***Financial Markets and Institutions, 7e* (Saunders)**

**Chapter 4 The Federal Reserve System, Monetary Policy, and Interest Rates**

1) Federal Reserve interest rate decisions can be vetoed by the U.S. president or the Congress.

Answer: FALSE

Difficulty: 1 Easy

Topic: Major Duties and Responsibilities of the Federal Reserve System: Chapter Overview

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-01 Understand the major functions of the Federal Reserve System.

Accessibility: Keyboard Navigation

2) Four seats on the FOMC are allocated to Federal Reserve Bank presidents on an annual rotating basis.

Answer: TRUE

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

3) The monetary base is the amount of coin and currency in circulation plus reserves.

Answer: TRUE

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

4) Nationally chartered banks are required to become members of the Federal Reserve System.

Answer: TRUE

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

5) About 34 percent of all U.S. banks are members of the Federal Reserve System.

Answer: TRUE

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

6) The major asset of the Federal Reserve is currency outside banks and the major liability is U.S. Treasury securities.

Answer: FALSE

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

7) The seven members of the Board of Governors of the Federal Reserve System serve 14-year nonrenewable terms. Each Board member is appointed by the president and confirmed by the Senate.

Answer: TRUE

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

8) Federal Reserve Board members are appointed by the U.S. president and confirmed by the Senate for a nonrenewable 14-year term.

Answer: TRUE

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

9) If the FOMC wished to generate faster economic growth, they could issue a policy directive to the Federal Reserve Board Trading Desk to purchase U.S. government securities.

Answer: TRUE

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

10) An increase in Treasury securities held by the Fed leads to a decrease in the money supply.

Answer: FALSE

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

11) One of the objectives of the FOMC is to formulate policies to promote 100 percent employment.

Answer: FALSE

Difficulty: 2 Medium

Topic: Federal Open Market Committee

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

12) During the 2010–2014 period, the Federal Reserve purchased long-term treasury securities as part of the Quantitative Easing program.

Answer: TRUE

Difficulty: 1 Easy

Topic: Open Market Operations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

13) Quantitative Easing program initiated by the Federal Reserve during the 2010–2014 period, involved the purchase of long-term corporate bonds.

Answer: FALSE

Difficulty: 1 Easy

Topic: Open Market Operations

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

14) According to the current FOMC stances, inflation targeting promotes maximum employment.

Answer: TRUE

Difficulty: 1 Easy

Topic: Effects of monetary tools on various economic variables

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

15) Countries with independent central banks are subject to political pressure to conduct monetary policies with short-term expectations.

Answer: FALSE

Difficulty: 1 Easy

Topic: International Monetary Policies and Strategies

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-05 Understand how central banks around the world adjusted their monetary policy during the recent financial crisis.

Accessibility: Keyboard Navigation

16) The primary policy tool used by the Fed to meet its monetary policy goals is

A) changing the discount rate.

B) changing reserve requirements.

C) devaluing the currency.

D) changing bank regulations.

E) open market operations.

Answer: E

Difficulty: 1 Easy

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

17) The Federal Reserve System is charged with

A) regulating securities exchanges.

B) conducting monetary policy.

C) providing payment and other services to a variety of institutions.

D) setting bank prime rates.

E) conducting monetary policy and providing payment and other services to a variety of institutions.

Answer: E

Difficulty: 1 Easy

Topic: Major Duties and Responsibilities of the Federal Reserve System: Chapter Overview

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-01 Understand the major functions of the Federal Reserve System.

Accessibility: Keyboard Navigation

18) The \_\_\_\_\_\_\_\_ is a nationwide network jointly operated by the Fed and private institutions that electronically process credit and debit transfers of funds.

A) Fedwire

B) ACH

C) CHIPS

D) NASDAQ

E) SWIFT

Answer: B

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

19) The \_\_\_\_\_\_\_\_ is a network linking over 9,000 banks with the Federal Reserve that is used to transfer deposits and make loan payments between participants.

A) Fedwire

B) ACH

C) CHIPS

D) NASDAQ

E) SWIFT

Answer: A

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

20) Ceteris paribus, if the Fed was targeting the quantity of money supplied and money demand dropped, the Fed would likely \_\_\_\_\_\_\_\_. If the Fed was instead targeting interest rates and money demand dropped, the Fed would likely \_\_\_\_\_\_\_\_.

A) increase the money supply; do nothing

B) do nothing; decrease the money supply

C) decrease the money supply; do nothing

D) do nothing; increase the money supply

E) increase the money supply; decrease the money supply

Answer: B

Difficulty: 3 Hard

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

21) Which of the following is the major monetary policy-making body of the U.S. Federal Reserve System?

A) FOMC

B) OCC

C) FRB bank presidents

D) U.S. Congress

E) Group of Eight

Answer: A

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

22) The major liability of the Federal Reserve is

A) U.S. Treasury securities.

B) depository institution reserves.

C) currency outside banks.

D) vault cash of commercial banks.

E) gold and foreign exchange.

Answer: C

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

23) The major asset of the Federal Reserve is

A) U.S. Treasury securities.

B) depository institution reserves.

C) currency outside banks.

D) vault cash of commercial banks.

E) gold and foreign exchange.

Answer: A

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

24) The Fed funds rate is the rate that

A) banks charge for loans to corporate customers.

B) banks charge to lend foreign exchange to customers.

C) the Federal Reserve charges on emergency loans to commercial banks.

D) banks charge each other on loans of excess reserves.

E) banks charge securities dealers to finance their inventory.

Answer: D

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

25) The discount rate is the rate that

A) banks charge for loans to corporate customers.

B) banks charge to lend foreign exchange to customers.

C) banks charge each other on loans of excess reserves.

D) banks charge securities dealers to finance their inventory.

E) the Federal Reserve charges on loans to commercial banks.

Answer: E

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

26) The Fed offers three types of discount window loans. \_\_\_\_\_\_\_\_ credit is offered to small institutions with demonstrable patterns of financing needs, \_\_\_\_\_\_\_\_ credit is offered for short-term temporary funds outflows, and \_\_\_\_\_\_\_\_ credit may be offered at a higher rate to troubled institutions with more severe liquidity problems.

A) Seasonal; extended; adjustment

B) Extended; adjustment; seasonal

C) Adjustment; extended; seasonal

D) Seasonal; primary; secondary

E) Adjustment; seasonal; extended

Answer: D

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

27) Before 2003 the discount window loan rate was set

A) below the target Fed funds rate.

B) above the target Fed funds rate.

C) equal to the target Fed funds rate.

D) equal to the repurchase rate.

Answer: A

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

28) A decrease in reserve requirements could lead to an

A) increase in bank lending.

B) increase in the money supply.

C) increase in the discount rate.

D) increase in bank lending and an increase in the money supply.

E) increase in bank lending and an increase in the discount rate.

Answer: D

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

29) Bank A has an increase in deposits of $20 million dollars and all bank reserve requirements are 10 percent. Bank A loans out the full amount of the deposit increase that is allowed. This amount winds up deposited in Bank B. Bank B lends out the full amount possible as well and this amount winds up deposited in Bank C. What is the total increase in deposits resulting from these three banks?

A) $48.00 million

B) $54.20 million

C) $56.33 million

D) $57.10 million

E) $60.00 million

Answer: B

Explanation: 20 + (20 × 0.90) + (18 × 0.90)

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

30) The Fed changes reserve requirements from 10 percent to 7 percent, thereby creating $900 million in excess reserves. The total change in deposits (with no drains) would be

A) $3,000 million.

B) $15,625 million.

C) $12,857 million.

D) $3,795 million.

E) None of these choices are correct.

Answer: C

Explanation: (1/0.07) × $900 million

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

31) If the Fed wishes to stimulate the economy, it could

I. buy U.S. government securities.

II. raise the discount rate.

III. lower reserve requirements.

A) I and III only

B) II and III only

C) I and II only

D) II only

E) I, II, and III

Answer: A

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

32) Currently the Fed sets monetary policy by targeting

A) the Fed funds rate.

B) the prime rate.

C) the level of nonborrowed reserves.

D) the level of borrowed reserves.

E) the stock market.

Answer: A

Difficulty: 1 Easy

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

33) From October 1983 to July 1993, the Federal Reserve targeted

A) the Fed funds rate.

B) borrowed reserves.

C) nonborrowed reserves.

D) M1.

E) M3.

Answer: B

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

34) Assume oil prices rise in the United States, generating concerns that inflation may increase. If the Fed wishes to ensure that inflation does not get out of hand, the Fed could

A) intervene in the currency markets to push the value of the dollar down.

B) decrease the discount rate.

C) lower the target Fed funds rate.

D) lower the target money supply growth rate.

E) reduce reserve requirements at banks.

Answer: D

Difficulty: 2 Medium

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

35) The Fed changes reserve requirements from 10 percent to 14 percent, thereby eliminating $750 million in excess reserves. The total change in deposits (with no drains) would be (rounded)

A) $7.917 billion.

B) $6.630 billion.

C) $5.357 billion.

D) $4.934 billion.

E) None of these choices are correct.

Answer: C

Explanation: (1/0.14) × $750 million

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

36) The Fed increases bank reserves in the system by $75 million. If there are no drains, the expected change in bank deposits is

A) $82.5 million.

B) $945 million.

C) $750 million.

D) $1,500 million.

E) $655 million.

Answer: C

Explanation: (1/0.10) × $75 million

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

37) If the Fed is targeting interest rates and money demand increases, an appropriate policy response would be to

A) increase reserve requirements.

B) increase the discount rate.

C) buy U.S. Treasury securities from government bond dealers.

D) increase government spending.

E) None of these choices are correct.

Answer: C

Difficulty: 2 Medium

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

38) The major monetary policy-making arm of the Federal Reserve is the

A) Board of Governors.

B) Council of Federal Reserve Bank presidents.

C) Office of the Comptroller of the Currency.

D) Federal Reserve Bank of New York.

E) None of these choices are correct.

Answer: E

Explanation: The Federal Open Market Committee is the correct answer.

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

39) In the area of bank supervision, which of the following are functions of the Federal Reserve Banks?

I. Examinations of state member banks

II. Approval of member bank and bank holding company acquisitions

III. Deposit insurance

A) I only

B) I and II only

C) II and III only

D) I and III only

E) I, II, and III

Answer: B

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

40) The Check 21 Act, effective in October 2004, does which of the following?

A) Allows bank customers to better take advantage of bank float

B) Requires banks to immediately clear all customer deposits

C) Prohibits the Fed from being involved in check clearing to prevent unfair competition with private check clearing agencies

D) Authorizes the use of an electronic image to facilitate paperless check clearing

E) Eliminates all fees on checking

Answer: D

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

41) A bank has $770 million in checkable deposits. The bank has $85 million in reserves. The bank's required reserves are \_\_\_\_\_\_\_\_ and its excess reserves are \_\_\_\_\_\_\_\_.

A) $85 million; $0

B) $770 million; $85 million

C) $89 million; $21 million

D) $685 million; $8.5 million

E) $77 million; $8 million

Answer: E

Explanation: Required = 10% (770); Excess = 85 − 10% (770)

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Analyze; Apply

AACSB: Analytical Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

42) The Federal Reserve does all but which one of the following?

A) Conducts monetary policy

B) Supervises and regulates bank activities

C) Serves as the commercial bank for the U.S. Treasury

D) Operates check clearing and wire transfer facilities

E) Insures deposits

Answer: E

Difficulty: 2 Medium

Topic: Major Duties and Responsibilities of the Federal Reserve System: Chapter Overview

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-01 Understand the major functions of the Federal Reserve System.

Accessibility: Keyboard Navigation

43) Which of the following is not a goal of monetary policy?

A) Moderate long-term interest rates.

B) Stable interest rates.

C) High employment.

D) Stable prices.

E) All of these choices are correct.

Answer: B

Difficulty: 2 Medium

Topic: Major Duties and Responsibilities of the Federal Reserve System: Chapter Overview

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-01 Understand the major functions of the Federal Reserve System.

Accessibility: Keyboard Navigation

44) Which of the following is not a program initiated by world's major central banks during the financial crisis of 2007 to avoid a deep worldwide recession?

A) Expansion of retail deposit insurance

B) Capital injections

C) Purchase of U.S. dollars

D) Debt guarantees

E) Asset purchases/guarantees

Answer: C

Difficulty: 2 Medium

Topic: International Monetary Policies and Strategies

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-05 Understand how central banks around the world adjusted their monetary policy during the recent financial crisis.

Accessibility: Keyboard Navigation

45) What are the intended consequences from charging an interest on excess reserves by Central banks?

A) Banks lend less money.

B) Interest rates increase.

C) Banks deposits increase.

D) Banks lend more money.

E) All of these choices are correct.

Answer: D

Difficulty: 2 Medium

Topic: International Monetary Policies and Strategies

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-05 Understand how central banks around the world adjusted their monetary policy during the recent financial crisis.

Accessibility: Keyboard Navigation

46) In the aftermath of the 2007 financial crisis, the Fed used several programs to increase liquidity, including \_\_\_\_\_\_\_\_.

A) expansion of the discount window

B) setting up the Term Auction Facility

C) lending to investment banks

D) purchase of long-term treasury bonds

E) All of these choices are correct.

Answer: E

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

47) What are the four major functions of the Federal Reserve System?

Answer:

1. Conducts monetary policy.

2. Supervises and regulates depository institutions.

3. Maintains the stability of the financial system.

4. Provides payment and other services to institutions.

Difficulty: 1 Easy

Topic: Major Duties and Responsibilities of the Federal Reserve System: Chapter Overview

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-01 Understand the major functions of the Federal Reserve System.

Accessibility: Keyboard Navigation

48) The 12 Federal Reserve Banks perform what functions?

Answer:

1. Assist in monetary policy.

2. Supervise and regulate district state-chartered member banks and bank holding companies.

3. Write regulations to implement consumer protection laws and establish programs to promote access to credit and community development.

4. Serve as commercial banks for the U.S. Treasury.

5. Distribute and replace currency.

6. Provide check clearing services.

7. Provide wire transfer services.

8. Provide economic research for monetary policy.

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

49) How do Federal Reserve Banks generate income? Do they require supplemental funding from Congress?

Answer:

* Interest earned on government securities acquired in open market transactions
* Interest earned on reserves that banks are required to deposit at the Fed
* Fees from services and membership fees
* The Fed does not need supplemental funding from Congress.

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

50) Why did the Fed switch from increasing rates prior to 2007 to reducing interest rates in 2007 and 2008?

Answer: The growing problems in the housing markets led to problems in the subprime mortgage markets. Many financial institutions held or guaranteed mortgage-backed securities, which were becoming increasingly risky in 2007 and early 2008. It became apparent that banks had made too many risky mortgage-backed loans with borrowed funds. Lenders to these institutions were wary of accepting mortgage collateral, causing short-term funding problems at banks and investment banks. The Fed began to aggressively cut interest rates to help the mortgage market, particularly the subprime portion, and to encourage economic growth. Banks were cutting risky lending because of the problems in their mortgage loans and mortgage-backed securities, and the resulting "credit crunch" (banks' unwillingness to lend) led to rapidly slowing economic growth.

Difficulty: 3 Hard

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

51) What are the main responsibilities of the FOMC?

Answer: Promote full employment; promote economic growth; promote price stability; promote sustainable pattern of international trade.

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

52) Explain how a change in open market operations can affect a new college graduate.

Answer: If the Fed increases bank reserves by buying securities, interest rates on all loan types will be affected. For instance, when interest rates fall, corporations will likely have more projects with positive NPVs, leading to more spending and more jobs. A college graduate is then more likely to get hired, and your interest rates on new cars, homes, and so forth, will likely be lower, not to mention that the value of your stock holdings would probably go up.

Difficulty: 1 Easy

Topic: Structure of the Federal Reserve System

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

53) How have recent changes in discount window credit programs affected the use of this tool for monetary policy?

Answer: In the past, the discount rate was kept below the Fed funds rate to allow troubled banks that could not obtain private credit to borrow on an emergency basis. Changes in the announced discount rate signaled to investors about the way the Fed wanted interest rates to move. Under the new rules, however, the discount rate is generally tied to the current Fed funds rate target. This largely eliminates the use of the discount rate as a signal to the market. In recent years the FOMC has announced a target Fed funds target rate and the discount rate is adjusted as the Fed funds target is changed.

In early 2008 the Fed opened the discount window to nonbank brokers and dealers who were experiencing liquidity problems in their mortgage portfolios. Securities firms could exchange some of their illiquid mortgage assets with the Fed for liquid Treasury securities.

Difficulty: 3 Hard

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

54) Explain how the deposit multiplier works.

Answer: Suppose the Fed increases bank reserves via open market operations. The bank now has too many excess reserves that earn no interest, so it seeks to loan out the funds. The lent funds are deposited in another bank. The second bank keeps some funds in the form of required reserves and lends the rest. The second loan is also redeposited at another bank and a portion of those funds is lent again, and so forth. At the limit, a change in reserves increases deposits by the amount equal to Δreserves x 1/reserve requirement.

Difficulty: 2 Medium

Topic: Monetary Policy Tools

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation

55) The Fed wishes to expand the money supply. What three things can it do? Which has the most predictable effects? Be specific.

Answer: Buy U.S. government securities.

Decrease the discount rate.

Decrease reserve requirements.

Buying U.S. government securities has the most predictable effect.

Difficulty: 1 Easy

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

56) Is there a trade-off between controlling domestic inflation and maintaining a sustainable pattern of international trade?

Answer: Yes. If the United States curtails money supply growth to the point that U.S. inflation is lower than inflation elsewhere, the dollar will tend to appreciate against foreign currencies. With a strong dollar, the United States will tend to import more and export less, possibly leading to a large and potentially unsustainable trade deficit.

Difficulty: 2 Medium

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Understand

AACSB: Reflective Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

57) Suppose that oil prices hit an all-time high of $200 a barrel, driving U.S. inflation up to 7 percent per year. At the same time, weak U.S. growth and increasing foreign competition have generated unacceptably high levels of unemployment in the United States. You are the chair of the Federal Reserve. What do you suggest?

Answer: This is a very difficult scenario for the Fed chair. It is called stagflation and the combination of high inflation and unemployment reduces the effectiveness of any monetary policy action to provide sustained relief to the economy's problem. Increasing bank excess reserves and lowering interest rates may reduce unemployment temporarily, but these actions will also likely exacerbate inflation, drive up wages, and with a higher labor supply cost, will eventually drive unemployment back up. The end result is that the employed and the unemployed face higher prices. Alternative policy actions may include fiscal spending, removing the factor(s) causing the problems (such as a supply constraint causing a lack of oil availability), or perhaps stimulating greater global growth to get U.S. domestic demand growing.

Difficulty: 3 Hard

Topic: The Federal Reserve, the Money Supply, and Interest Rates

Bloom's: Understand; Analyze; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 04-04 Appreciate how monetary policy changes affect key economic variables.

Accessibility: Keyboard Navigation

58) What does the 2004 Check 21 Law allow? Why was this Law passed? Does it benefit the customer or banks? Explain.

Answer: The Check 21 Law authorizes the use of an electronic image as a substitute document for a paper check and helps move the financial system toward paperless, electronic transfers. It was passed because of the September 11 attacks that grounded cargo planes that fly checks all over the country. Switching to electronic check images saves an estimated $3 billion per year for the banking industry. If these cost savings are passed on to customers in the form of better deposit rates or reduced checking fees, customers benefit. However, the Law facilitates speedier clearing of checks that reduces customer's ability to "play the float." The float is the time period between tendering a check and your account being debited, which used to be as many as several days. Checks may now instantly clear.

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Understand; Analyze; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

59) What supervisory and regulatory authority does the Fed have under current law?

Answer:

1. The authority to conduct examinations and inspections of member banks, bank holding companies, and foreign bank offices by teams of bank examiners

2. The authority to require banks to suspend bank activities deemed excessively risky or in violation of federal laws

3. The authority to approve or not allow mergers and acquisitions and other line of business restrictions for both banks and bank holding companies

Difficulty: 2 Medium

Topic: Structure of the Federal Reserve System

Bloom's: Remember

AACSB: Reflective Thinking

Learning Goal: 04-02 Identify the structure of the Federal Reserve System.

Accessibility: Keyboard Navigation

60) Why do changes in reserve requirements have less predictable effects on the money supply in comparison to changes in open market operations?

Answer: Changing the reserve requirements changes the multiplier effect and large changes in the money supply may result. However, it is difficult to predict the level of excess reserves held by banks, the willingness of banks to make loans instead of investments, and the uncertainty about how much money the public will redeposit into the banking system. Therefore, the true new multiplier is difficult to estimate; hence, the net effect on the money supply is somewhat unpredictable.

Difficulty: 3 Hard

Topic: Monetary Policy Tools

Bloom's: Understand; Analyze; Evaluate

AACSB: Reflective Thinking; Analytical Thinking

Learning Goal: 04-03 Identify the monetary policy tools used by the Federal Reserve.

Accessibility: Keyboard Navigation