

○ solve the issue of liquidity constraints.

Correct. Banks need to hold reserves to cover their customers’ withdrawals. Without reserves, they would need to sell their loans and other assets in a hurry, potentially suffering losses in the process. The alternative would be to pay very high interest rates on deposits to induce customers to keep their savings in the bank, which would require the bank to make very risky investments which promise high enough returns for the bank to make a profit. This risk would make bank failure a serious probability..

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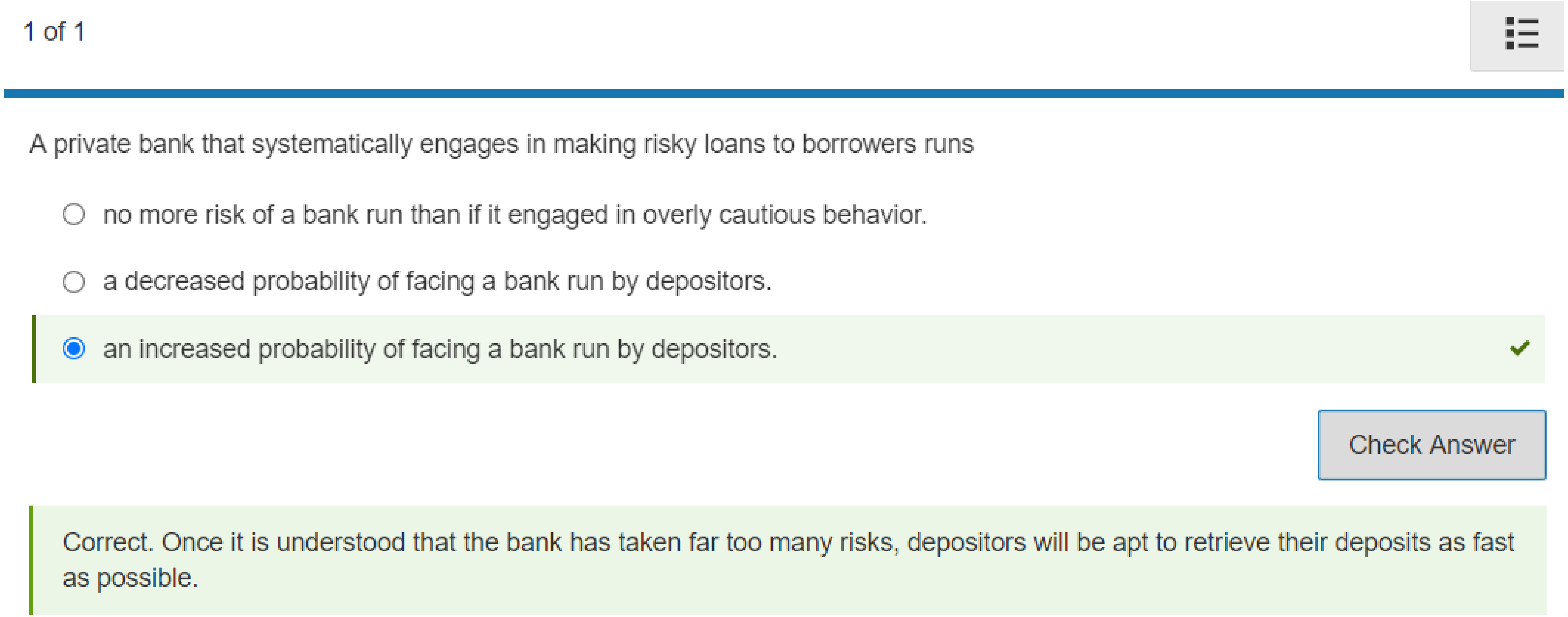

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A private bank that systematically engages in making risky loans to borrowers runs

○ no more risk of a bank run than if it engaged in overly cautious behavior.

○ a decreased probability of facing a bank run by depositors.

● an increased probability of facing a bank run by depositors. ✓

Correct. Once it is understood that the bank has taken far too many risks, depositors will be apt to retrieve their deposits as fast as possible.

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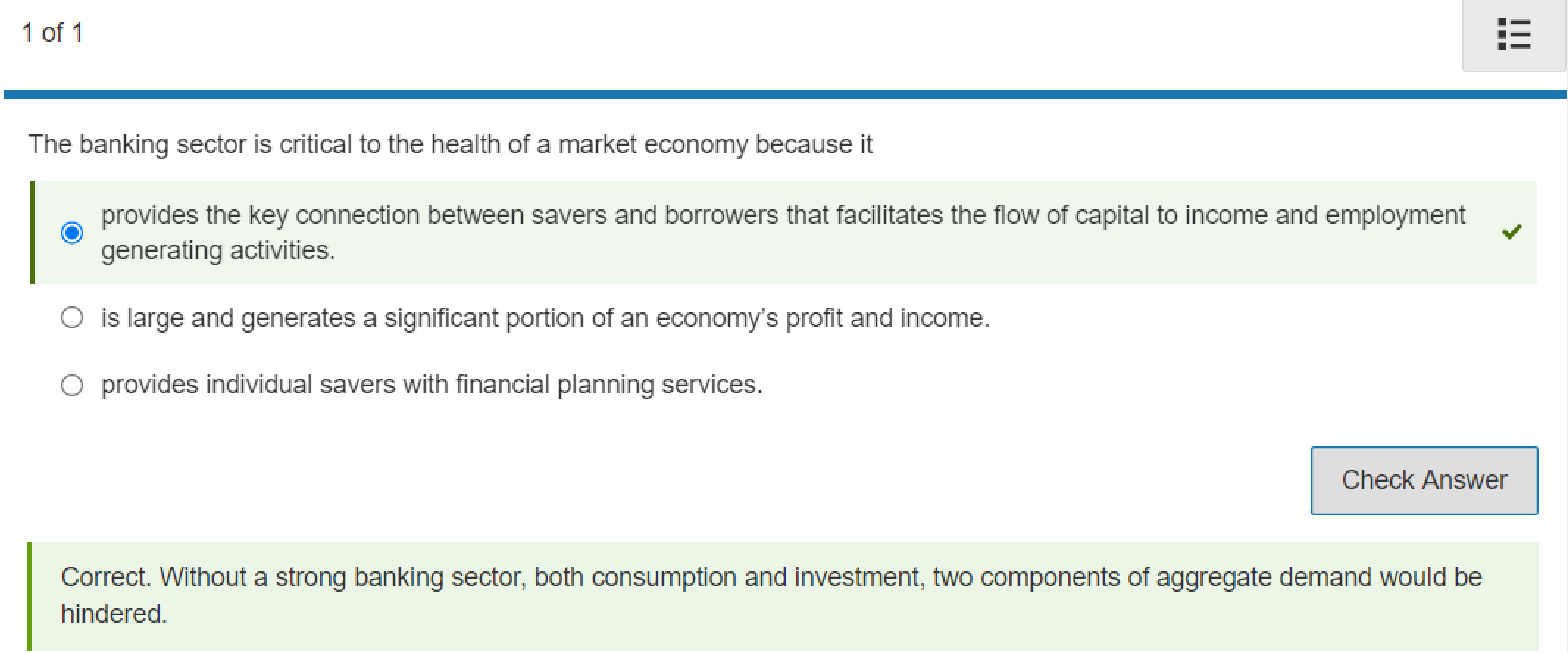

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The banking sector is critical to the health of a market economy because it

● provides the key connection between savers and borrowers that facilitates the flow of capital to income and employment generating activities. ✓

○ is large and generates a significant portion of an economy's profit and income.

○ provides individual savers with financial planning services.

Correct. Without a strong banking sector, both consumption and investment, two components of aggregate demand would be hindered.

GLOSSARY

financial contagion:

when fears that one bank is insolvent spread to fears that other banks are insolvent; can cause bank runs to occur at multiple banks

illiquidity:

when the demand for cash by depositors exceeds the bank's available reserves

insolvency:

when the value of a bank's assets is less than the value of its liabilities; i.e. bankrupt

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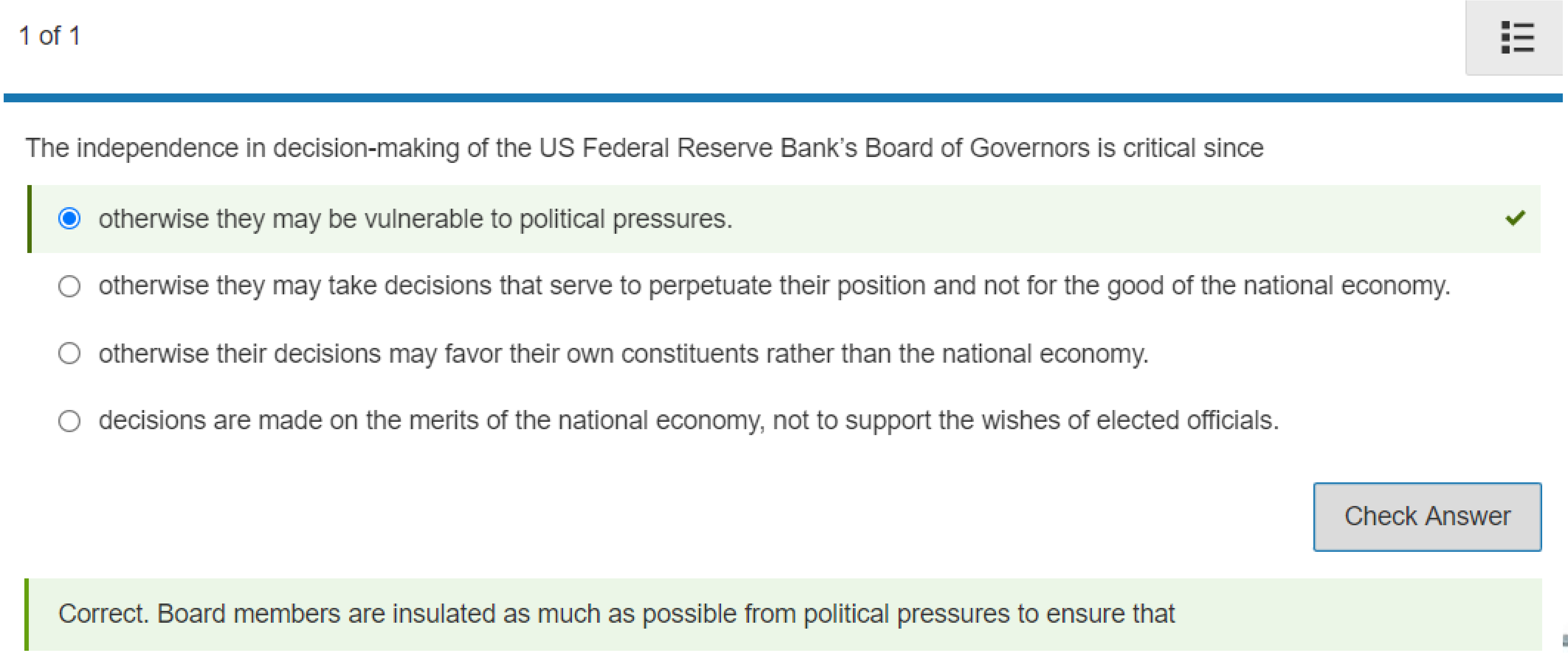

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The independence in decision-making of the US Federal Reserve Bank’s Board of Governors is critical since

● otherwise they may be vulnerable to political pressures. ✓

○ otherwise they may take decisions that serve to perpetuate their position and not for the good of the national economy.

○ otherwise their decisions may favor their own constituents rather than the national economy.

○ decisions are made on the merits of the national economy, not to support the wishes of elected officials.

Correct. Board members are insulated as much as possible from political pressures to ensure that

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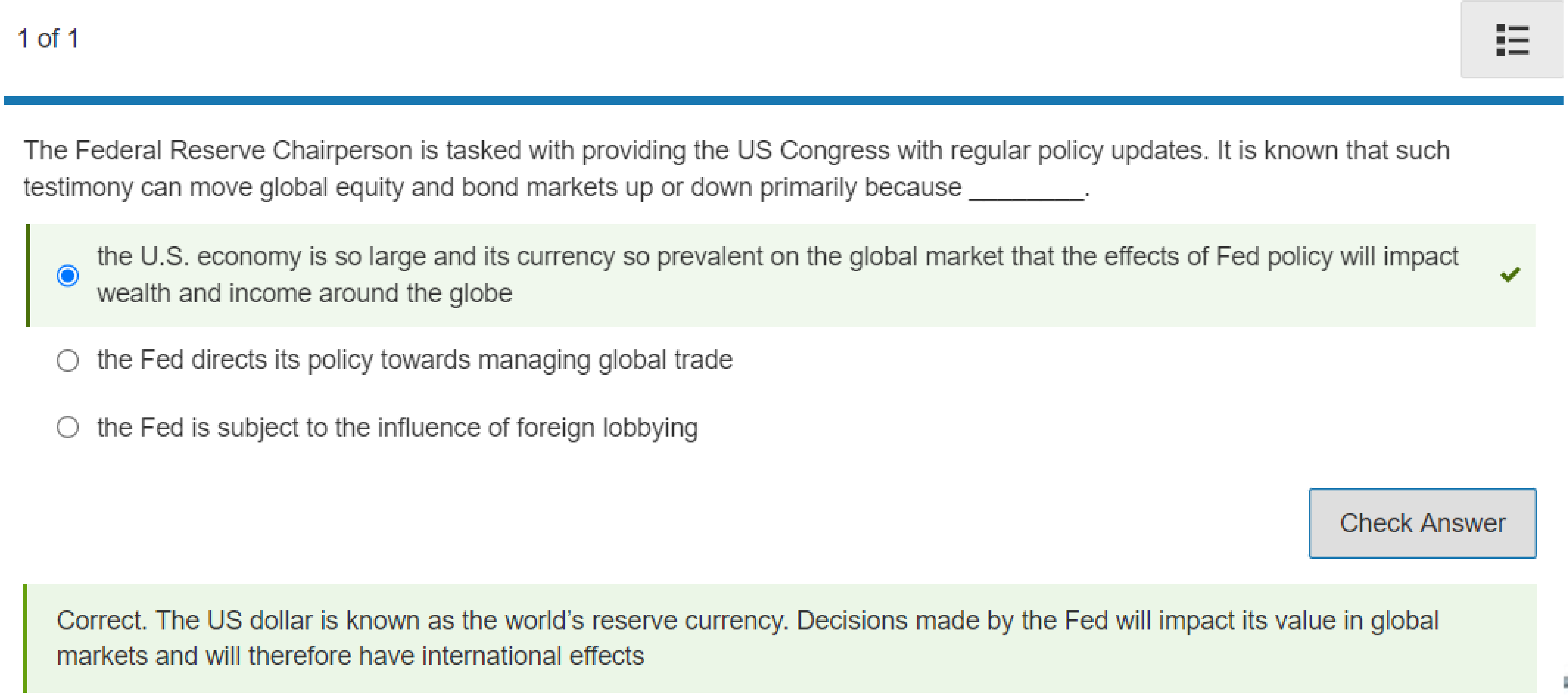

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The Federal Reserve Chairperson is tasked with providing the US Congress with regular policy updates. It is known that such testimony can move global equity and bond markets up or down primarily because _________.

- ● the U.S. economy is so large and its currency so prevalent on the global market that the effects of Fed policy will impact wealth and income around the globe ✓
- ○ the Fed directs its policy towards managing global trade
- ○ the Fed is subject to the influence of foreign lobbying

Correct. The US dollar is known as the world’s reserve currency. Decisions made by the Fed will impact its value in global markets and will therefore have international effects

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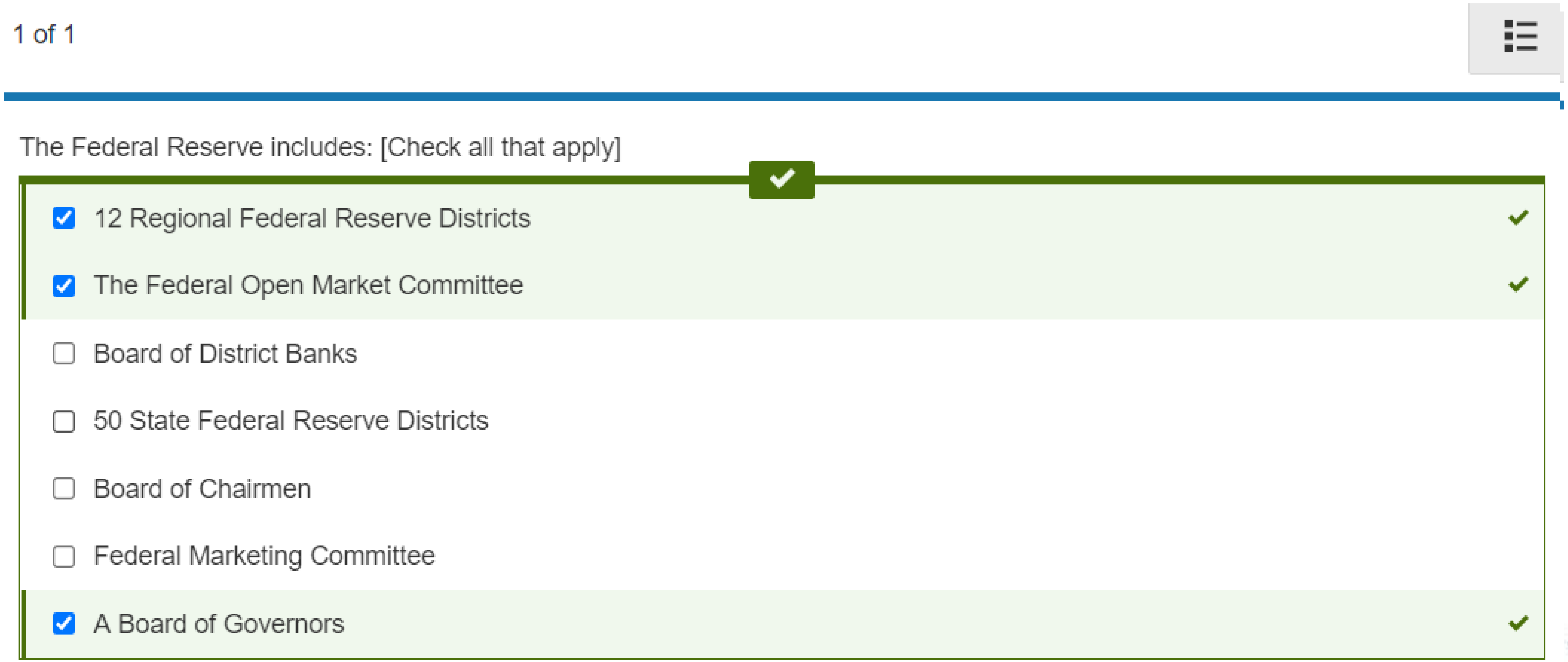

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The Federal Reserve includes: [Check all that apply]

- ☑ 12 Regional Federal Reserve Districts ✓
- ☑ The Federal Open Market Committee ✓
- ☐ Board of District Banks
- ☐ 50 State Federal Reserve Districts
- ☐ Board of Chairmen
- ☐ Federal Marketing Committee
- ☑ A Board of Governors ✓

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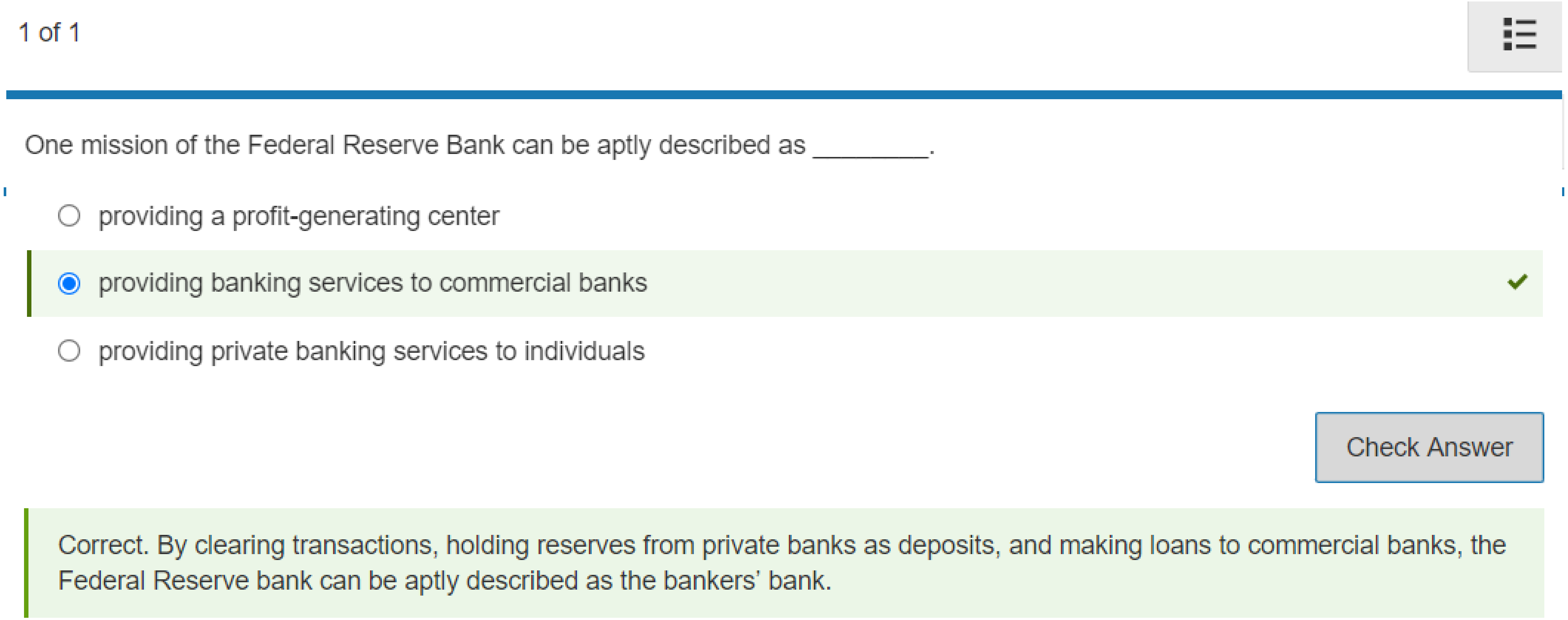

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One mission of the Federal Reserve Bank can be aptly described as ________.

○ providing a profit-generating center

● providing banking services to commercial banks ✓

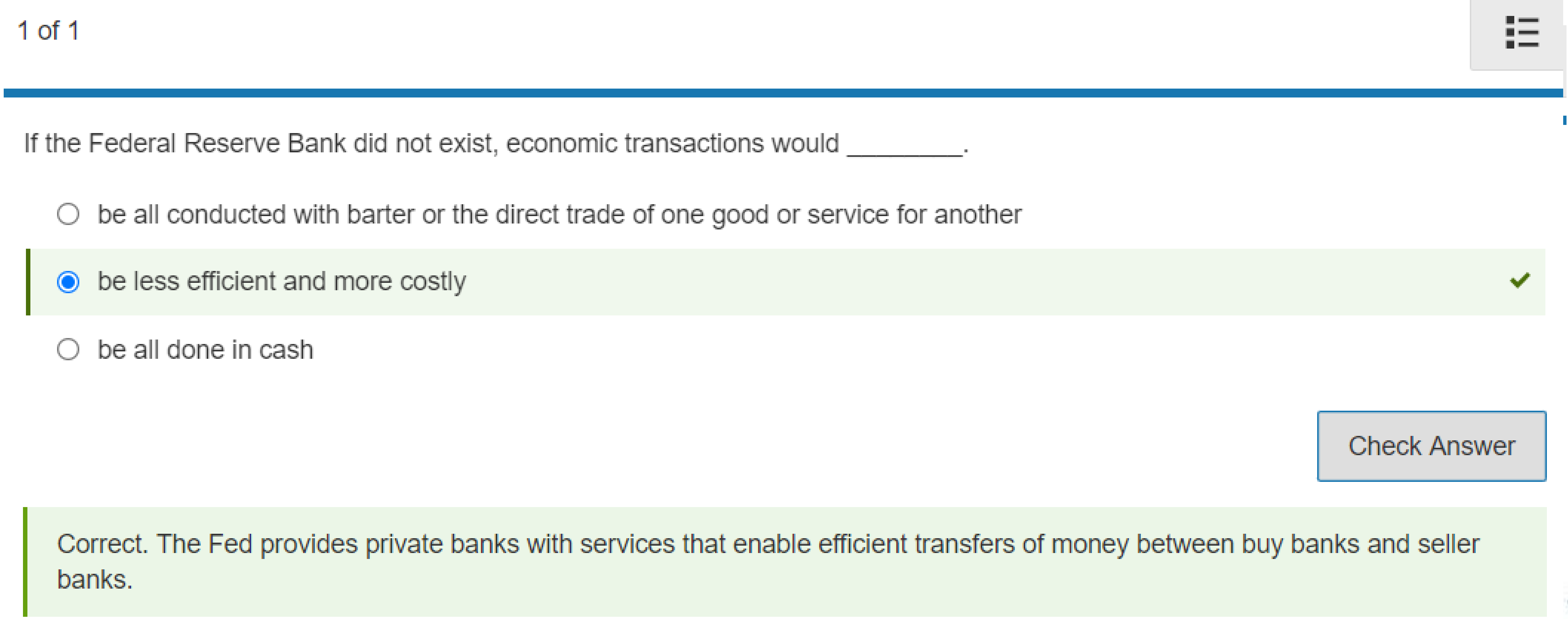
○ providing private banking services to individuals

Correct. By clearing transactions, holding reserves from private banks as deposits, and making loans to commercial banks, the Federal Reserve bank can be aptly described as the bankers’ bank.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

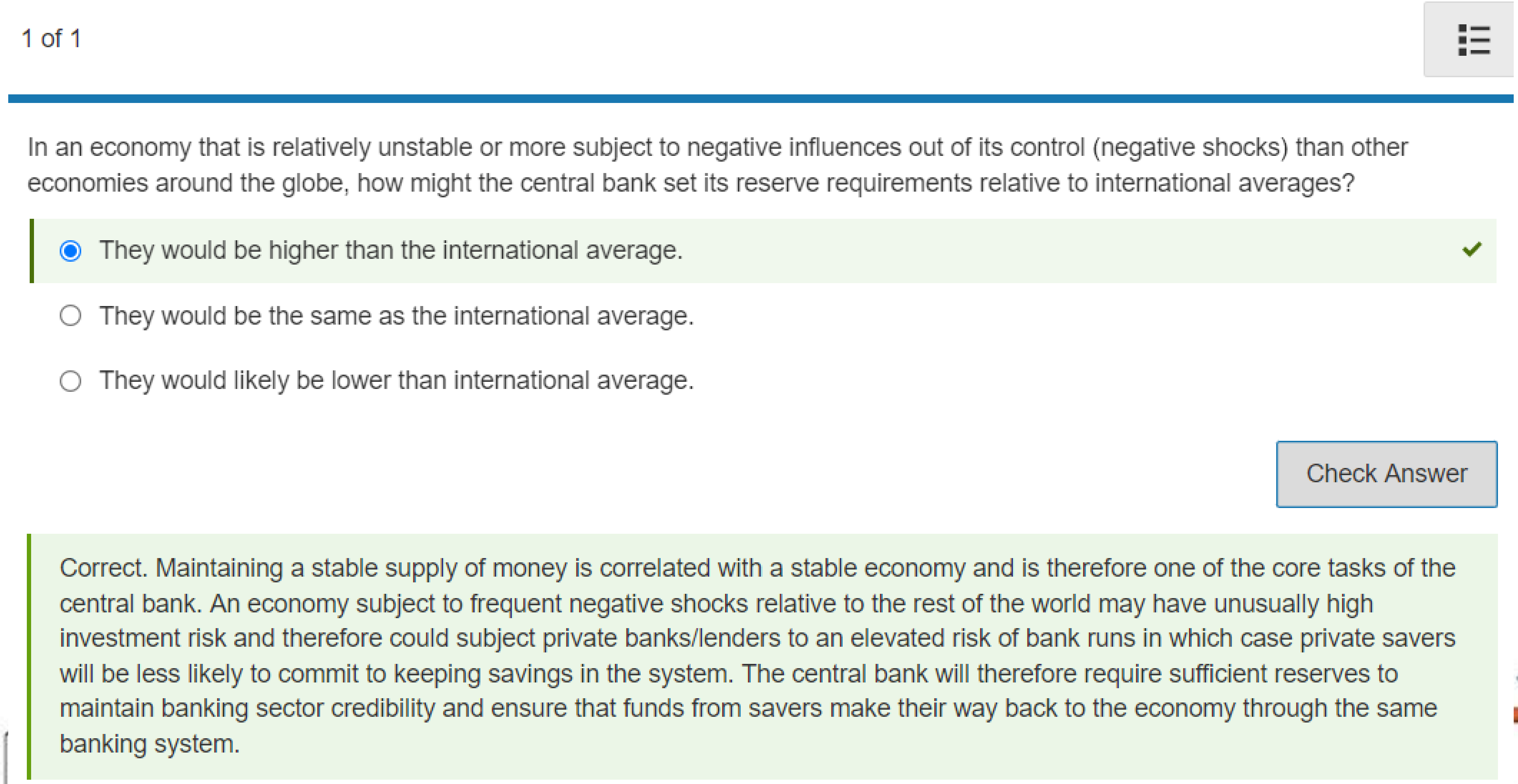
If the Federal Reserve Bank did not exist, economic transactions would ________.

- ○ be all conducted with barter or the direct trade of one good or service for another
- ● be less efficient and more costly ✓
- ○ be all done in cash

Correct. The Fed provides private banks with services that enable efficient transfers of money between buy banks and seller banks.

0:30

Q Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



In an economy that is relatively unstable or more subject to negative influences out of its control (negative shocks) than other economies around the globe, how might the central bank set its reserve requirements relative to international averages?

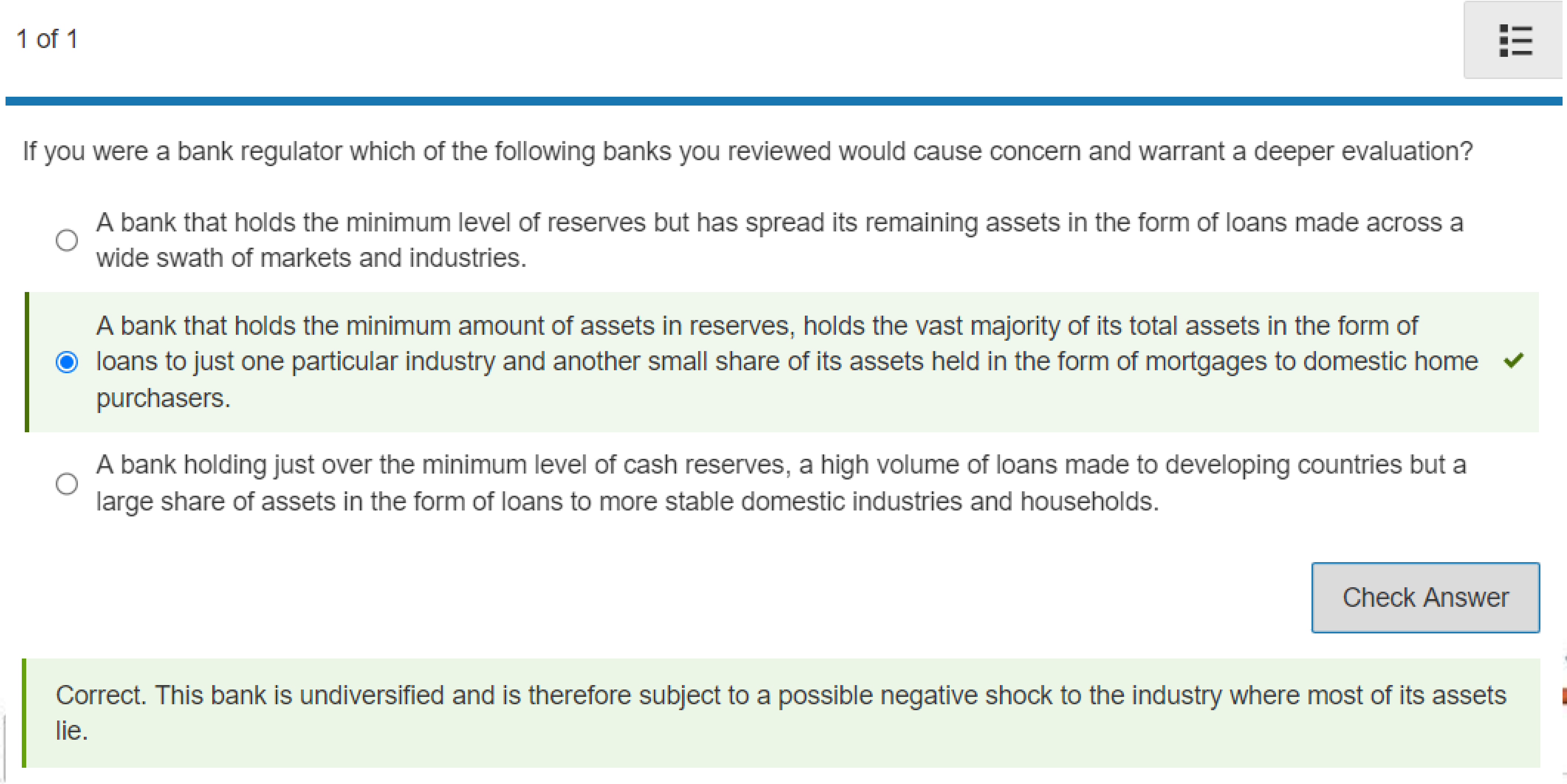
- ● They would be higher than the international average. ✓
- ○ They would be the same as the international average.
- ○ They would likely be lower than international average.

Correct. Maintaining a stable supply of money is correlated with a stable economy and is therefore one of the core tasks of the central bank. An economy subject to frequent negative shocks relative to the rest of the world may have unusually high investment risk and therefore could subject private banks/lenders to an elevated risk of bank runs in which case private savers will be less likely to commit to keeping savings in the system. The central bank will therefore require sufficient reserves to maintain banking sector credibility and ensure that funds from savers make their way back to the economy through the same banking system.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

If you were a bank regulator which of the following banks you reviewed would cause concern and warrant a deeper evaluation?

○ A bank that holds the minimum level of reserves but has spread its remaining assets in the form of loans made across a wide swath of markets and industries.

● A bank that holds the minimum amount of assets in reserves, holds the vast majority of its total assets in the form of loans to just one particular industry and another small share of its assets held in the form of mortgages to domestic home purchasers. ✓

○ A bank holding just over the minimum level of cash reserves, a high volume of loans made to developing countries but a large share of assets in the form of loans to more stable domestic industries and households.

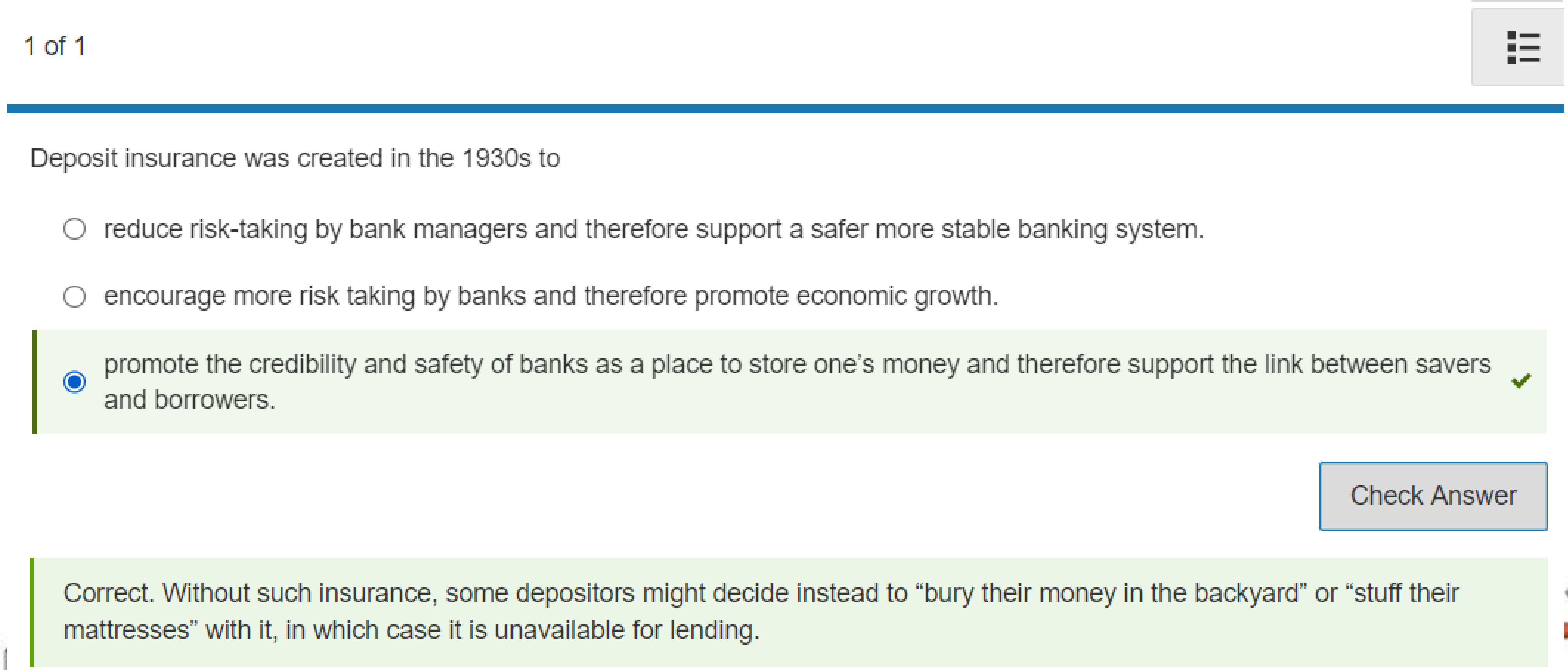
Check Answer

Correct. This bank is undiversified and is therefore subject to a possible negative shock to the industry where most of its assets lie.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Deposit insurance was created in the 1930s to

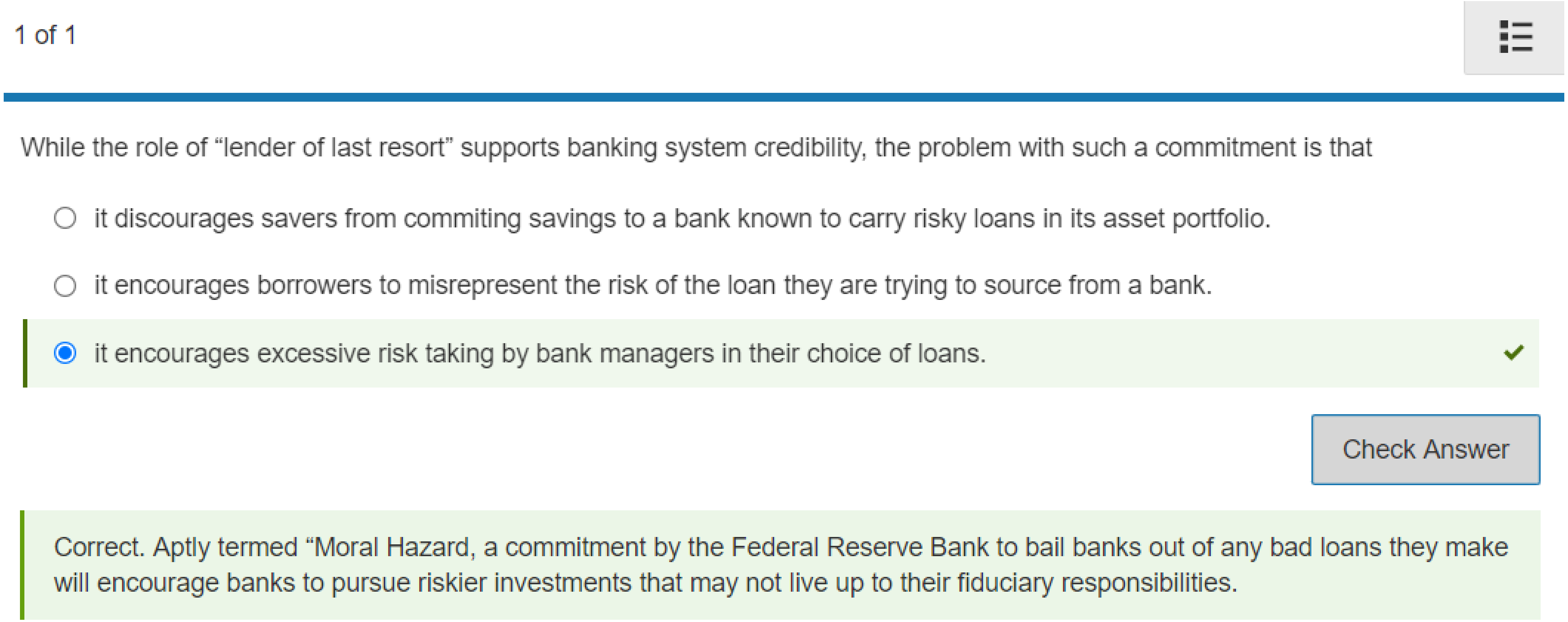
- ○ reduce risk-taking by bank managers and therefore support a safer more stable banking system.
- ○ encourage more risk taking by banks and therefore promote economic growth.
- ● promote the credibility and safety of banks as a place to store one’s money and therefore support the link between savers and borrowers. ✓

Correct. Without such insurance, some depositors might decide instead to “bury their money in the backyard” or “stuff their mattresses” with it, in which case it is unavailable for lending.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

While the role of “lender of last resort” supports banking system credibility, the problem with such a commitment is that

○ it discourages savers from commiting savings to a bank known to carry risky loans in its asset portfolio.

○ it encourages borrowers to misrepresent the risk of the loan they are trying to source from a bank.

● it encourages excessive risk taking by bank managers in their choice of loans. ✓

Correct. Aptly termed “Moral Hazard, a commitment by the Federal Reserve Bank to bail banks out of any bad loans they make will encourage banks to pursue riskier investments that may not live up to their fiduciary responsibilities.

GLOSSARY

bank capital requirements minimum percentage (of assets): a bank’s capital must exceed to stay in operation

bank run: when depositors fear their bank is insolvent, they will “run” to withdraw their deposits; because of fractional reserve banking, bank runs can turn solvent banks insolvent

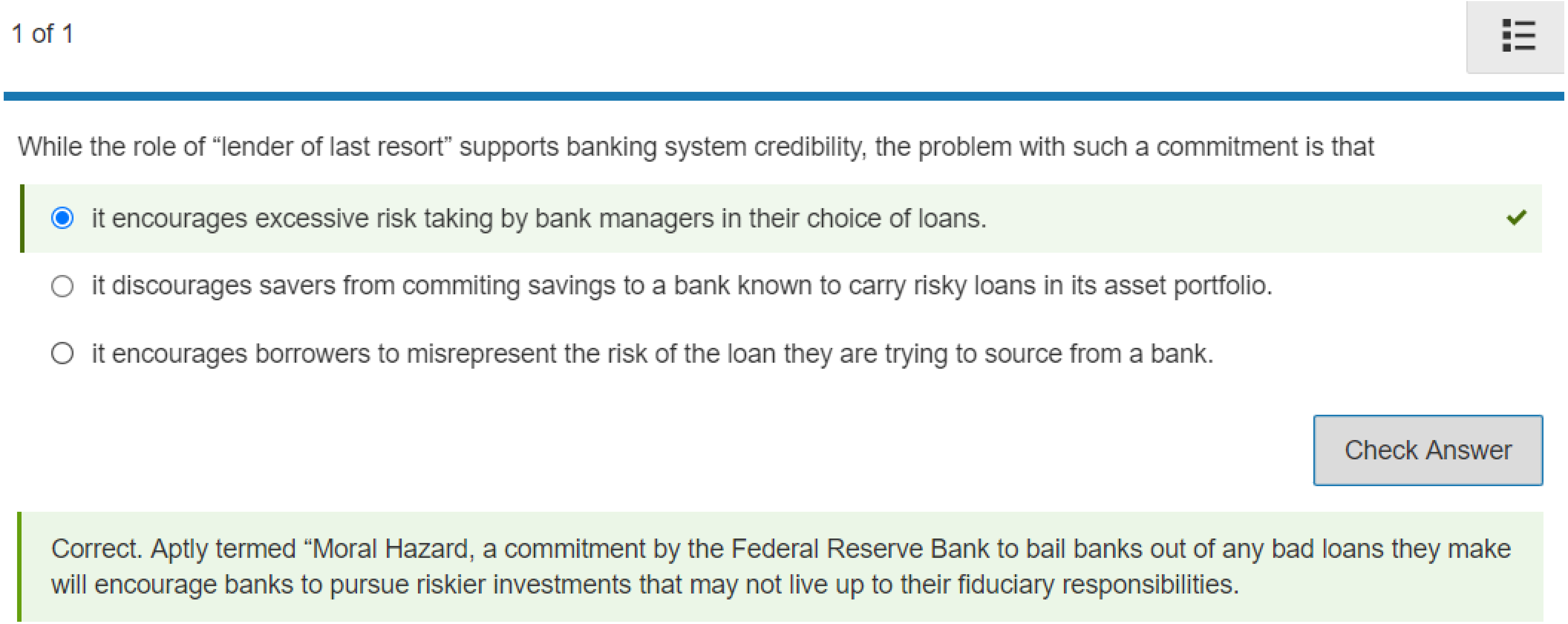
deposit insurance: program which insures commercial bank depositors up to $250,000 per bank in the U.S.

lender of last resort: role of the Fed to provide loans to distressed banks when the banks can’t obtain credit from anywhere else

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



While the role of “lender of last resort” supports banking system credibility, the problem with such a commitment is that

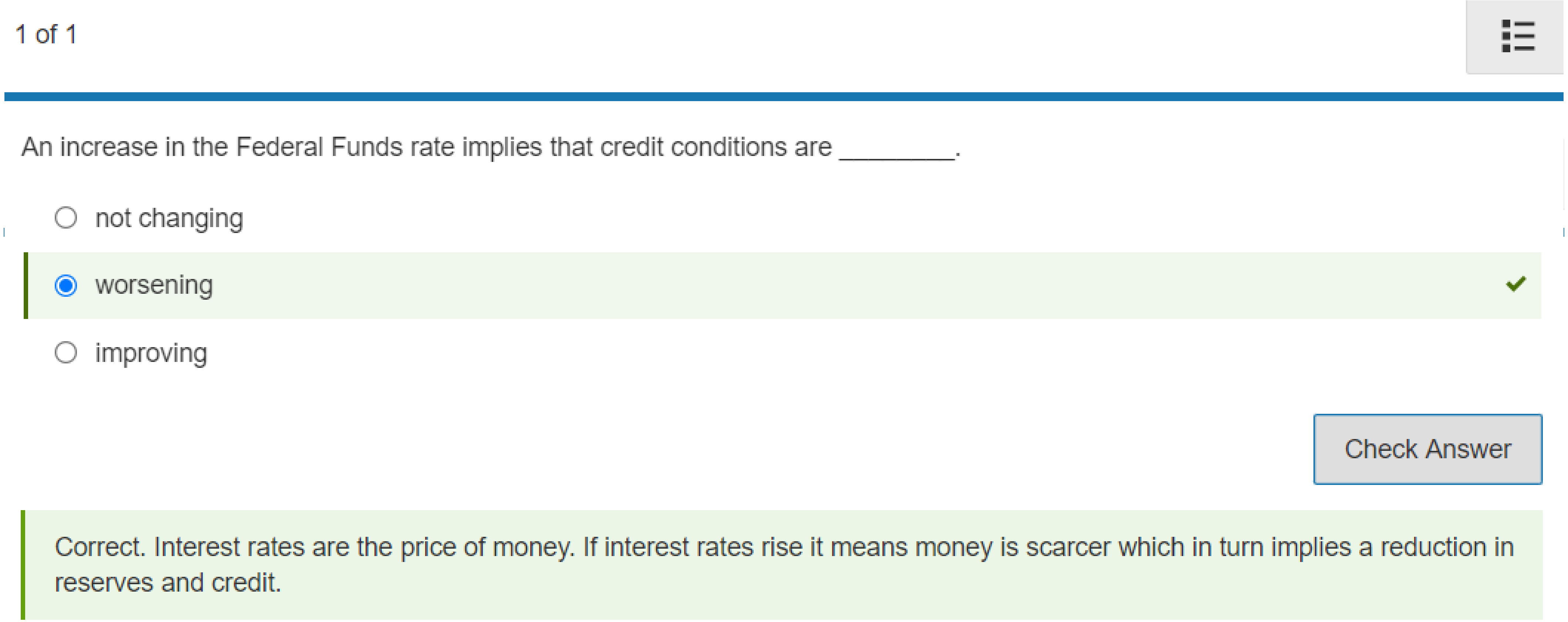
- ● it encourages excessive risk taking by bank managers in their choice of loans. ✓
- ○ it discourages savers from commiting savings to a bank known to carry risky loans in its asset portfolio.
- ○ it encourages borrowers to misrepresent the risk of the loan they are trying to source from a bank.

Correct. Aptly termed “Moral Hazard, a commitment by the Federal Reserve Bank to bail banks out of any bad loans they make will encourage banks to pursue riskier investments that may not live up to their fiduciary responsibilities.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

An increase in the Federal Funds rate implies that credit conditions are ________.

○ not changing

● worsening ✓

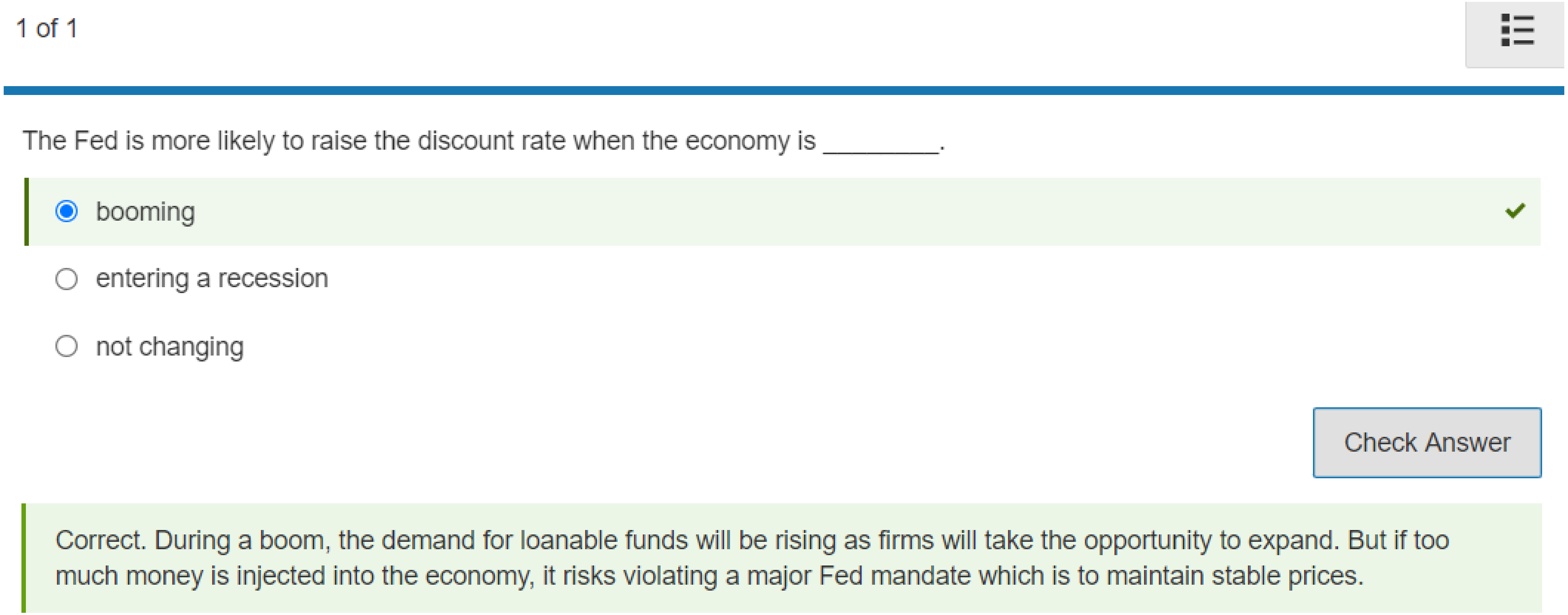
○ improving

Correct. Interest rates are the price of money. If interest rates rise it means money is scarcer which in turn implies a reduction in reserves and credit.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

The Fed is more likely to raise the discount rate when the economy is ________.

● booming ✓

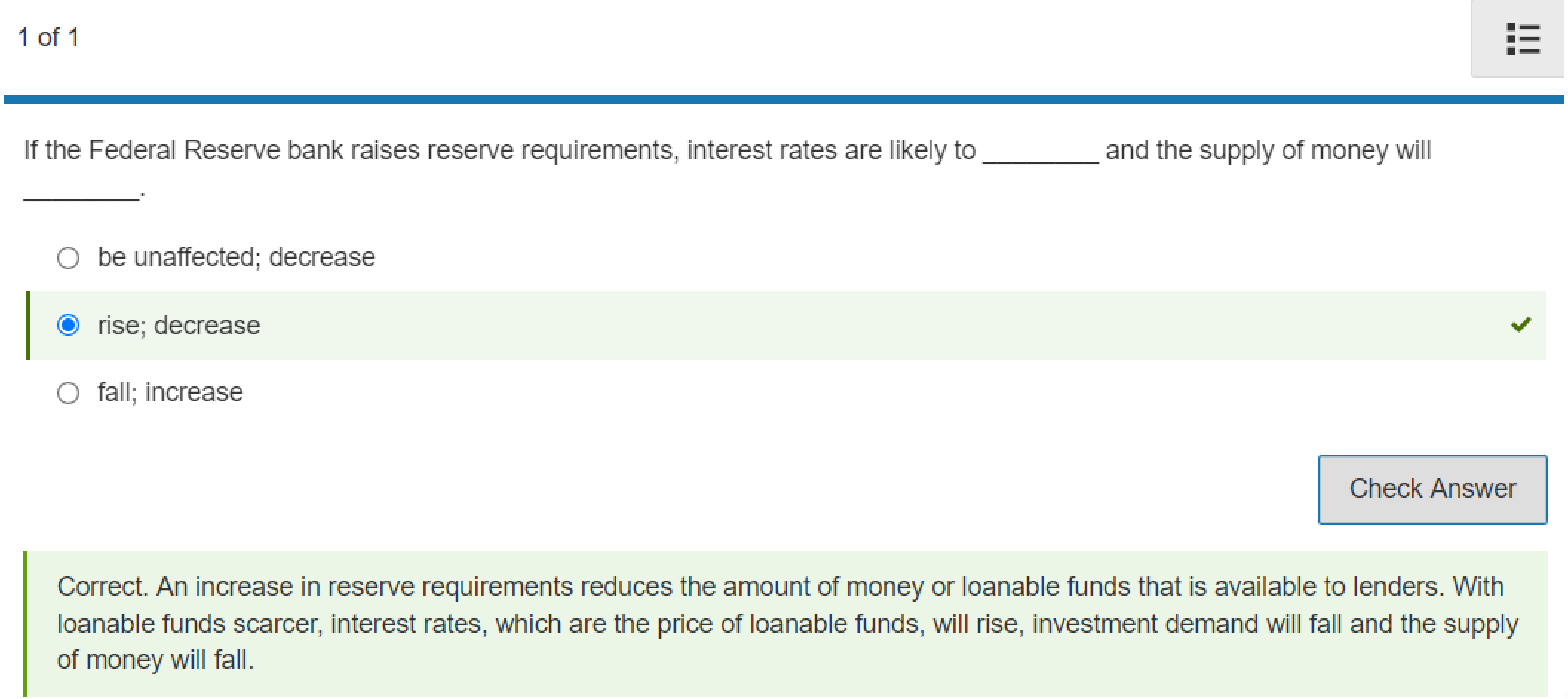
○ entering a recession

○ not changing

Correct. During a boom, the demand for loanable funds will be rising as firms will take the opportunity to expand. But if too much money is injected into the economy, it risks violating a major Fed mandate which is to maintain stable prices.

0:30

Q Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

If the Federal Reserve bank raises reserve requirements, interest rates are likely to ________ and the supply of money will ________.

○ be unaffected; decrease

● rise; decrease ✓

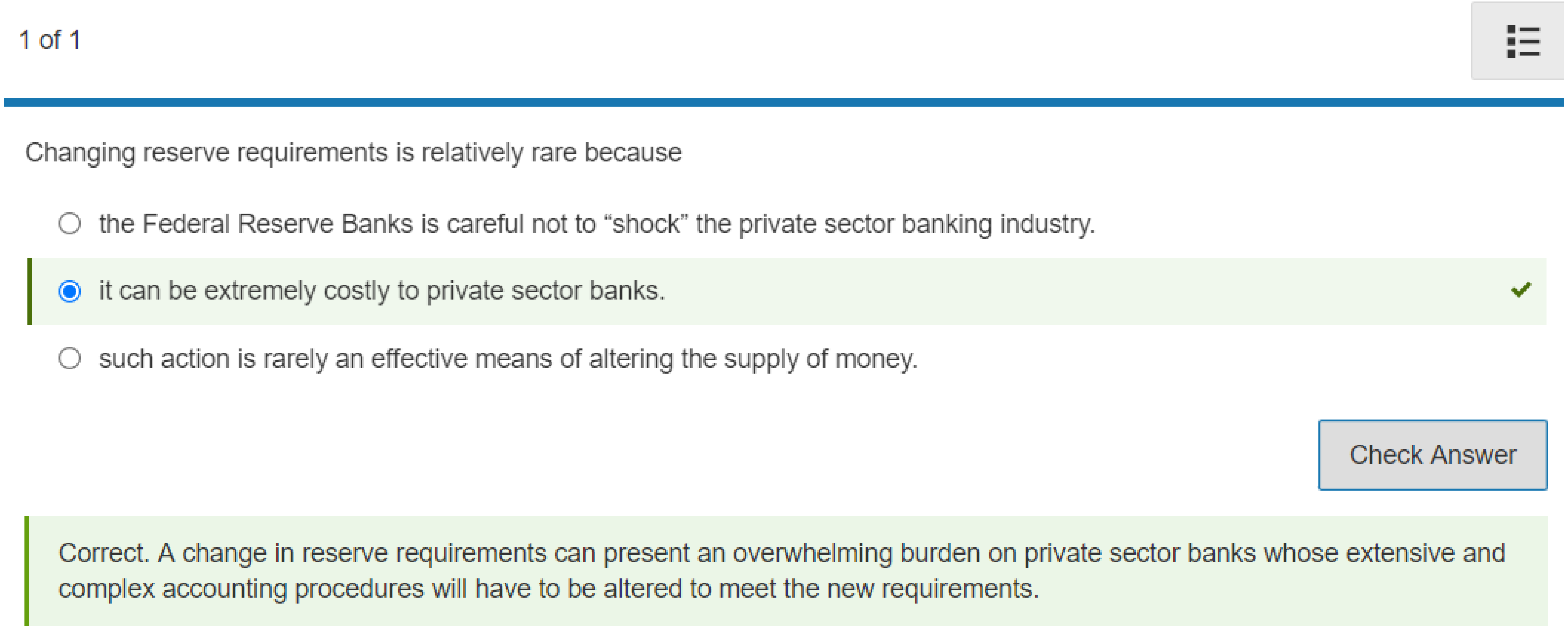
○ fall; increase

Correct. An increase in reserve requirements reduces the amount of money or loanable funds that is available to lenders. With loanable funds scarcer, interest rates, which are the price of loanable funds, will rise, investment demand will fall and the supply of money will fall.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Changing reserve requirements is relatively rare because

○ the Federal Reserve Banks is careful not to “shock” the private sector banking industry.

● it can be extremely costly to private sector banks. ✓

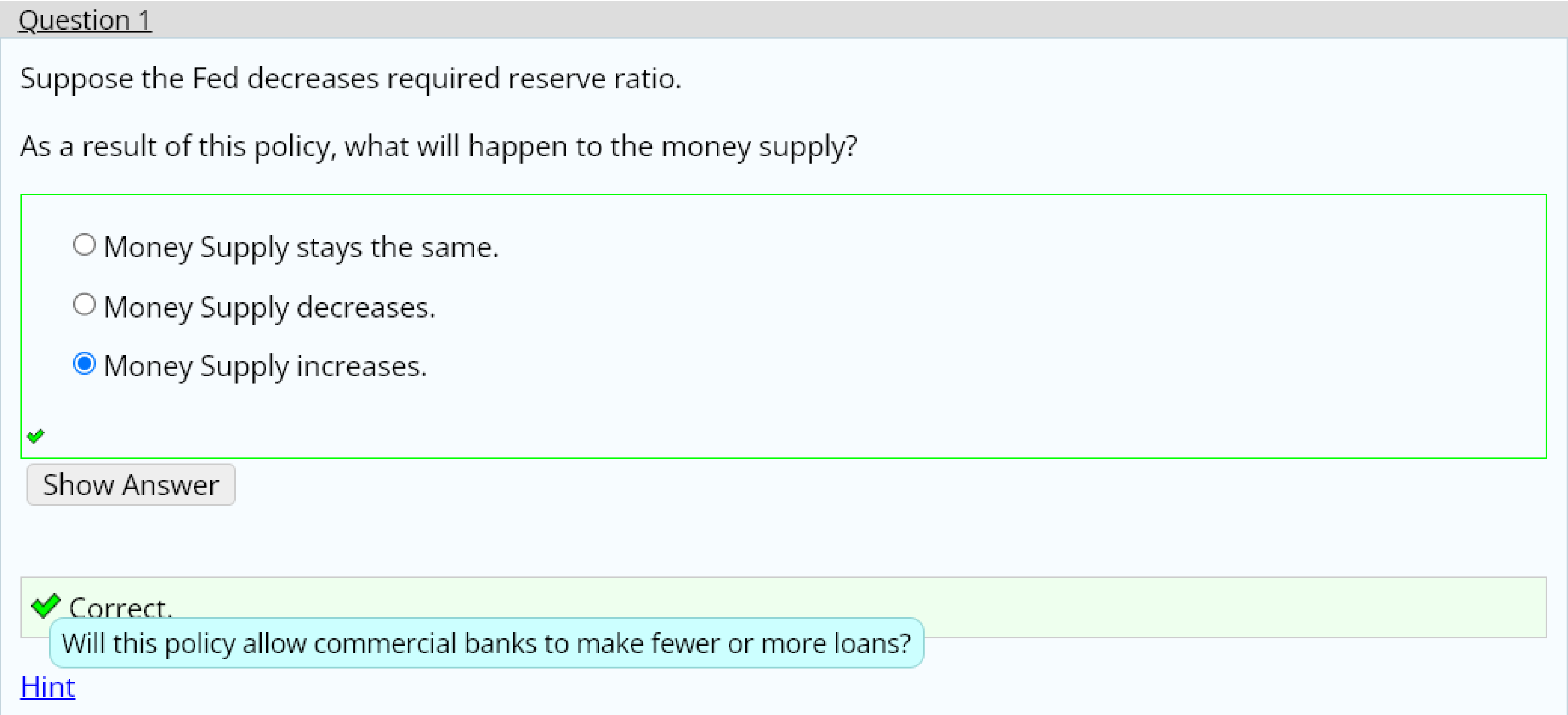
○ such action is rarely an effective means of altering the supply of money.

Correct. A change in reserve requirements can present an overwhelming burden on private sector banks whose extensive and complex accounting procedures will have to be altered to meet the new requirements.

0:30

Q

710 we stopped here 08-10-2023Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 1

Suppose the Fed decreases required reserve ratio.

As a result of this policy, what will happen to the money supply?

○ Money Supply stays the same.

○ Money Supply decreases.

● Money Supply increases.

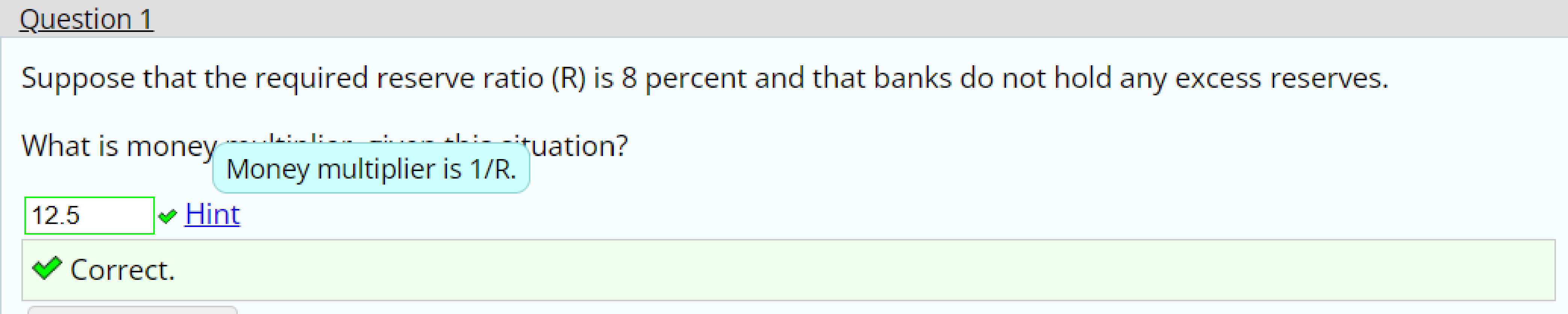
✓

✓ Correct.

Will this policy allow commercial banks to make fewer or more loans?

0:30

Q1 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 1

Suppose that the required reserve ratio (R) is 8 percent and that banks do not hold any excess reserves.

What is money multiplier given this situation?

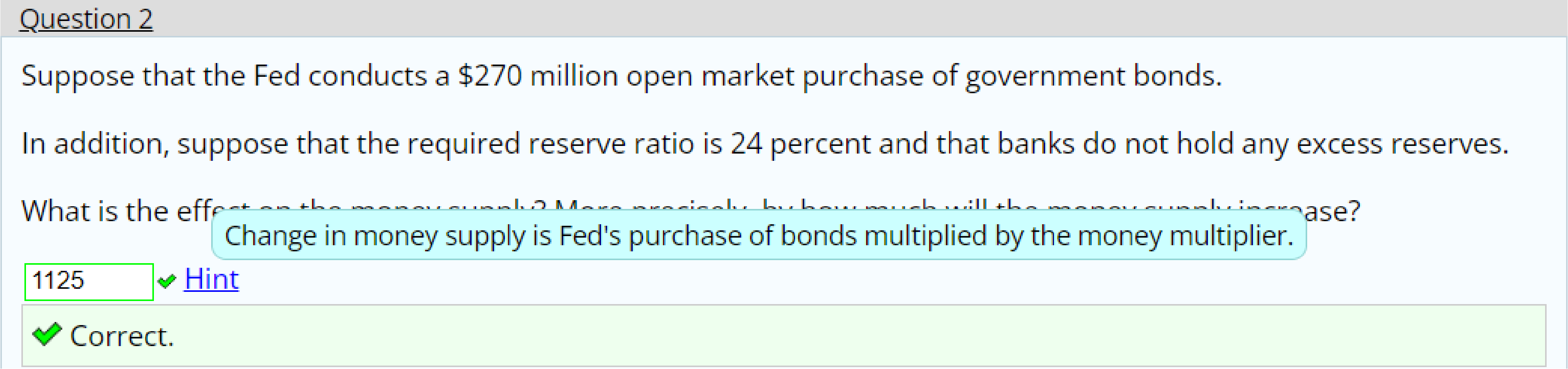
Money multiplier is 1/R.

12.5 ✓ Hint

✓ Correct.

0:30

Q2 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 2

Suppose that the Fed conducts a $270 million open market purchase of government bonds.

In addition, suppose that the required reserve ratio is 24 percent and that banks do not hold any excess reserves.

What is the effect on the money supply? More precisely, by how much will the money supply increase?

Change in money supply is Fed's purchase of bonds multiplied by the money multiplier.

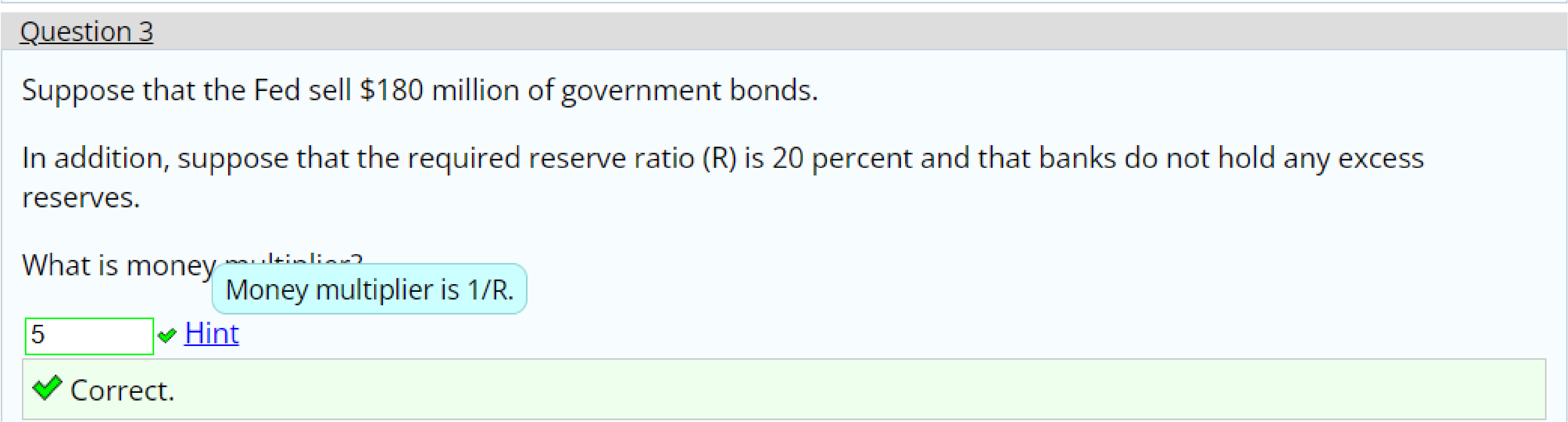
1125 ✓ Hint

✓ Correct.

0:30

Q3

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 3

Suppose that the Fed sell $180 million of government bonds.

In addition, suppose that the required reserve ratio (R) is 20 percent and that banks do not hold any excess reserves.

What is money multiplier?

Money multiplier is 1/R.

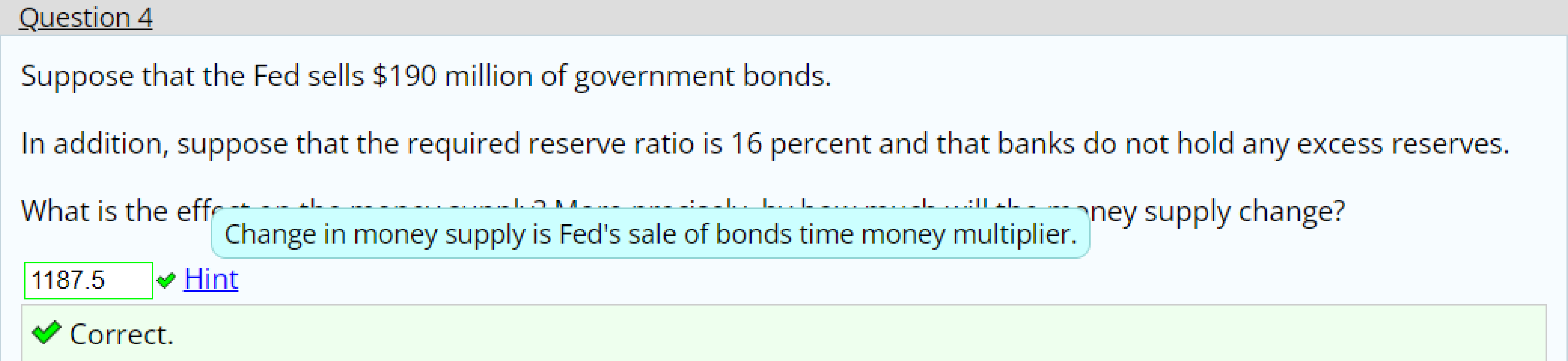
5 ✓ Hint

✓ Correct.

0:30

5-minute break

Q4 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 4

Suppose that the Fed sells $190 million of government bonds.

In addition, suppose that the required reserve ratio is 16 percent and that banks do not hold any excess reserves.

What is the effect on the money supply? More precisely, by how much will the money supply change?

Change in money supply is Fed's sale of bonds time money multiplier.

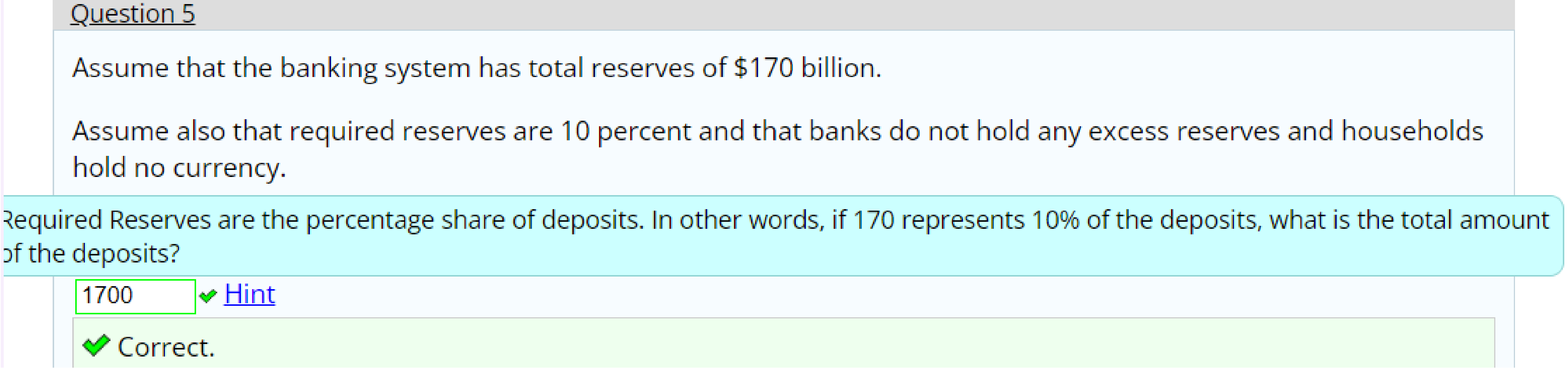
1187.5 ✓ Hint

✓ Correct.

0:30

5-minute break

Q5 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 5

Assume that the banking system has total reserves of $170 billion.

Assume also that required reserves are 10 percent and that banks do not hold any excess reserves and households hold no currency.

Required Reserves are the percentage share of deposits. In other words, if 170 represents 10% of the deposits, what is the total amount of the deposits?

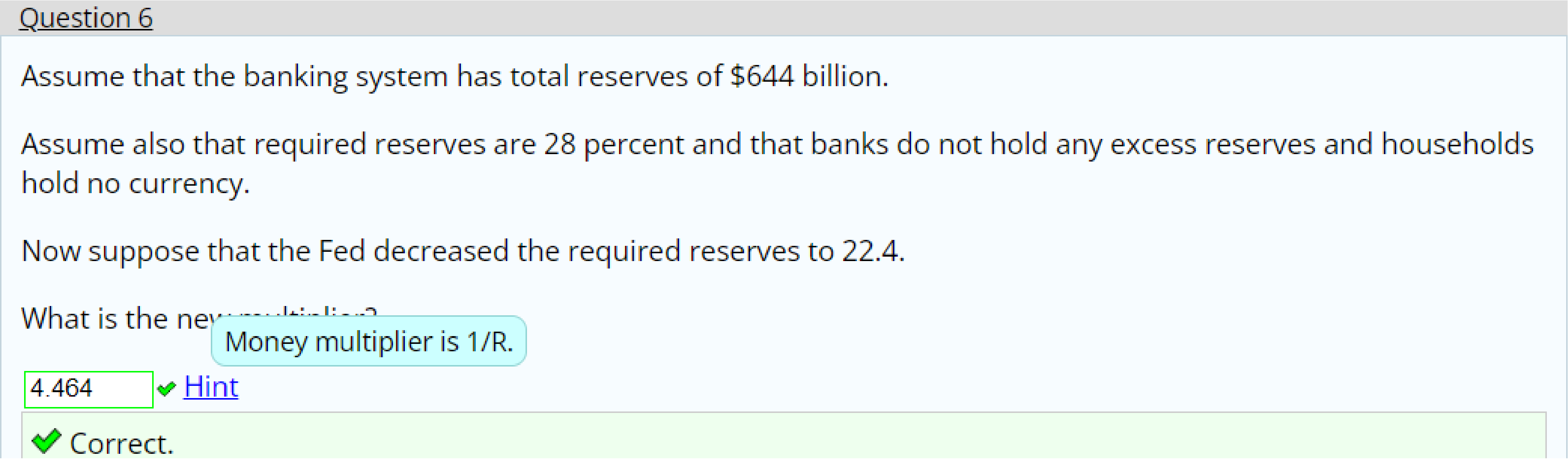
1700 ✓ Hint

✓ Correct.

0:30

Q6

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 6

Assume that the banking system has total reserves of $644 billion.

Assume also that required reserves are 28 percent and that banks do not hold any excess reserves and households hold no currency.

Now suppose that the Fed decreased the required reserves to 22.4.

What is the new multiplier?

Money multiplier is 1/R.

4.464 ✓ Hint

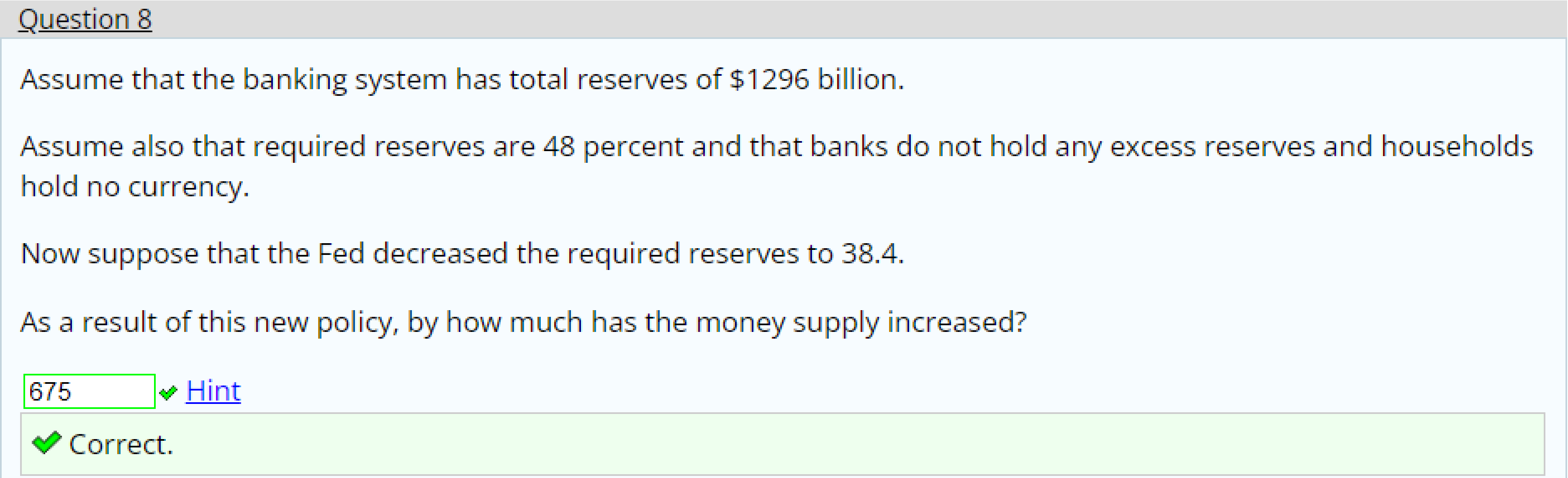
✓ Correct.

0:30

5-minute break

Q8

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 8

Assume that the banking system has total reserves of $1296 billion.

Assume also that required reserves are 48 percent and that banks do not hold any excess reserves and households hold no currency.

Now suppose that the Fed decreased the required reserves to 38.4.

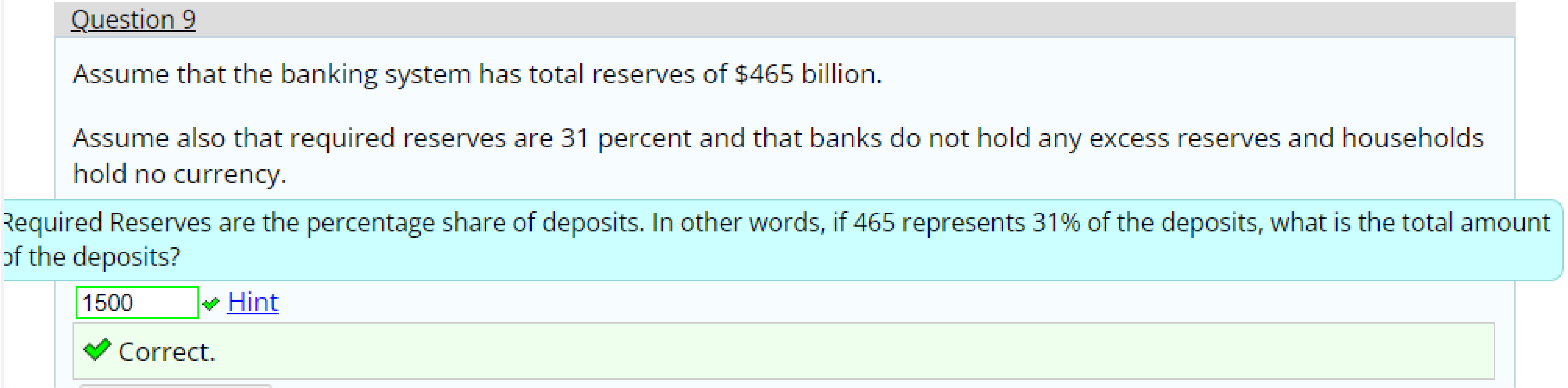
As a result of this new policy, by how much has the money supply increased?

675 ✓ Hint

✓ Correct.

0:30

Q9 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 9

Assume that the banking system has total reserves of $465 billion.

Assume also that required reserves are 31 percent and that banks do not hold any excess reserves and households hold no currency.

Required Reserves are the percentage share of deposits. In other words, if 465 represents 31% of the deposits, what is the total amount of the deposits?

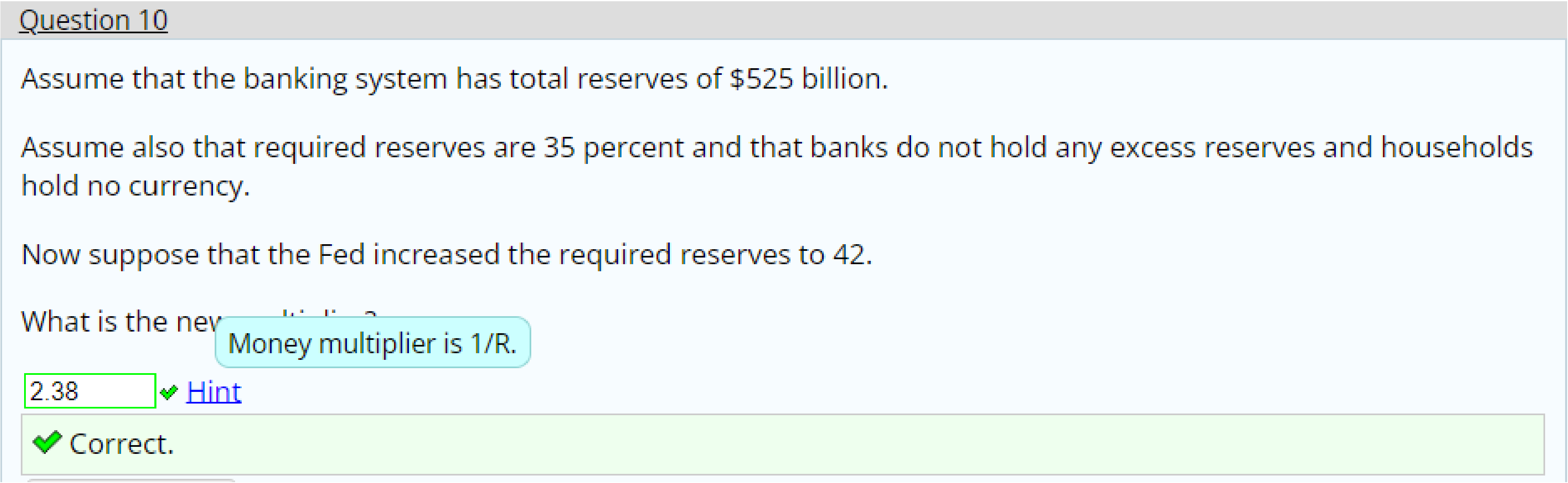
1500 ✓ Hint

✓ Correct.

0:30

Q10

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 10

Assume that the banking system has total reserves of $525 billion.

Assume also that required reserves are 35 percent and that banks do not hold any excess reserves and households hold no currency.

Now suppose that the Fed increased the required reserves to 42.

What is the nev

Money multiplier is 1/R.

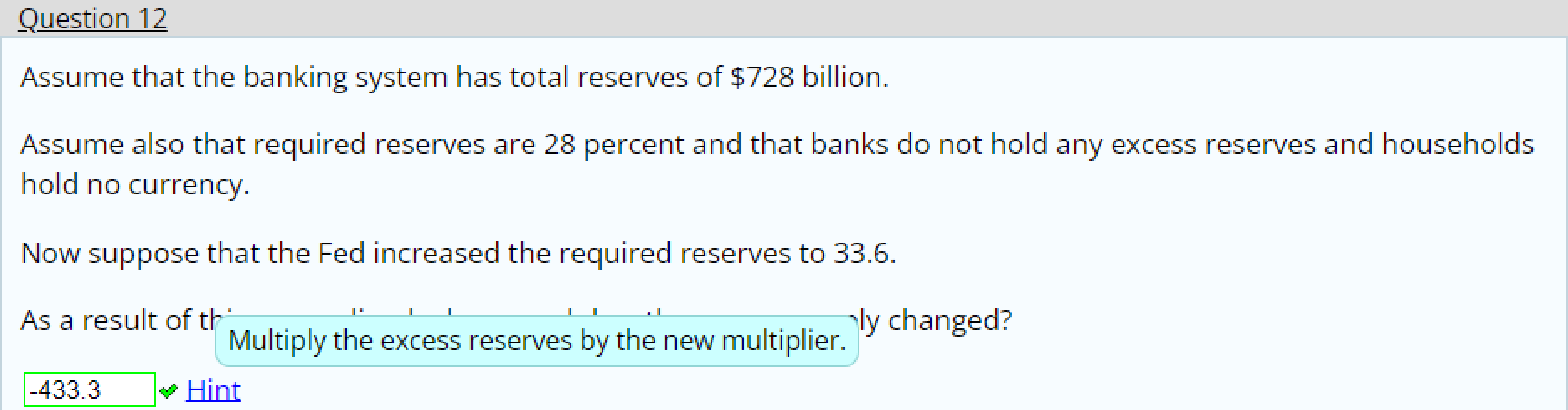
2.38 ✓ Hint

✓ Correct.

Q12

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



Question 12

Assume that the banking system has total reserves of $728 billion.

Assume also that required reserves are 28 percent and that banks do not hold any excess reserves and households hold no currency.

Now suppose that the Fed increased the required reserves to 33.6.

As a result of th ly changed?

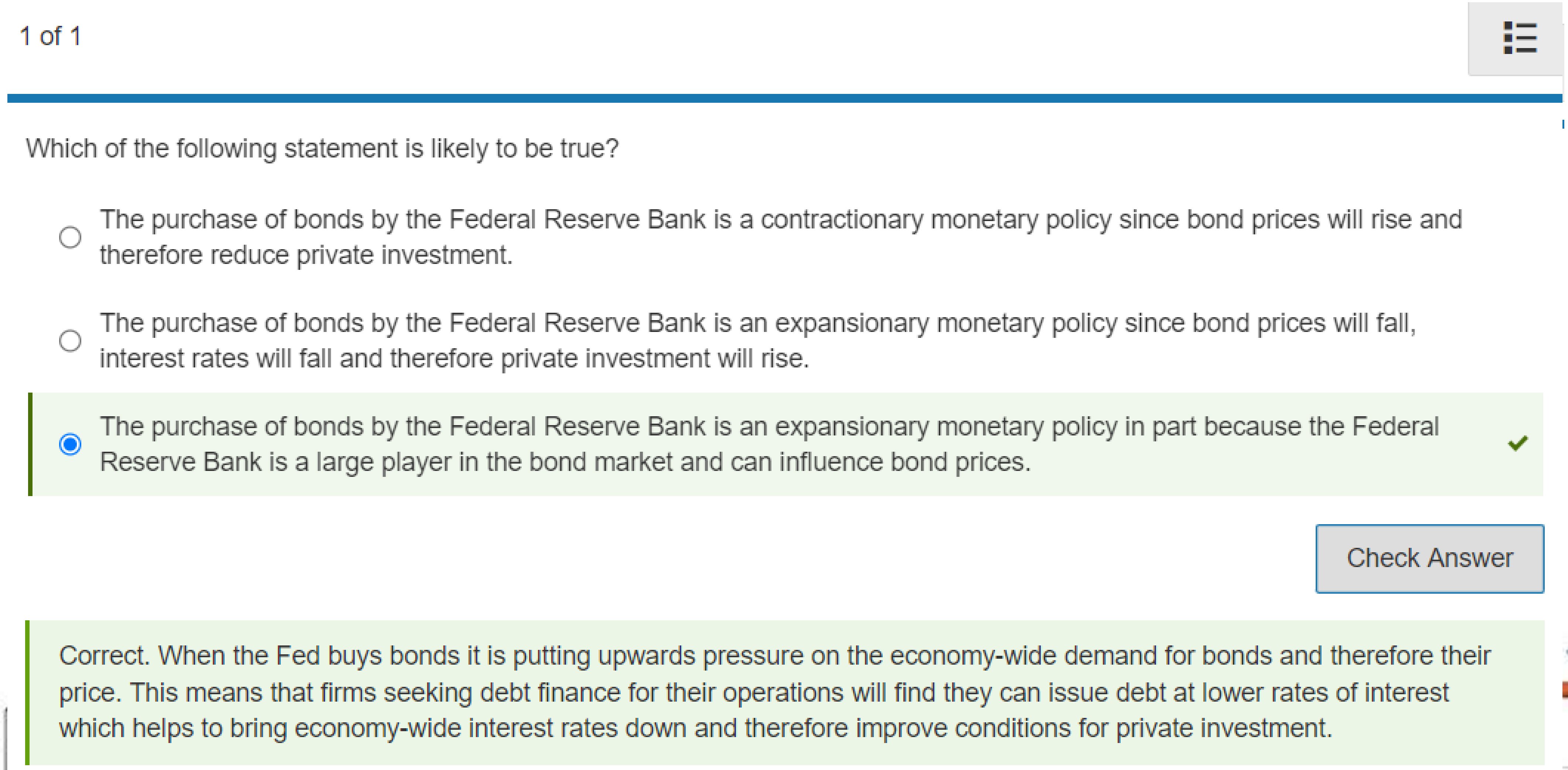
Multiply the excess reserves by the new multiplier.

-433.3 ✓ Hint

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which of the following statement is likely to be true?

○ The purchase of bonds by the Federal Reserve Bank is a contractionary monetary policy since bond prices will rise and therefore reduce private investment.

○ The purchase of bonds by the Federal Reserve Bank is an expansionary monetary policy since bond prices will fall, interest rates will fall and therefore private investment will rise.

● The purchase of bonds by the Federal Reserve Bank is an expansionary monetary policy in part because the Federal Reserve Bank is a large player in the bond market and can influence bond prices. ✓

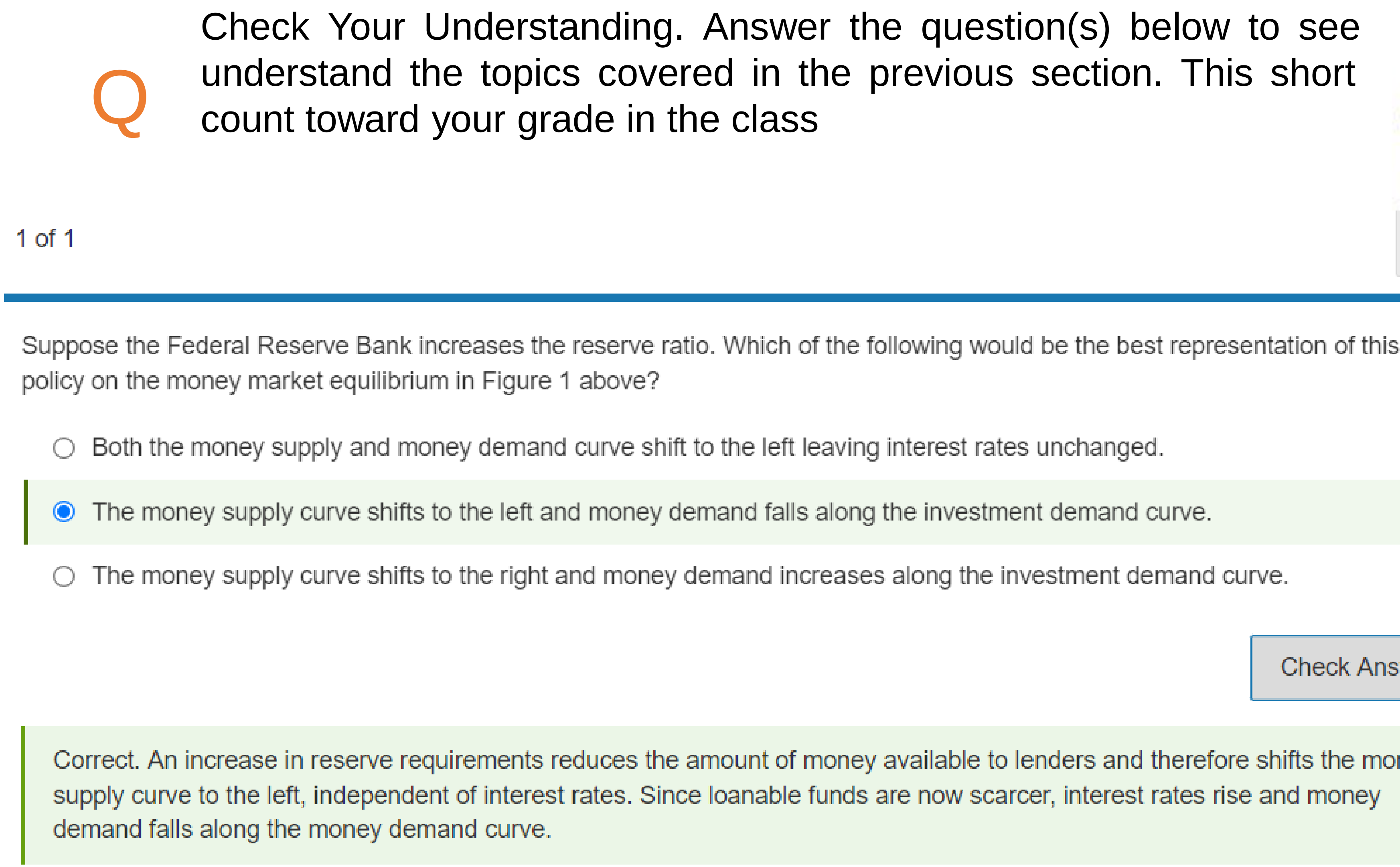
Correct. When the Fed buys bonds it is putting upwards pressure on the economy-wide demand for bonds and therefore their price. This means that firms seeking debt finance for their operations will find they can issue debt at lower rates of interest which helps to bring economy-wide interest rates down and therefore improve conditions for private investment.

GLOSSARY

open market operations: the central bank selling or buying Treasury securities to influence the quantity of money and the level of interest rates

open market purchase: the central bank buys Treasure securities to increase bank reserves and lower interest rates

open market sale: the central bank sells Treasure securities to decrease bank reserves and raise interest rates



Q

Check Your Understanding. Answer the question(s) below to see understand the topics covered in the previous section. This short count toward your grade in the class

1 of 1

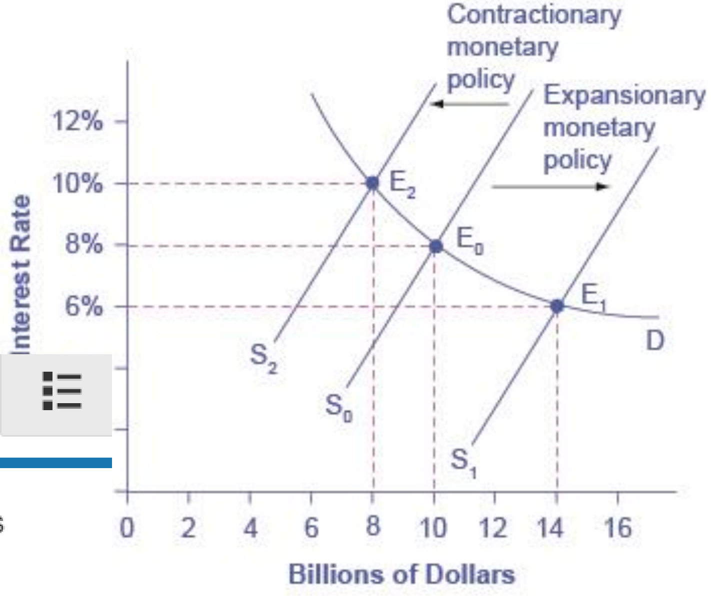
Suppose the Federal Reserve Bank increases the reserve ratio. Which of the following would be the best representation of this policy on the money market equilibrium in Figure 1 above?

○ Both the money supply and money demand curve shift to the left leaving interest rates unchanged.

● The money supply curve shifts to the left and money demand falls along the investment demand curve. ✓

○ The money supply curve shifts to the right and money demand increases along the investment demand curve.

Correct. An increase in reserve requirements reduces the amount of money available to lenders and therefore shifts the money supply curve to the left, independent of interest rates. Since loanable funds are now scarcer, interest rates rise and money demand falls along the money demand curve.



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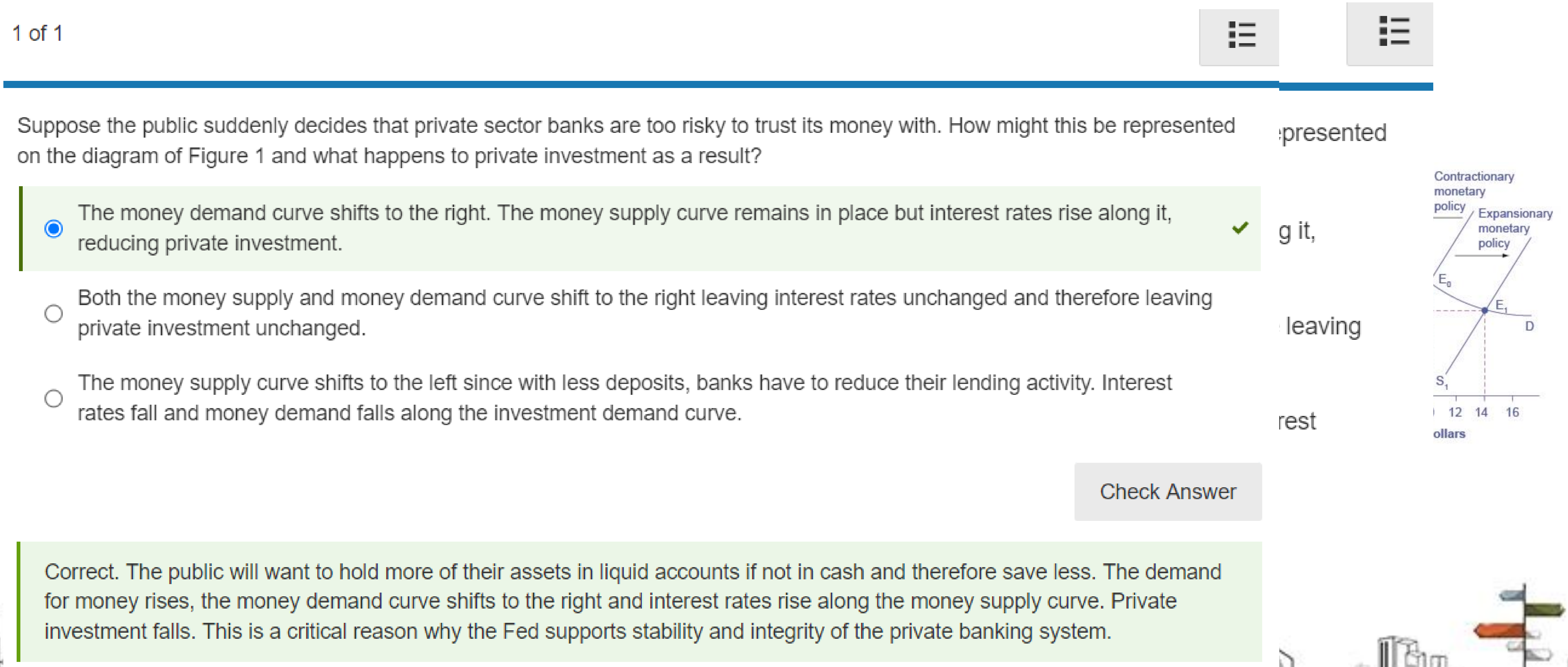
Q Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Suppose the public suddenly decides that private sector banks are too risky to trust its money with. How might this be represented on the diagram of Figure 1 and what happens to private investment as a result?

● The money demand curve shifts to the right. The money supply curve remains in place but interest rates rise along it, reducing private investment. ✓

○ Both the money supply and money demand curve shift to the right leaving interest rates unchanged and therefore leaving private investment unchanged.

○ The money supply curve shifts to the left since with less deposits, banks have to reduce their lending activity. Interest rates fall and money demand falls along the investment demand curve.

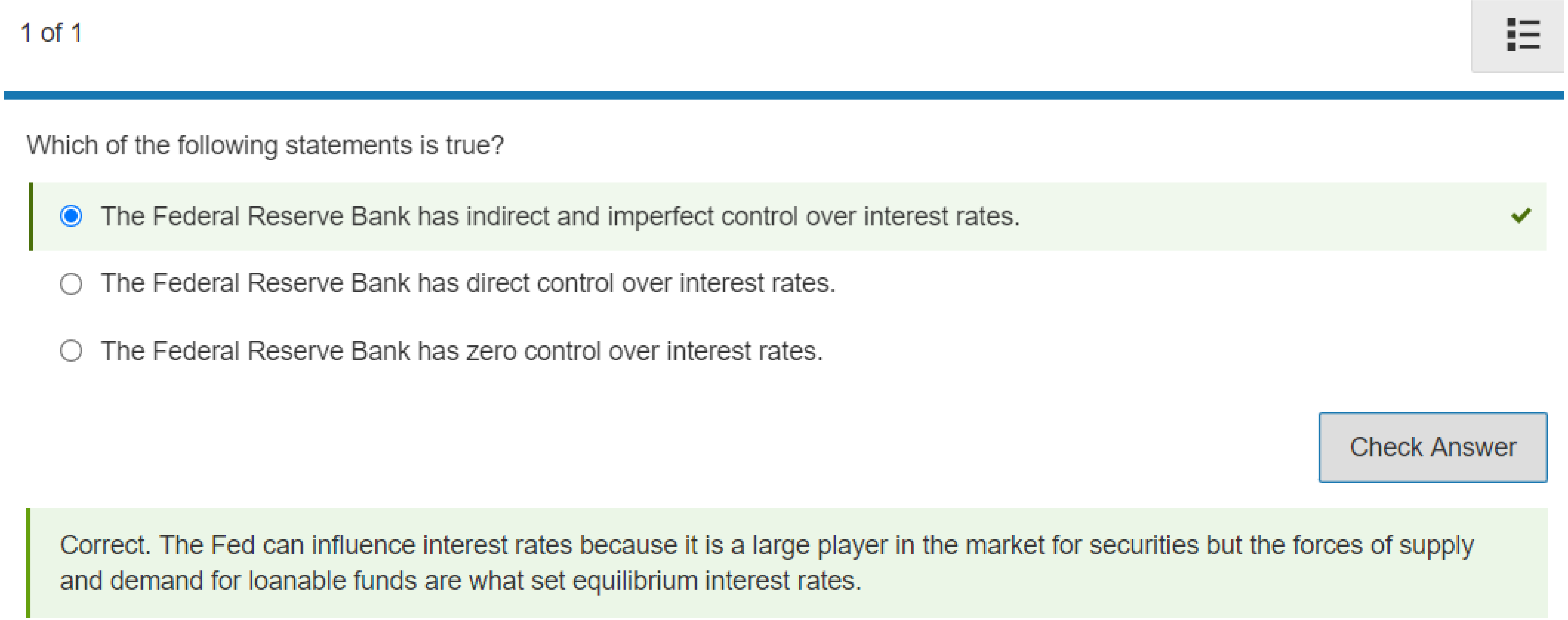
Check Answer

Correct. The public will want to hold more of their assets in liquid accounts if not in cash and therefore save less. The demand for money rises, the money demand curve shifts to the right and interest rates rise along the money supply curve. Private investment falls. This is a critical reason why the Fed supports stability and integrity of the private banking system.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which of the following statements is true?

● The Federal Reserve Bank has indirect and imperfect control over interest rates. ✓

○ The Federal Reserve Bank has direct control over interest rates.

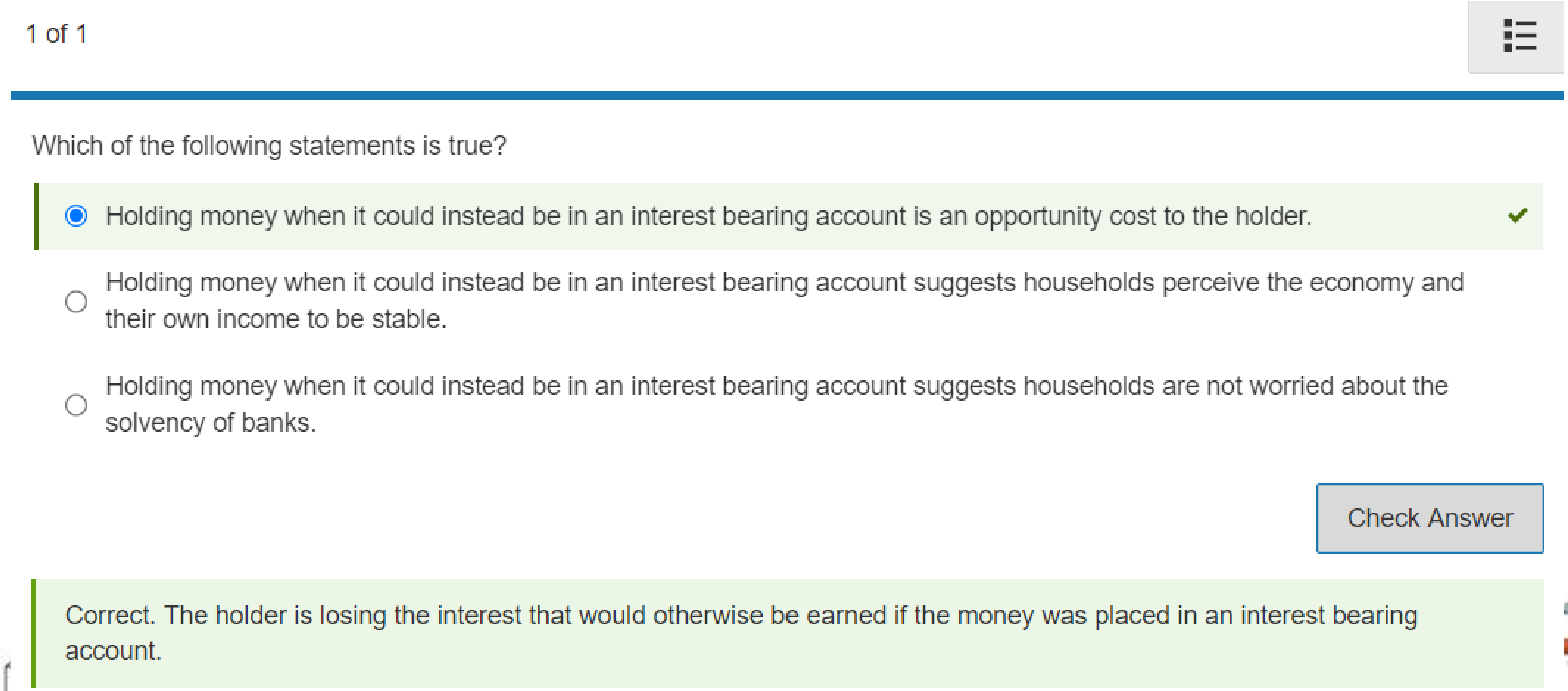
○ The Federal Reserve Bank has zero control over interest rates.

Correct. The Fed can influence interest rates because it is a large player in the market for securities but the forces of supply and demand for loanable funds are what set equilibrium interest rates.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Which of the following statements is true?

● Holding money when it could instead be in an interest bearing account is an opportunity cost to the holder. ✓

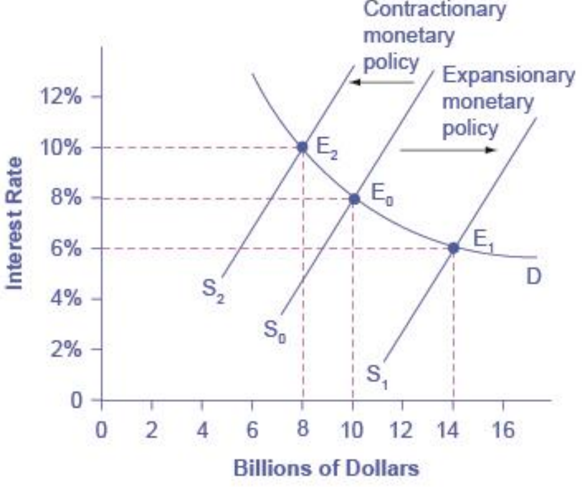
○ Holding money when it could instead be in an interest bearing account suggests households perceive the economy and their own income to be stable.

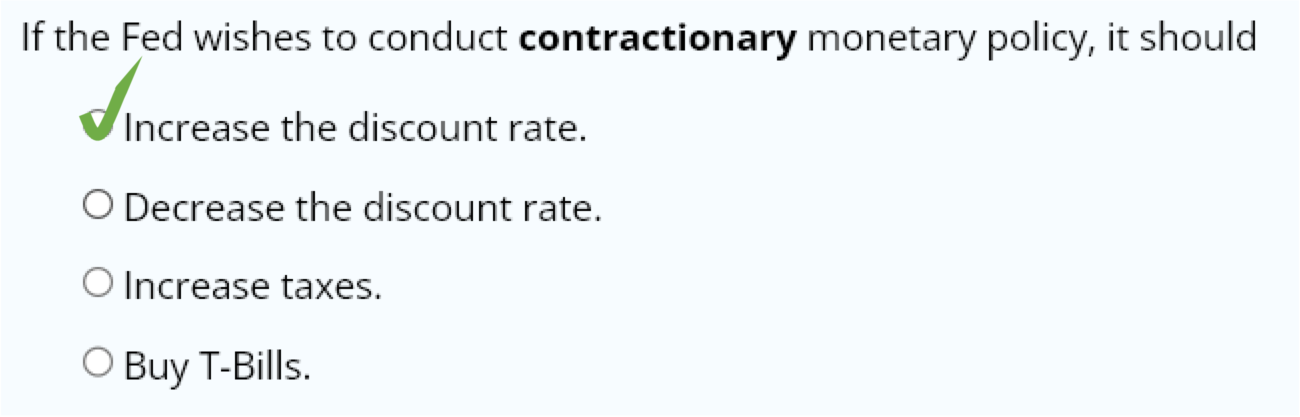
○ Holding money when it could instead be in an interest bearing account suggests households are not worried about the solvency of banks.

Correct. The holder is losing the interest that would otherwise be earned if the money was placed in an interest bearing account.

Q4

Check Your Understanding. Answer the question(s) below to see how w understand the topics covered in the previous section. This short quiz d count toward your grade in the class



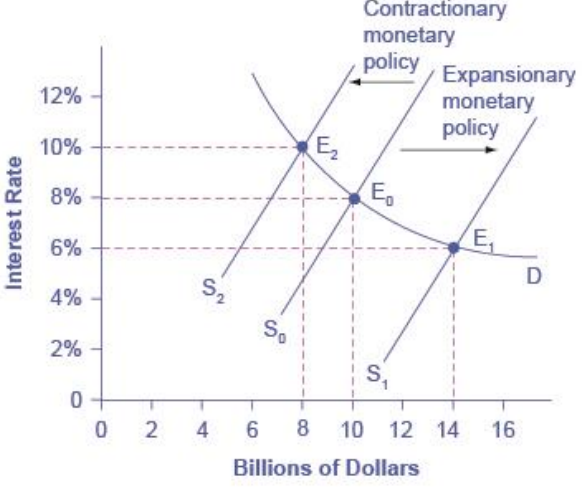


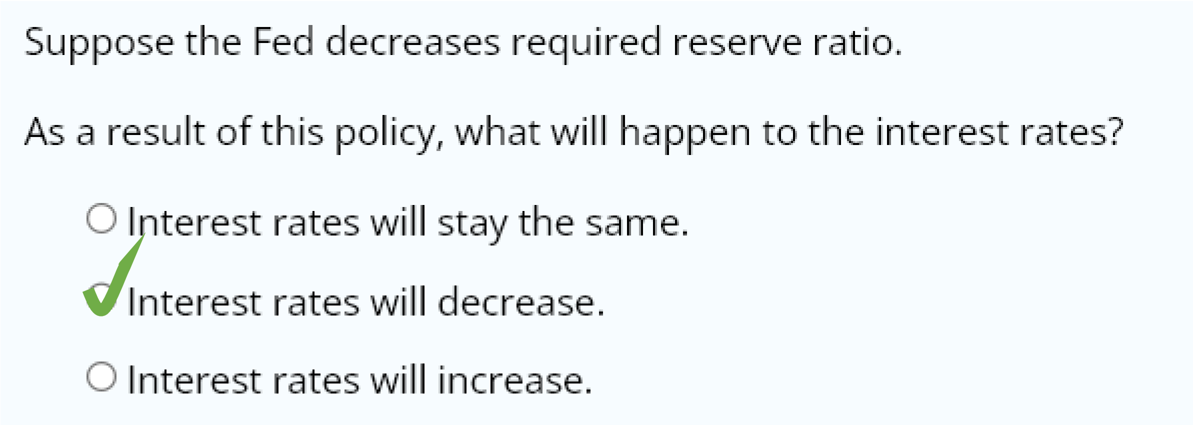
If the Fed wishes to conduct **contractionary** monetary policy, it should

- ✓ Increase the discount rate.
- ○ Decrease the discount rate.
- ○ Increase taxes.
- ○ Buy T-Bills.

Q5

Check Your Understanding. Answer the question(s) below to see how understand the topics covered in the previous section. This short quiz d count toward your grade in the class





Suppose the Fed decreases required reserve ratio.

As a result of this policy, what will happen to the interest rates?

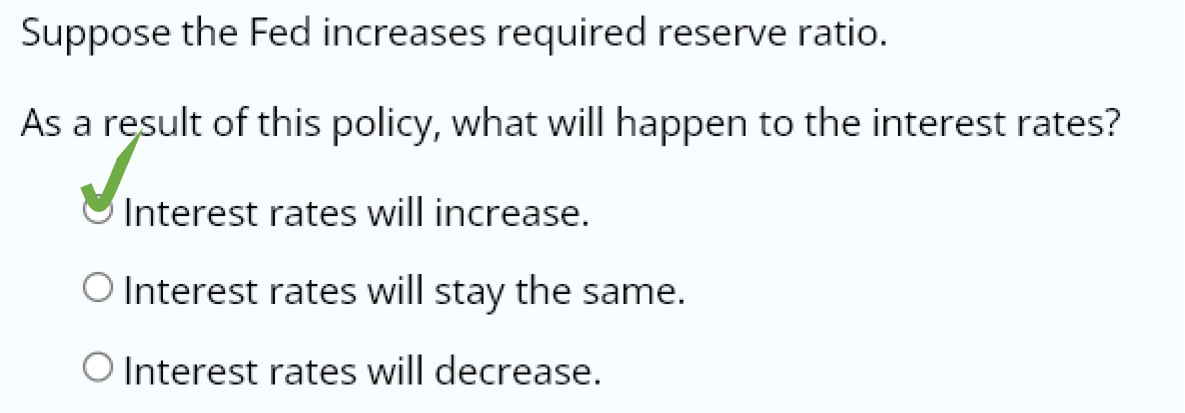
○ Interest rates will stay the same.

✓ Interest rates will decrease.

○ Interest rates will increase.

Q6 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



Suppose the Fed increases required reserve ratio.

As a result of this policy, what will happen to the interest rates?

✓ ○ Interest rates will increase.

○ Interest rates will stay the same.

○ Interest rates will decrease.

GLOSSARY

capital market:

the markets for long term financial assets

contractionary (or tight) monetary policy:

a monetary policy that reduces the supply of money and increases interest rates

expansionary (or loose) monetary policy:

a monetary policy that increases the supply of money and reduces interest rate

federal funds rate

the interest rate at which one bank lends funds to another bank overnight

market for loanable funds

a broad view of financial markets, including equities, bonds, bank accounts, credit, and all other financial assets

money market:

the markets for short term financial assets

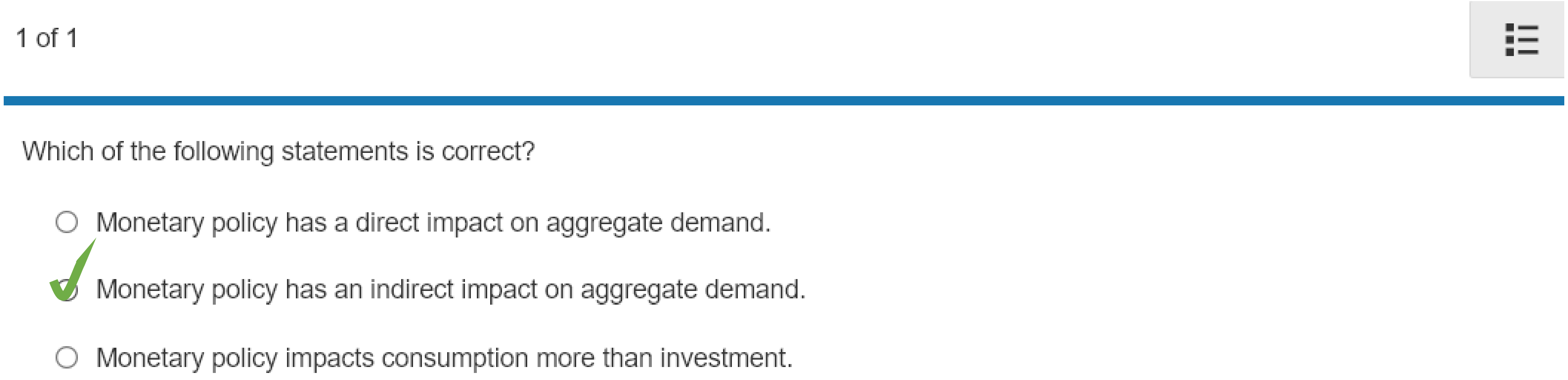
prime rate:

the interest rate banks charge their very best corporate customers, borrowers with the strongest credit ratings

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which of the following statements is correct?

○ Monetary policy has a direct impact on aggregate demand.

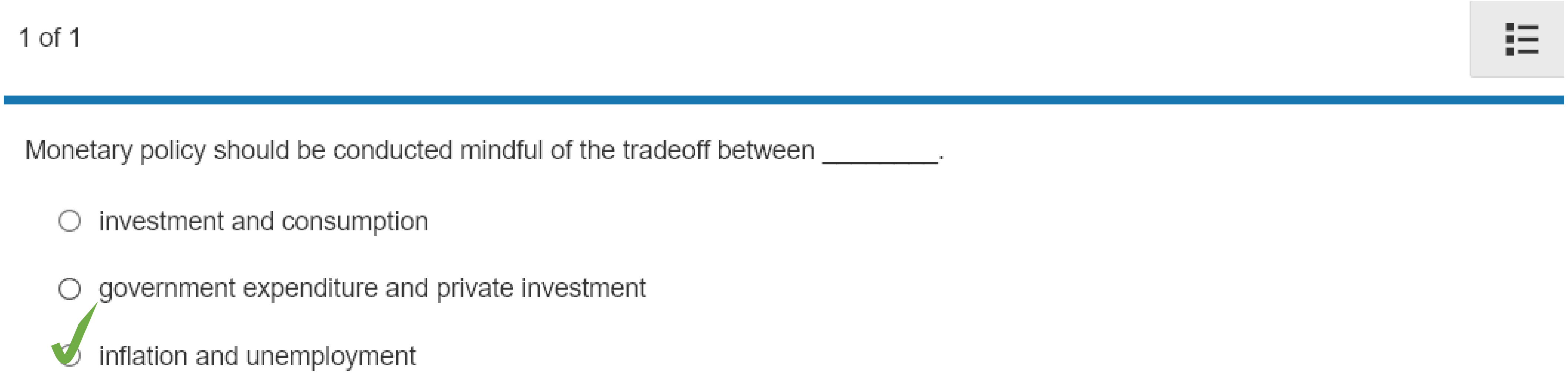
[✓ Monetary policy has an indirect impact on aggregate demand.]

○ Monetary policy impacts consumption more than investment.

0:30

Q

With y711 we stopped here on E-10-2023. Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Monetary policy should be conducted mindful of the tradeoff between ________.

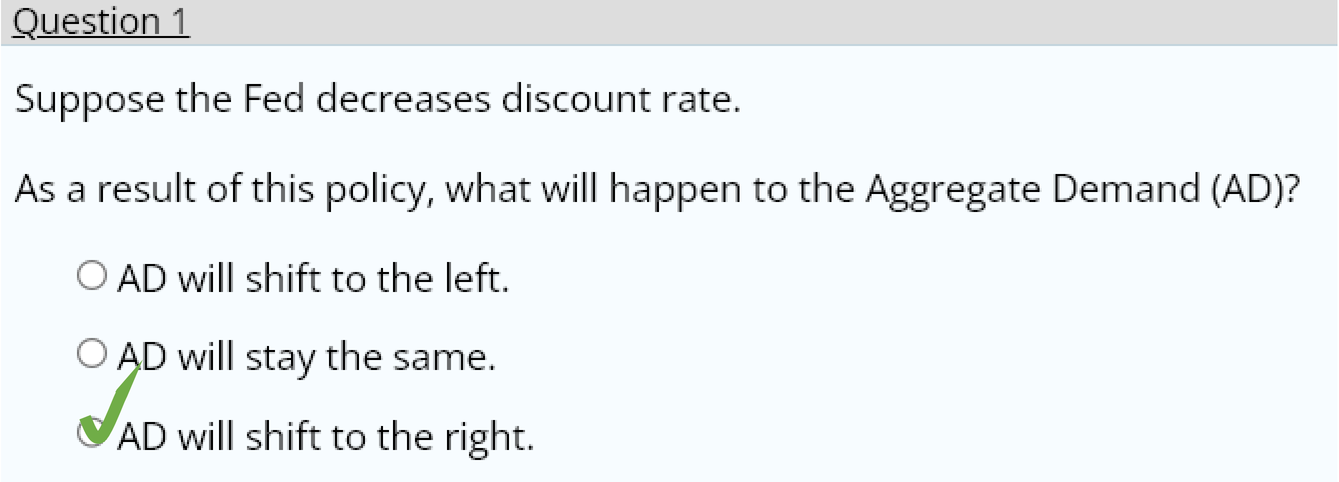
○ investment and consumption

○ government expenditure and private investment

[✓ inflation and unemployment]

0:30

Q1 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 1

Suppose the Fed decreases discount rate.

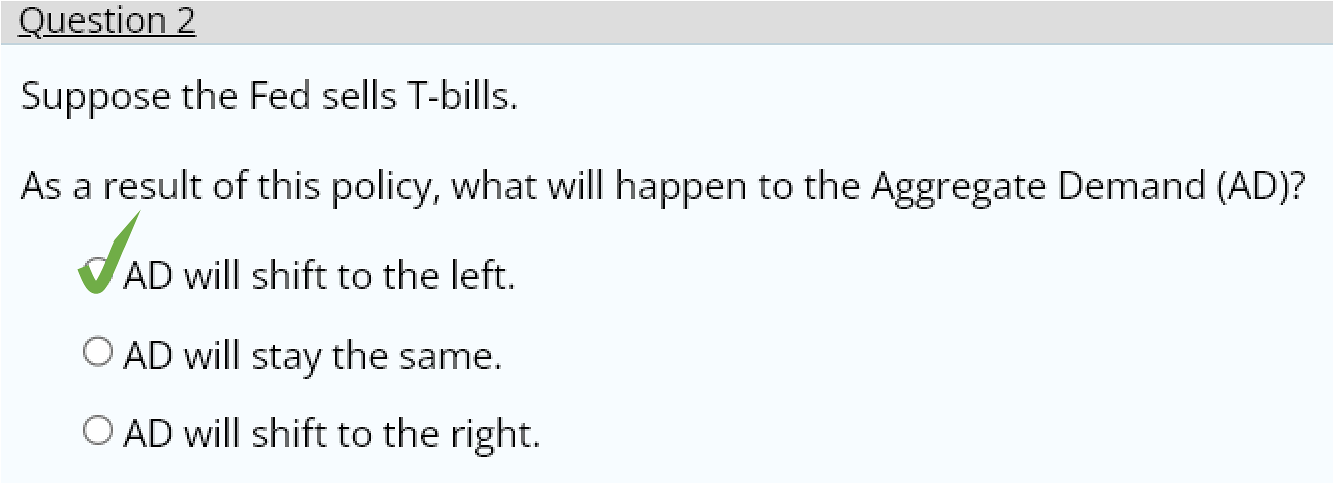
As a result of this policy, what will happen to the Aggregate Demand (AD)?

- ○ AD will shift to the left.
- ○ AD will stay the same.
- ✓ AD will shift to the right.

0:30

Q2

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 2

Suppose the Fed sells T-bills.

As a result of this policy, what will happen to the Aggregate Demand (AD)?

✓ AD will shift to the left.

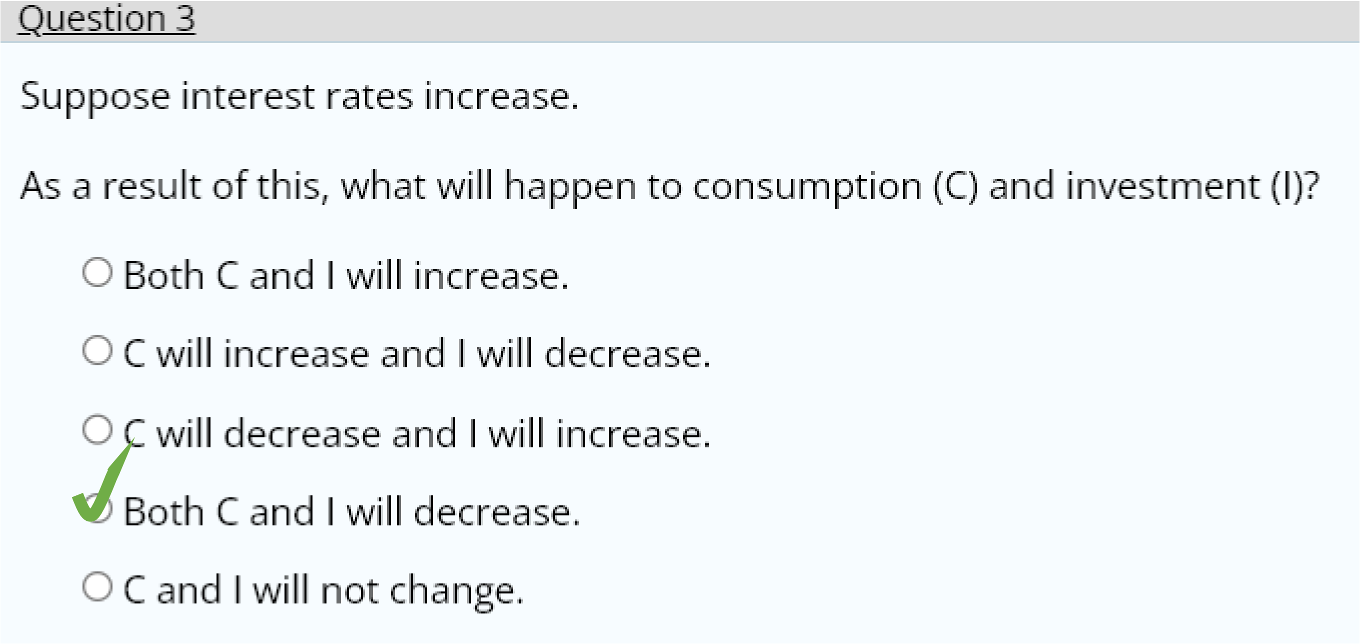
○ AD will stay the same.

○ AD will shift to the right.

0:30

Q3

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 3

Suppose interest rates increase.

As a result of this, what will happen to consumption (C) and investment (I)?

○ Both C and I will increase.

○ C will increase and I will decrease.

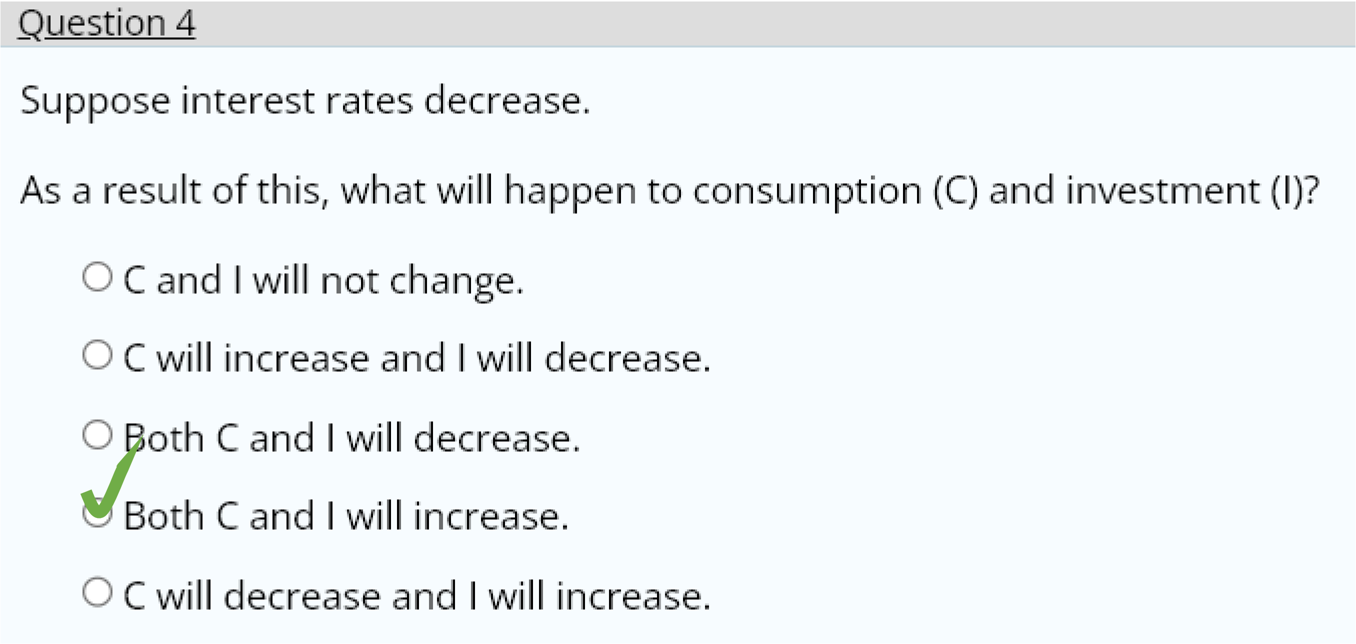
○ C will decrease and I will increase.

✓ Both C and I will decrease.

○ C and I will not change.

0:30

Q4 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 4

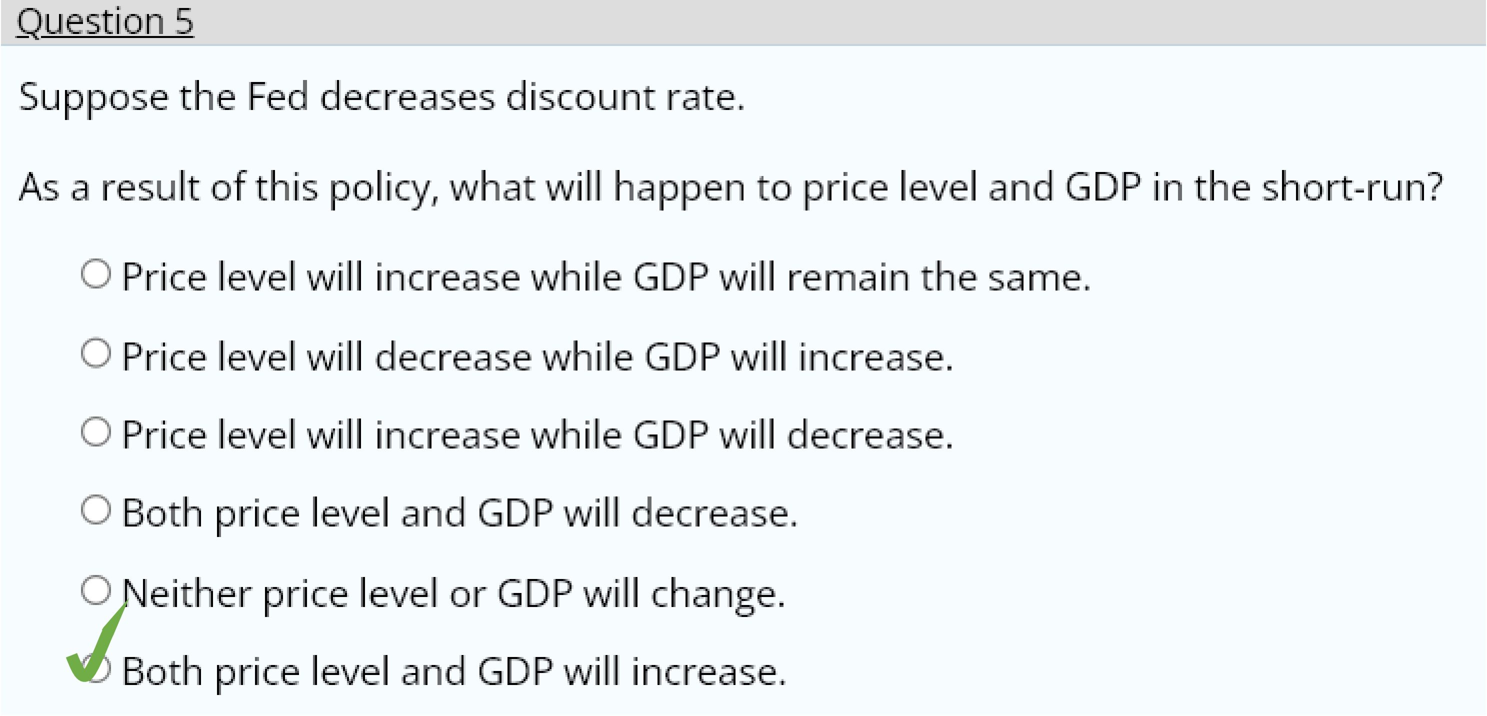
Suppose interest rates decrease.

As a result of this, what will happen to consumption (C) and investment (I)?

- ○ C and I will not change.
- ○ C will increase and I will decrease.
- ○ Both C and I will decrease.
- ○ ✓ Both C and I will increase.
- ○ C will decrease and I will increase.

0:30

Q5 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 5

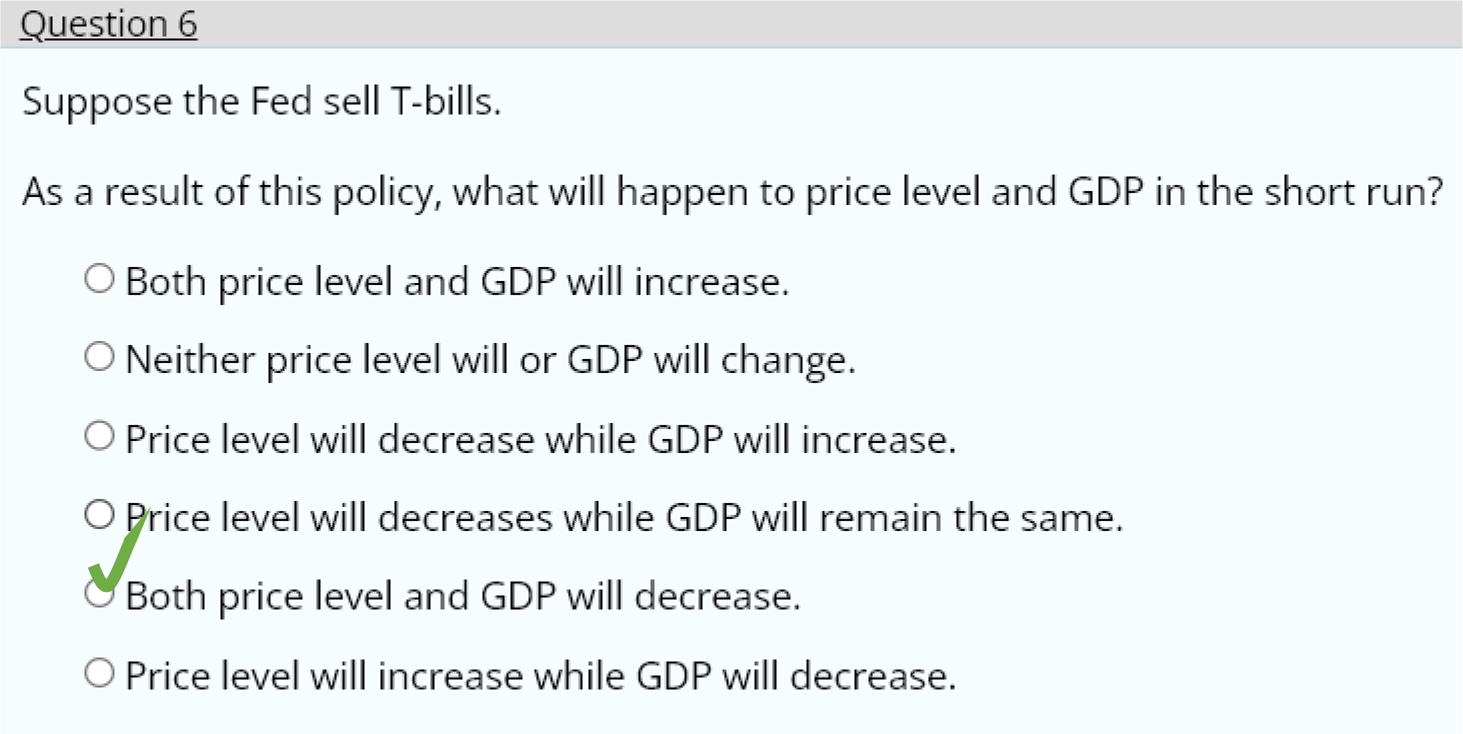
Suppose the Fed decreases discount rate.

As a result of this policy, what will happen to price level and GDP in the short-run?

- ○ Price level will increase while GDP will remain the same.
- ○ Price level will decrease while GDP will increase.
- ○ Price level will increase while GDP will decrease.
- ○ Both price level and GDP will decrease.
- ○ Neither price level or GDP will change.
- [✓ ○ Both price level and GDP will increase.]

0:30

Q6 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 6

Suppose the Fed sell T-bills.

As a result of this policy, what will happen to price level and GDP in the short run?

- ○ Both price level and GDP will increase.
- ○ Neither price level will or GDP will change.
- ○ Price level will decrease while GDP will increase.
- ○ Price level will decreases while GDP will remain the same.
- ✓ ○ Both price level and GDP will decrease.
- ○ Price level will increase while GDP will decrease.

GLOSSARY

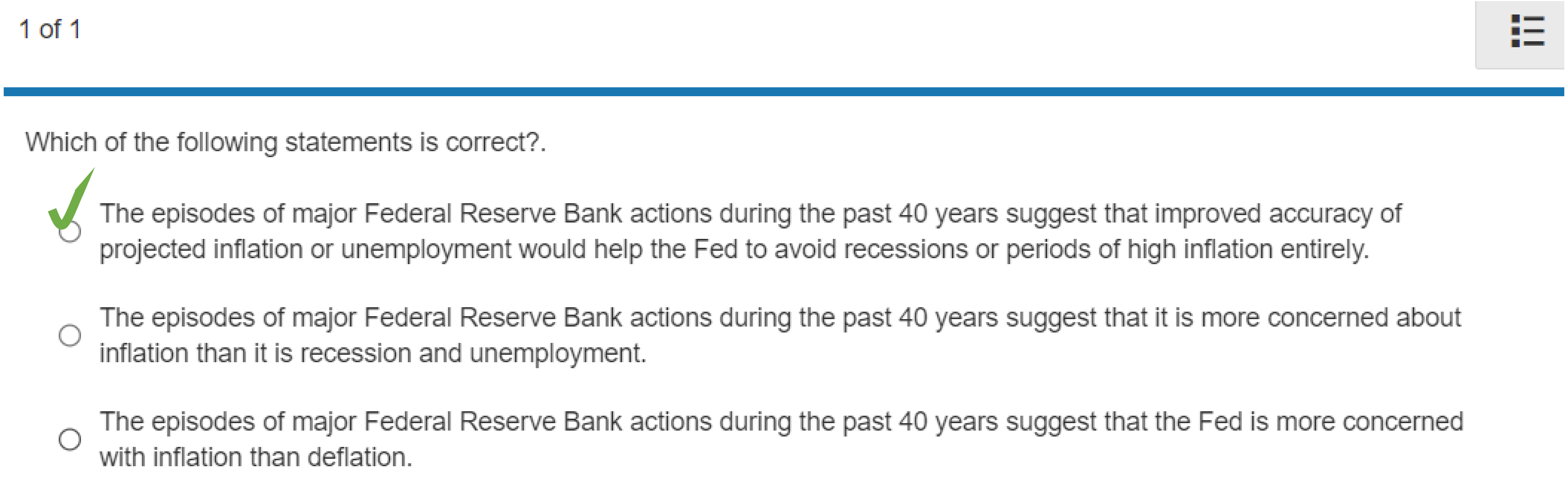
countercyclical:

moving in the opposite direction of the business cycle of economic downturns and upswings

0:30

Q1

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which of the following statements is correct?.

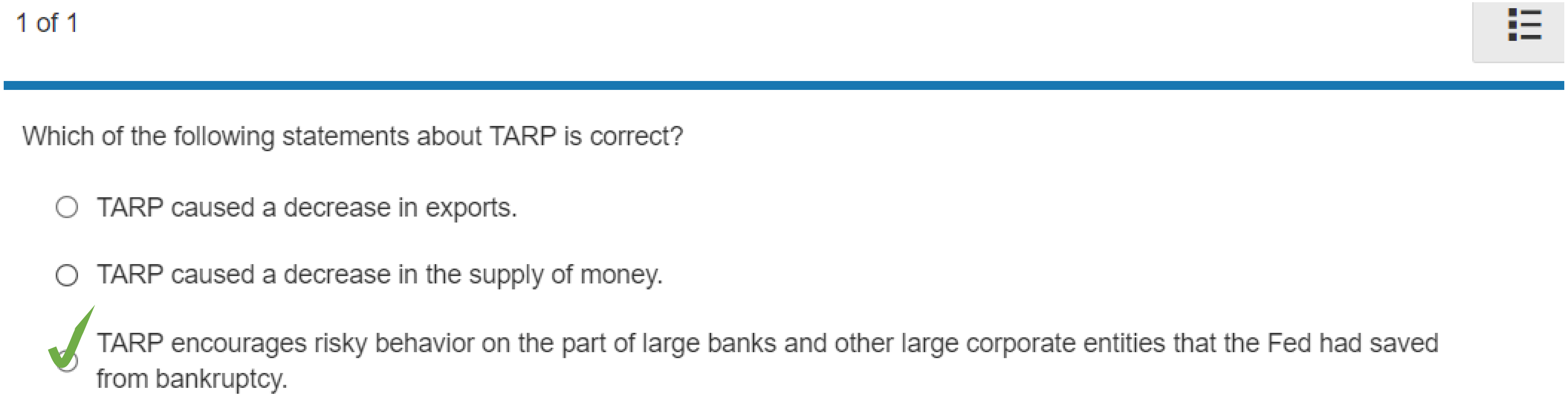
✓ ○ The episodes of major Federal Reserve Bank actions during the past 40 years suggest that improved accuracy of projected inflation or unemployment would help the Fed to avoid recessions or periods of high inflation entirely.

○ The episodes of major Federal Reserve Bank actions during the past 40 years suggest that it is more concerned about inflation than it is recession and unemployment.

○ The episodes of major Federal Reserve Bank actions during the past 40 years suggest that the Fed is more concerned with inflation than deflation.

Q2 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



1 of 1

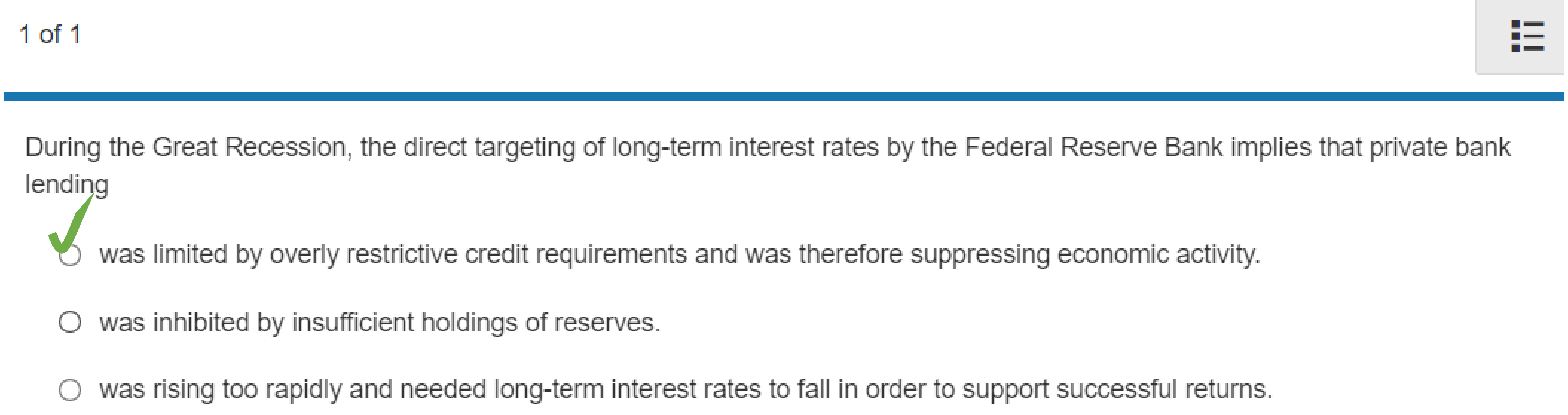
Which of the following statements about TARP is correct?

- ○ TARP caused a decrease in exports.
- ○ TARP caused a decrease in the supply of money.
- ✓ TARP encourages risky behavior on the part of large banks and other large corporate entities that the Fed had saved from bankruptcy.

Q2

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



1 of 1

During the Great Recession, the direct targeting of long-term interest rates by the Federal Reserve Bank implies that private bank lending

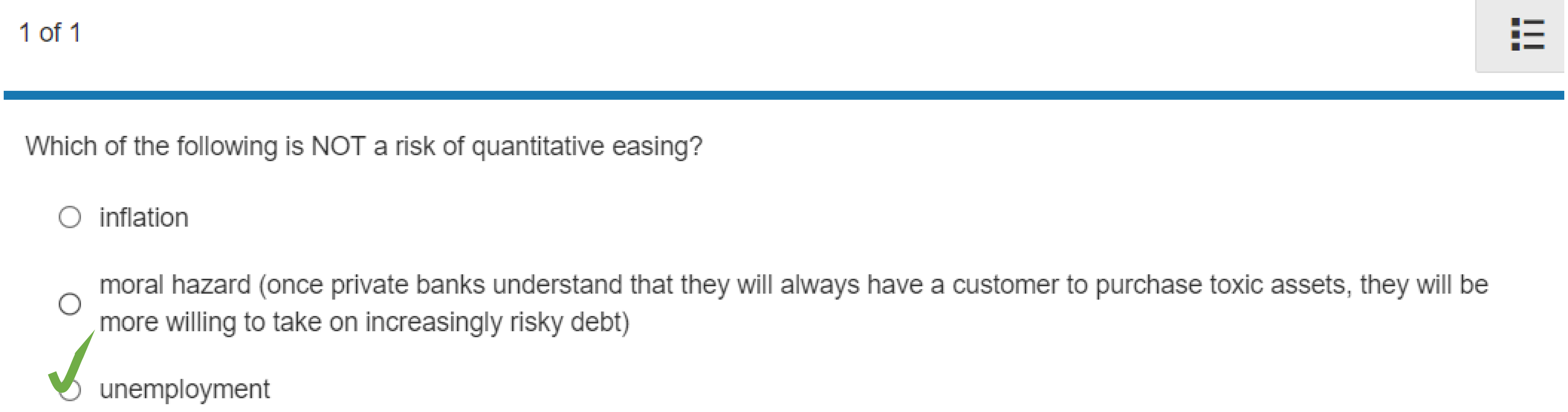
✓ ○ was limited by overly restrictive credit requirements and was therefore suppressing economic activity.

○ was inhibited by insufficient holdings of reserves.

○ was rising too rapidly and needed long-term interest rates to fall in order to support successful returns.

0:30

Q2 Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which of the following is NOT a risk of quantitative easing?

○ inflation

○ moral hazard (once private banks understand that they will always have a customer to purchase toxic assets, they will be more willing to take on increasingly risky debt)

[✓ ○ unemployment]

GLOSSARY

countercyclical:

moving in the opposite direction of the business cycle of economic downturns and upswings

federal funds rate:

the interest rate at which one bank lends funds to another bank overnight

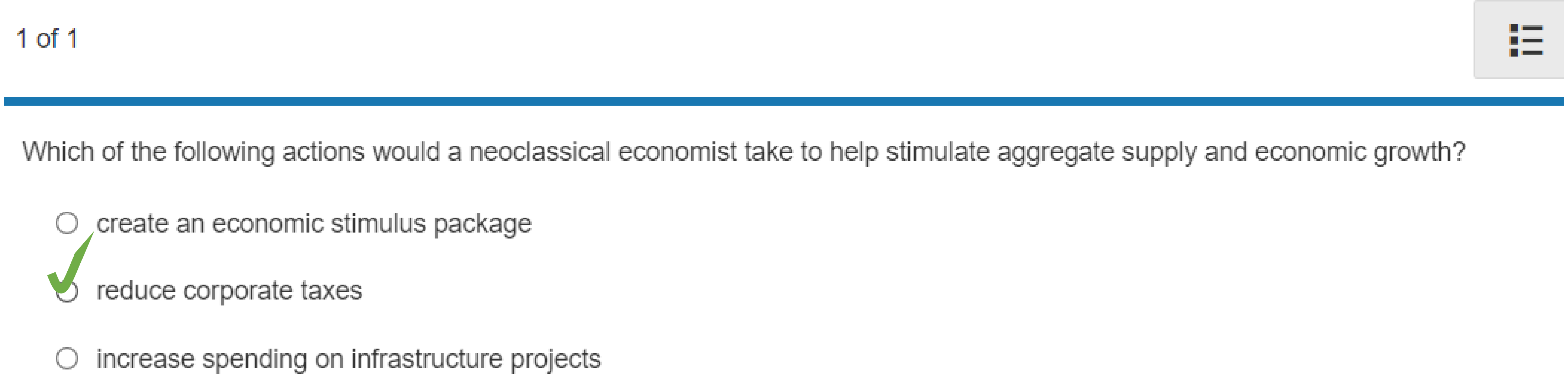
quantitative easing (QE):

the purchase of long-term government and private mortgage-backed securities by central banks to make credit available in hopes of stimulating aggregate demand

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

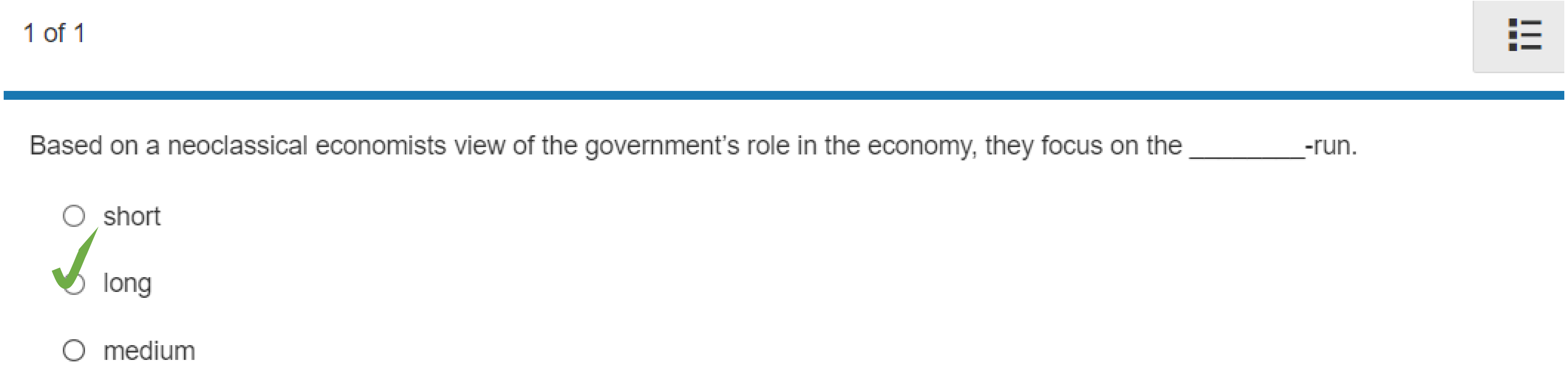
Which of the following actions would a neoclassical economist take to help stimulate aggregate supply and economic growth?

- ○ create an economic stimulus package
- ○ ✓ reduce corporate taxes
- ○ increase spending on infrastructure projects

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Based on a neoclassical economists view of the government’s role in the economy, they focus on the ________-run.

○ short

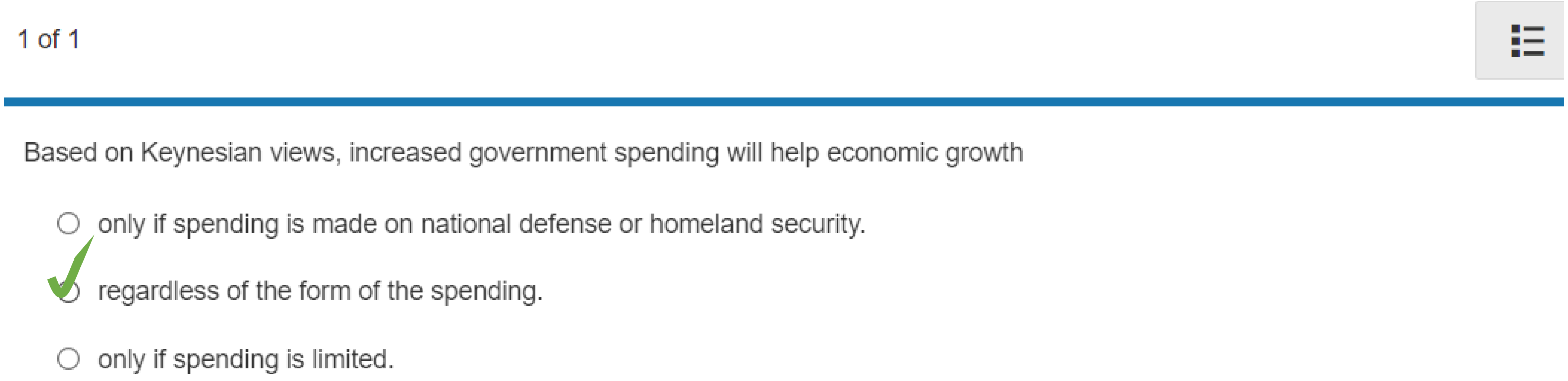
[✓ ○ long]

○ medium

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

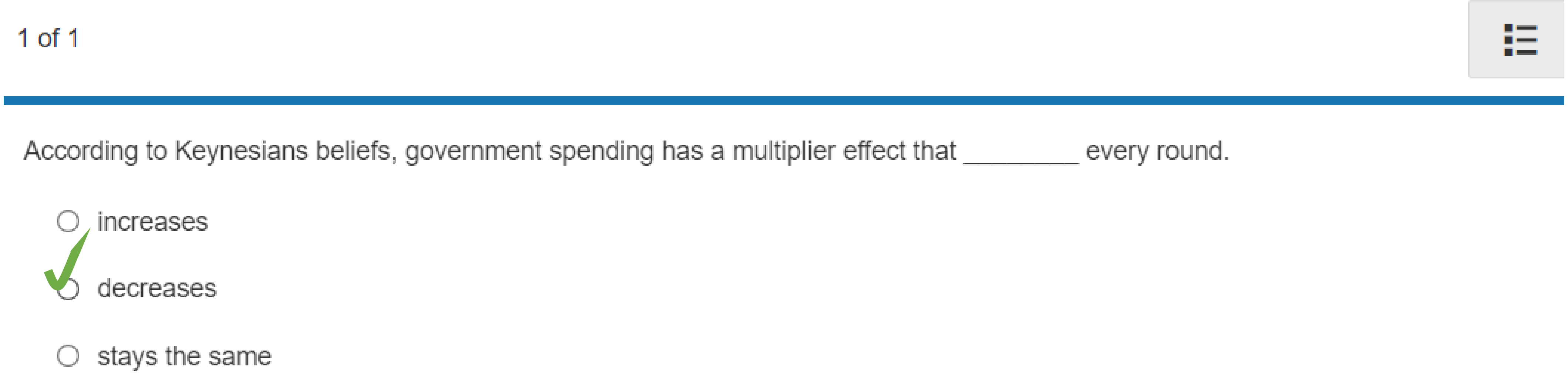
Based on Keynesian views, increased government spending will help economic growth

- ○ only if spending is made on national defense or homeland security.
- ✓ regardless of the form of the spending.
- ○ only if spending is limited.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



According to Keynesians beliefs, government spending has a multiplier effect that ________ every round.

○ increases

✓ ○ decreases

○ stays the same

GLOSSARY

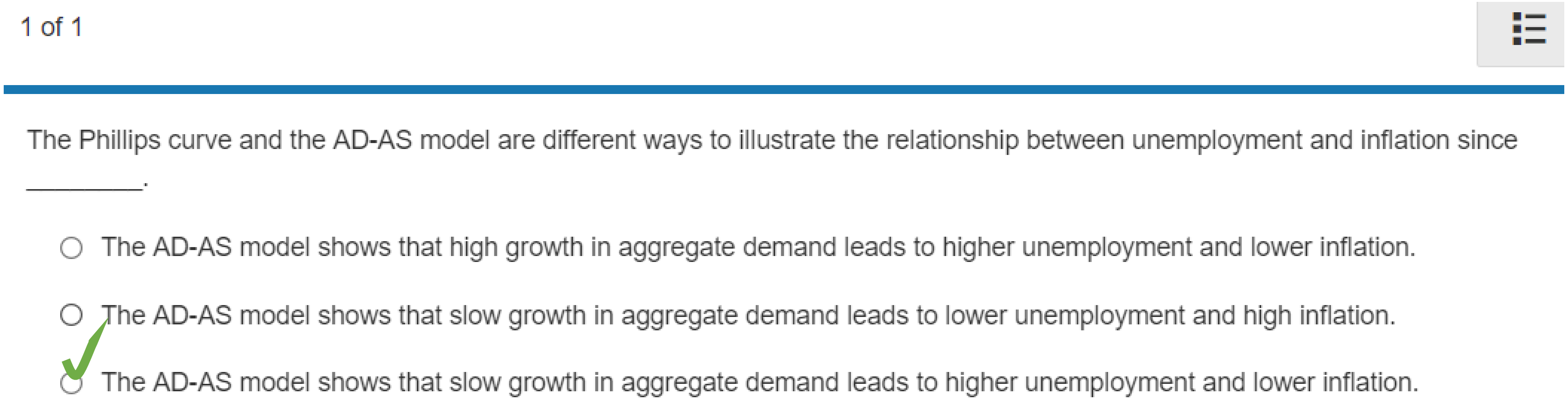
liquidity trap:

Keynesian idea that when interest rates are very low, people are willing to hold cash, rather than put it into financial markets, eliminating the ability for expansionary monetary policy to work

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

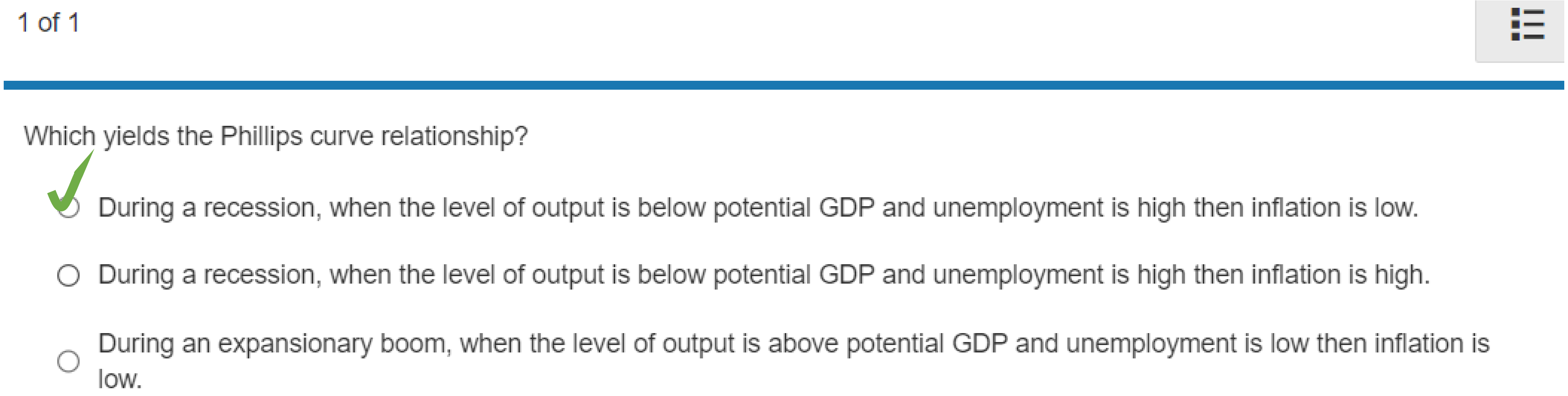
The Phillips curve and the AD-AS model are different ways to illustrate the relationship between unemployment and inflation since ________.

- ○ The AD-AS model shows that high growth in aggregate demand leads to higher unemployment and lower inflation.
- ○ The AD-AS model shows that slow growth in aggregate demand leads to lower unemployment and high inflation.
- ✓ ○ The AD-AS model shows that slow growth in aggregate demand leads to higher unemployment and lower inflation.

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



1 of 1

Which yields the Phillips curve relationship?

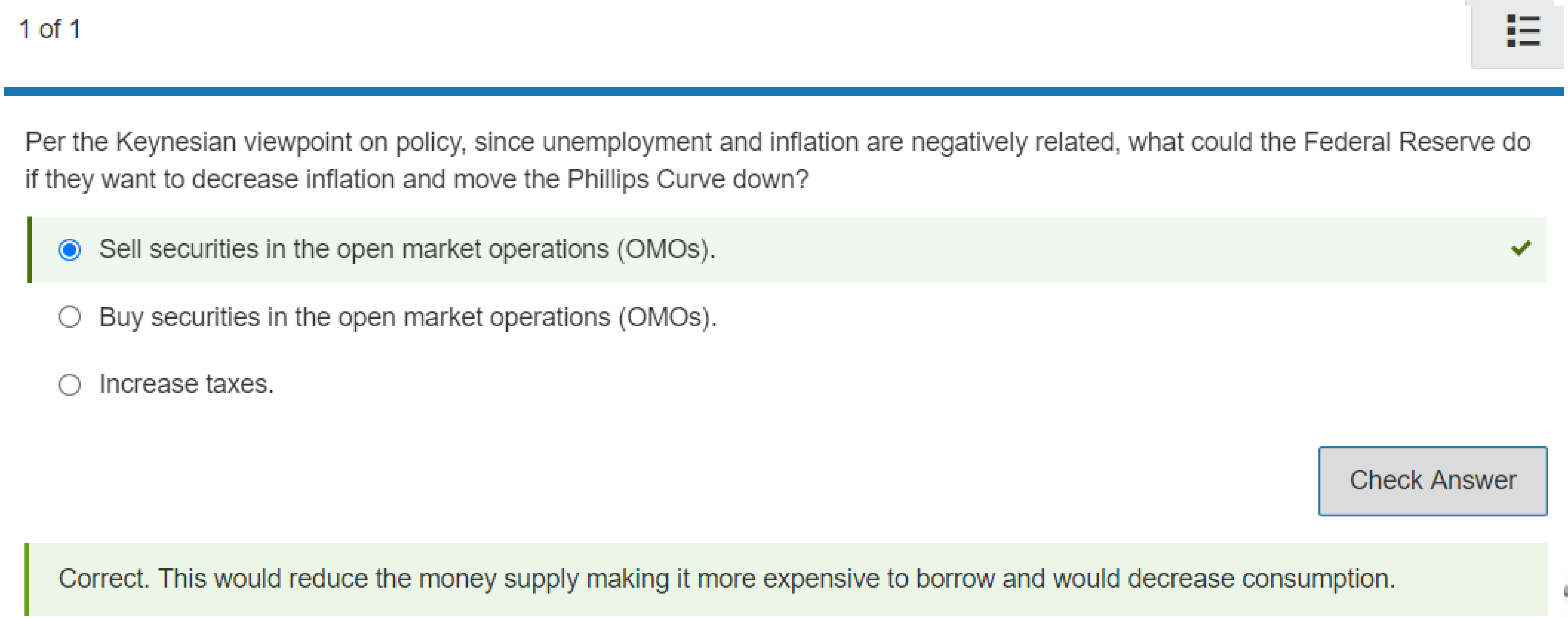
✓ During a recession, when the level of output is below potential GDP and unemployment is high then inflation is low.

○ During a recession, when the level of output is below potential GDP and unemployment is high then inflation is high.

○ During an expansionary boom, when the level of output is above potential GDP and unemployment is low then inflation is low.

Q Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



1 of 1

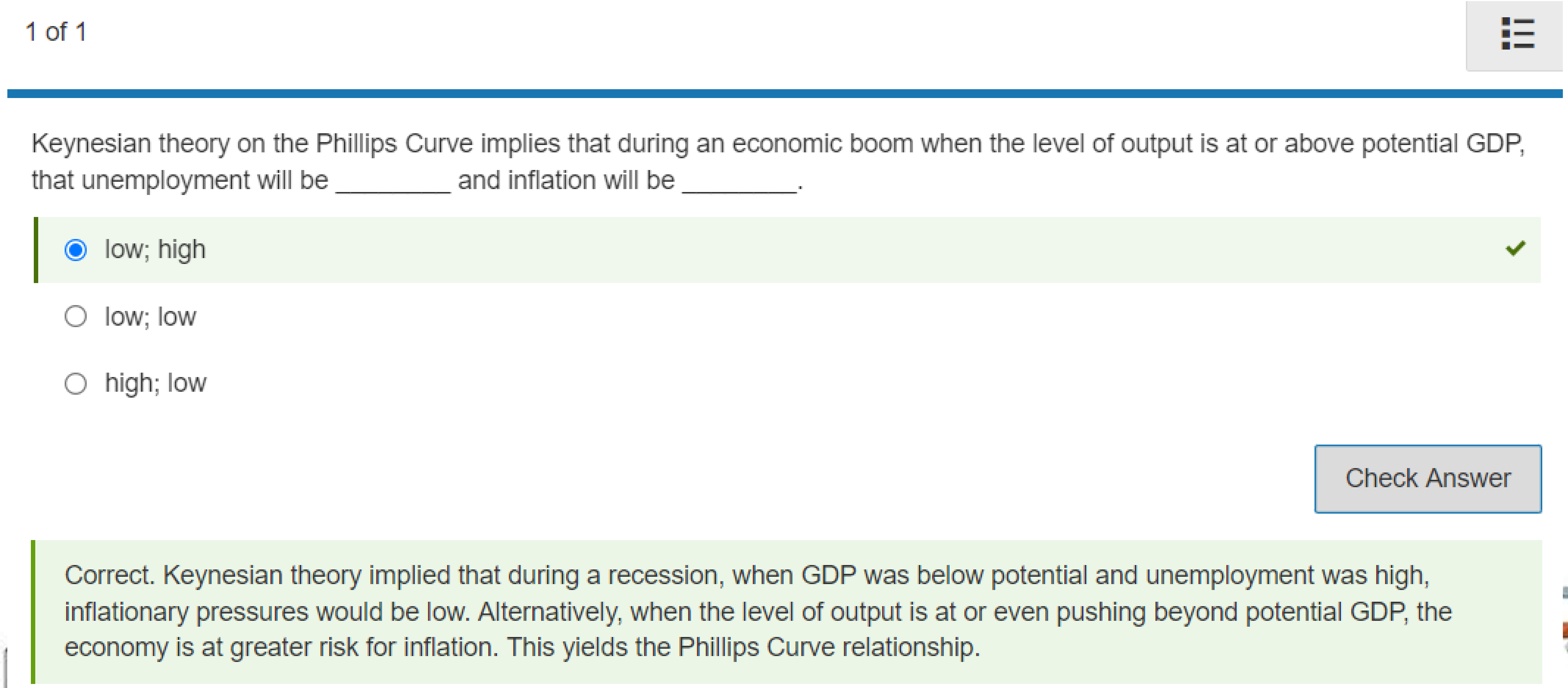
Per the Keynesian viewpoint on policy, since unemployment and inflation are negatively related, what could the Federal Reserve do if they want to decrease inflation and move the Phillips Curve down?

- ● Sell securities in the open market operations (OMOs). ✓
- ○ Buy securities in the open market operations (OMOs).
- ○ Increase taxes.

Correct. This would reduce the money supply making it more expensive to borrow and would decrease consumption.

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class

0:30



1 of 1

Keynesian theory on the Phillips Curve implies that during an economic boom when the level of output is at or above potential GDP, that unemployment will be ________ and inflation will be ________.

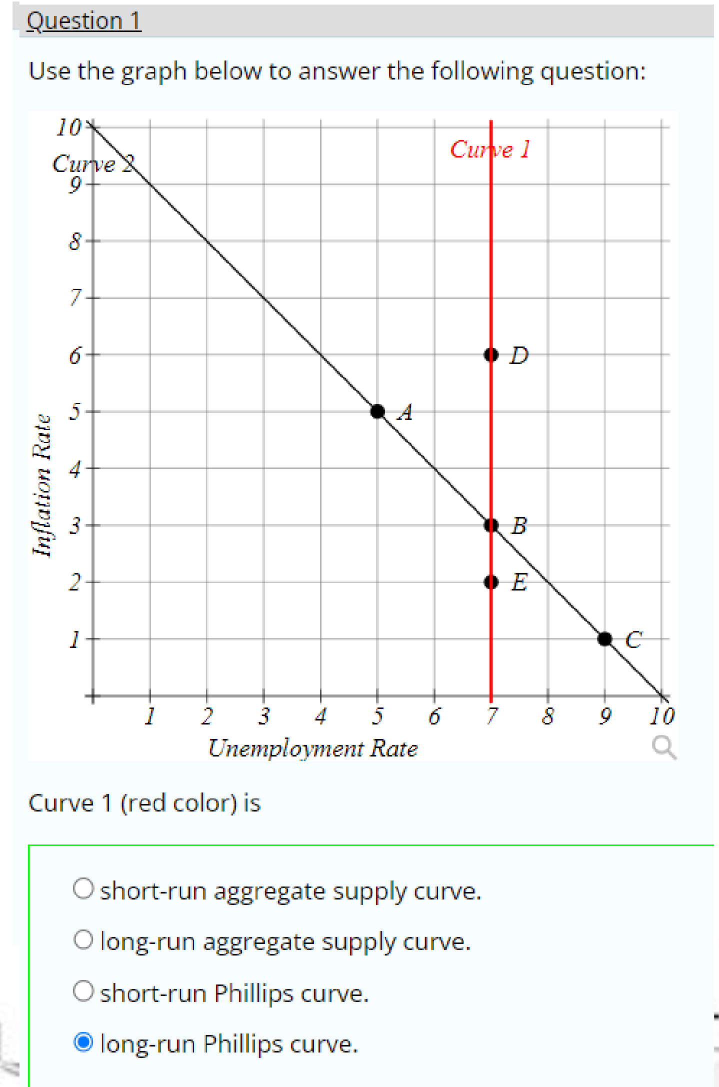
- ● low; high ✓
- ○ low; low
- ○ high; low

Correct. Keynesian theory implied that during a recession, when GDP was below potential and unemployment was high, inflationary pressures would be low. Alternatively, when the level of output is at or even pushing beyond potential GDP, the economy is at greater risk for inflation. This yields the Phillips Curve relationship.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 1

Use the graph below to answer the following question:

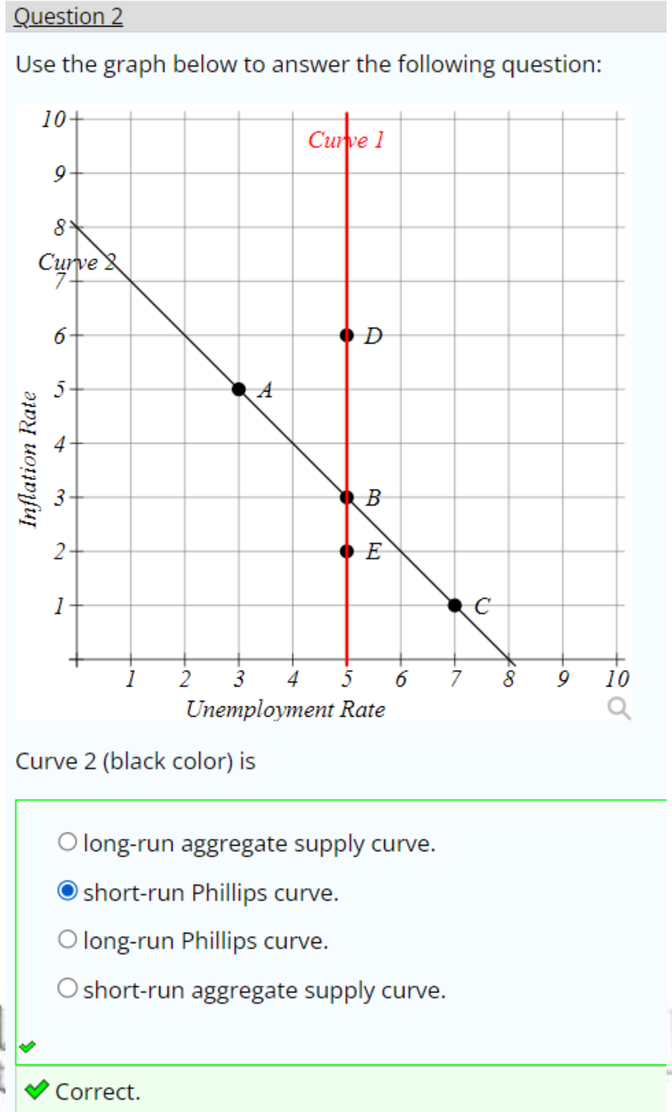
Curve 1 (red color) is

○ short-run aggregate supply curve.
○ long-run aggregate supply curve.
○ short-run Phillips curve.
● long-run Phillips curve.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 2

Use the graph below to answer the following question:

Curve 2 (black color) is

○ long-run aggregate supply curve.

● short-run Phillips curve.

○ long-run Phillips curve.

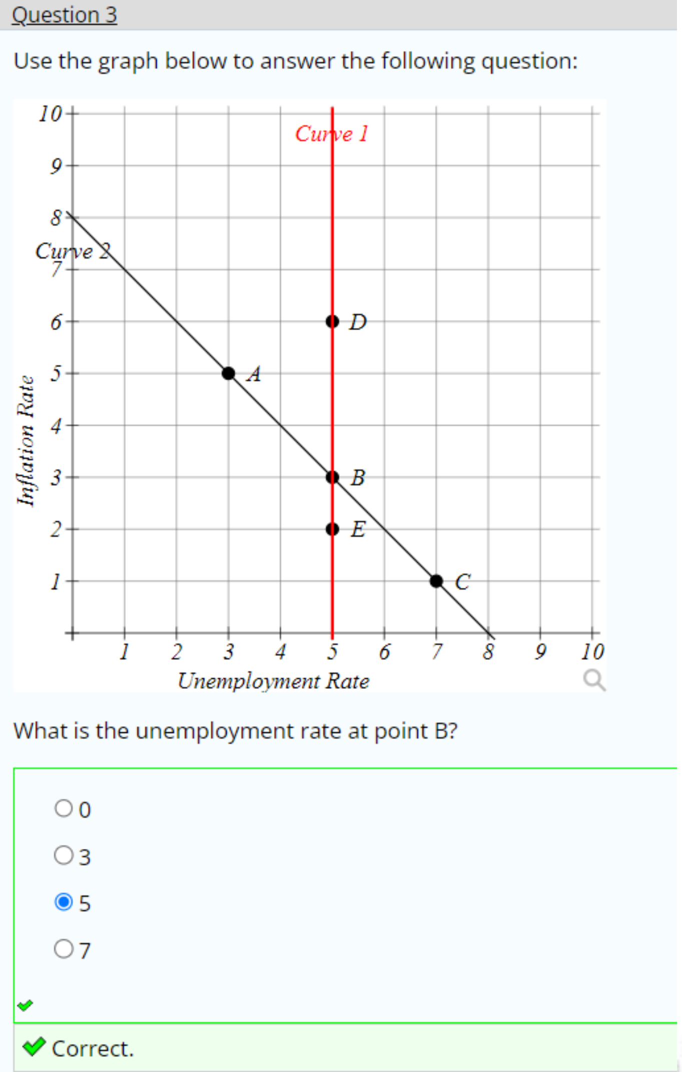
○ short-run aggregate supply curve.

✓ Correct.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 3

Use the graph below to answer the following question:

What is the unemployment rate at point B?

○ 0

○ 3

● 5

○ 7

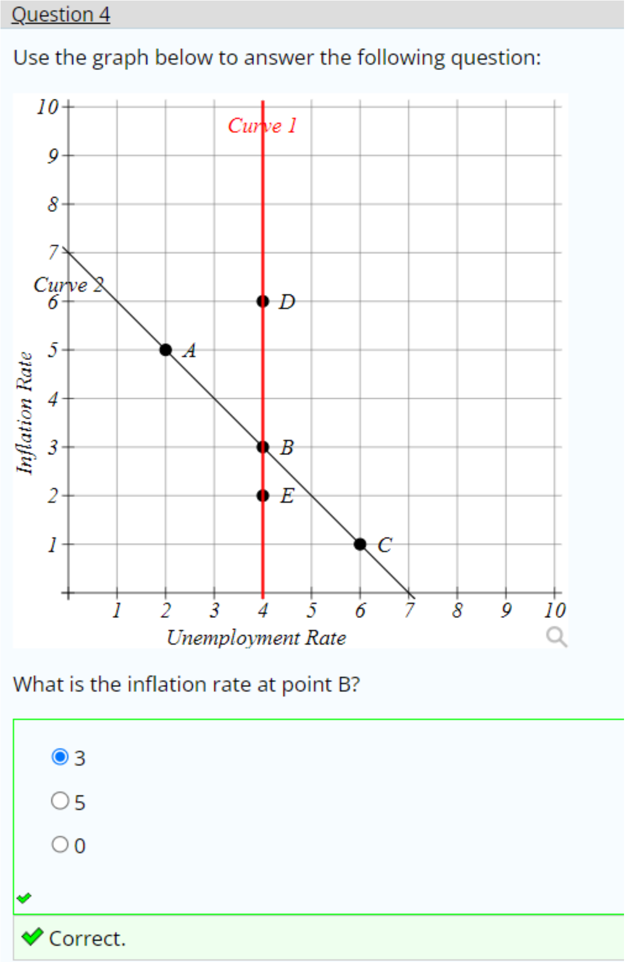
✓

✓ Correct.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



Question 4

Use the graph below to answer the following question:

What is the inflation rate at point B?

● 3

○ 5

○ 0

✓ Correct.

GLOSSARY

contractionary fiscal policy:

tax increases or cuts in government spending designed to decrease aggregate demand and reduce inflationary pressures

expansionary fiscal policy:

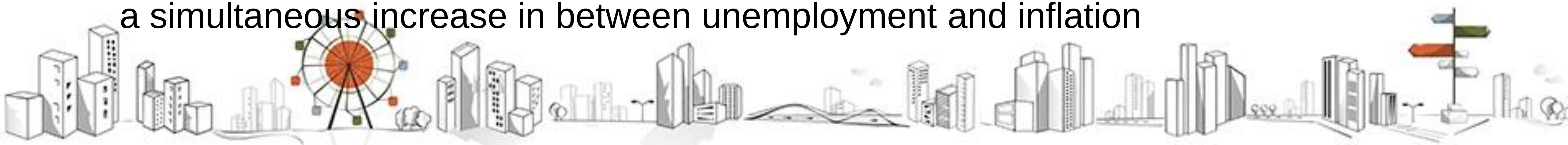
tax cuts or increases in government spending designed to stimulate aggregate demand and move the economy out of recession

Phillips curve:

the tradeoff between unemployment and inflation

Stagflation:

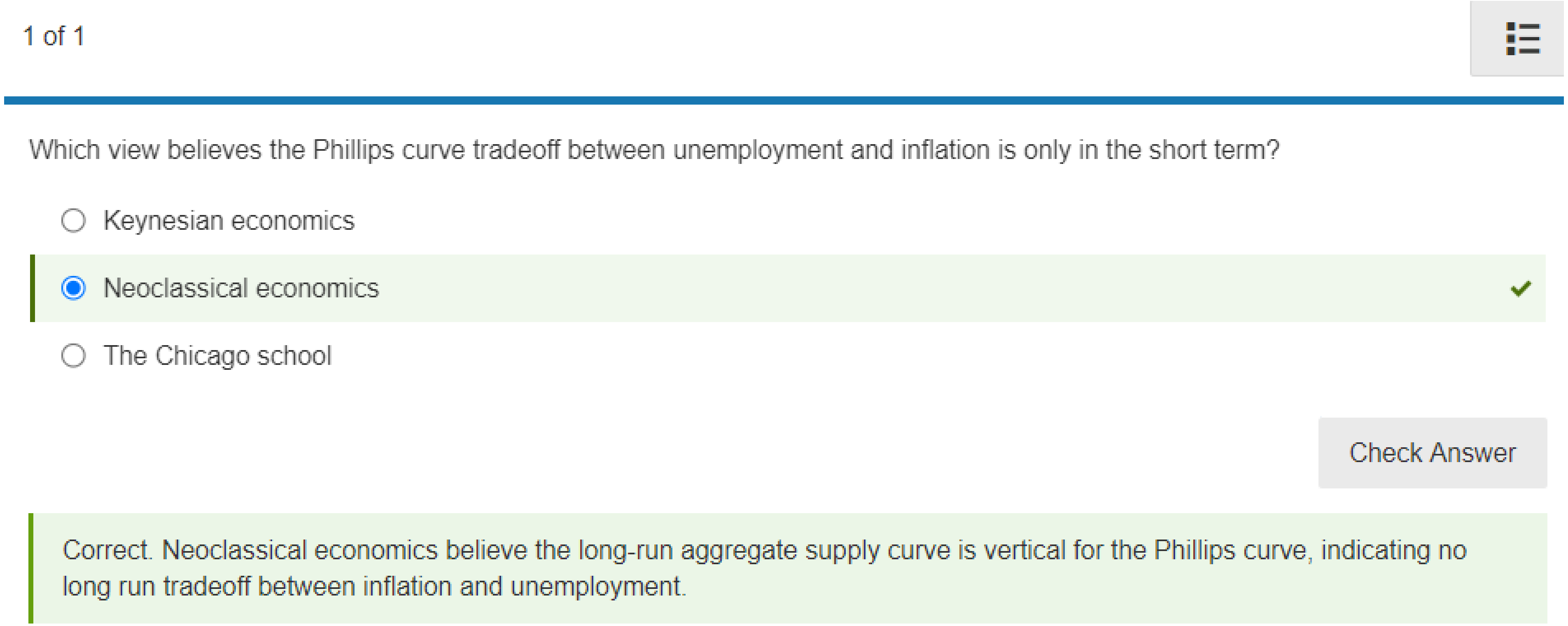
a simultaneous increase in between unemployment and inflation



0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

Which view believes the Phillips curve tradeoff between unemployment and inflation is only in the short term?

○ Keynesian economics

● Neoclassical economics ✓

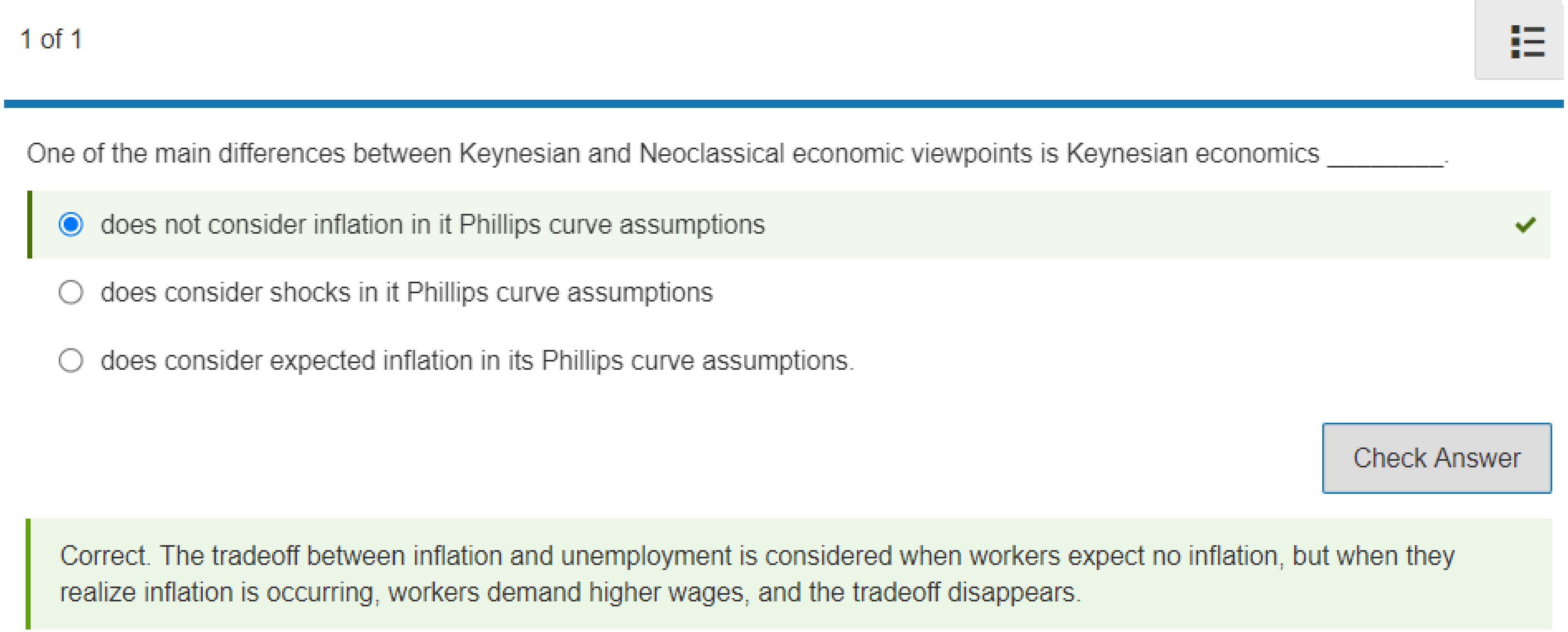
○ The Chicago school

Correct. Neoclassical economics believe the long-run aggregate supply curve is vertical for the Phillips curve, indicating no long run tradeoff between inflation and unemployment.

0:30

Q

Check Your Understanding. Answer the question(s) below to see how well you understand the topics covered in the previous section. This short quiz does not count toward your grade in the class



1 of 1

One of the main differences between Keynesian and Neoclassical economic viewpoints is Keynesian economics ________.

- ● does not consider inflation in it Phillips curve assumptions ✓
- ○ does consider shocks in it Phillips curve assumptions
- ○ does consider expected inflation in its Phillips curve assumptions.

Correct. The tradeoff between inflation and unemployment is considered when workers expect no inflation, but when they realize inflation is occurring, workers demand higher wages, and the tradeoff disappears.

GLOSSARY

Natural Rate Hypothesis

Neoclassical view that since the long run aggregate supply curve is vertical, the long run Phillips Curve is also vertical; there is no tradeoff in the long run between inflation and unemployment

Thank you