MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) There are ______ members of the Board of Governors of the Federal Reserve System.
   A) 5  B) 7  C) 12  D) 19

2) Measuring the sensitivity of bank profits to changes in interest rates by multiplying the gap times the change in the interest rate is called
   A) gap-exposure analysis.  B) basic gap analysis.
   C) interest-exposure analysis.  D) basic duration analysis.

3) Assuming initially that \( r = 10\% \), \( c = 40\% \), and \( e = 0 \), an increase in \( r \) to 15\% causes the M1 money multiplier to ______, everything else held constant.
   A) decrease from 2.8 to 2.55  B) increase from 2.55 to 2.8
   C) increase from 1.82 to 2  D) decrease from 2 to 1.82

4) As the costs associated with deposit outflows ______, the banks willingness to hold excess reserves will ______.
   A) increase; decrease  B) increase; increase
   C) decrease; increase  D) decrease; not be affected

5) Which of the following is NOT an entity of the Federal Reserve System?
   A) The Board of Governors  B) Federal Reserve Banks
   C) The Federal Open Market Committee  D) The Comptroller of the Currency

6) Each Federal Reserve bank has nine directors. Of these ______ are appointed by the member banks and ______ are appointed by the Board of Governors.
   A) four; five  B) six; three  C) five; four  D) three; six

7) The difference of rate-sensitive liabilities and rate-sensitive assets is known as the
   A) rate-risk index.  B) duration.
   C) interest-sensitivity index.  D) gap.

8) Everything else held constant, in the market for reserves, when the federal funds rate is 3\% raising the discount rate from 5\% to 6\%.
   A) has an indeterminate effect on the federal funds rate.
   B) has no effect on the federal funds rate.
   C) lowers the federal funds rate.
   D) raises the federal funds rate.
9) Because borrowers, once they have a loan, are more likely to invest in high-risk investment projects, banks face the
   A) adverse selection problem.  B) moral hazard problem.
   C) lemon problem.  D) adverse credit risk problem.

10) In order to reduce the ________ problem in loan markets, bankers collect
    information from prospective borrowers to screen out the bad credit
    risks from the good ones.
    A) moral hazard  B) adverse selection
    C) moral suasion  D) adverse lending

11) Because ________ are less liquid for the depositor than ________, they
    earn higher interest rates.
    A) money market deposit accounts; time deposits
    B) time deposits; passbook savings
    C) passbook savings; time deposits
    D) money market deposit accounts; passbook savings

12) If a bank has $100,000 of checkable deposits, a required reserve ratio of
    20 percent, and it holds $40,000 in reserves, then the maximum deposit
    outflow it can sustain without altering its balance sheet is
    A) $20,000.  B) $25,000.  C) $10,000.  D) $30,000.

13) The excess reserves ratio is ________ related to expected deposit outflows,
    and is ________ related to the market interest rate.
    A) positively; negatively  B) positively; positively
    C) negatively; negatively  D) negatively; positively

14) If a bank has ________ rate-sensitive assets than liabilities, a ________ in
    interest rates will reduce bank profits, while a ________ in interest rates
    will raise bank profits.
    A) fewer; decline; decline  B) fewer; rise; rise
    C) more; rise; decline  D) more; decline; rise

15) Suppose, at a given federal funds rate, there is an excess demand for
    reserves in the federal funds market. If the Fed wants the federal funds
    rate to stay at that level, then it should undertake an open market
    ________ of bonds, everything else held constant. If the Fed does
    nothing, however, the federal funds rate will ________.
    A) purchase; increase  B) purchase; decrease
    C) sale; decrease  D) sale; increase

16) Suppose that from a new checkable deposit, First National Bank holds
    eight million dollars on deposit with the Federal Reserve, nine million
    dollars in excess reserves, and faces a required reserve ratio of ten
    percent. Given this information, we can say First National Bank has
    ________ million dollars in vault cash.
    A) one  B) two  C) nine  D) ten
17) Which of the following is an entity of the Federal Reserve System?
   A) The FDIC
   B) The Comptroller of the Currency
   C) The FOMC
   D) The U.S. Treasury Secretary

18) A $5 million deposit outflow from a bank has the immediate effect of
   A) reducing deposits and reserves by $5 million.
   B) reducing deposits and loans by $5 million.
   C) reducing deposits and securities by $5 million.
   D) reducing deposits and capital by $5 million.

19) If a person selling bonds to the Fed cashes the Fed’s check, then reserves
    _______ and currency in circulation ________, everything else held
    constant.
    A) remain unchanged;  B) increase; remains
    increases unchanged  C) remain unchanged; declines  D) decline; remains unchanged

20) If, after a deposit outflow, a bank has a reserve deficiency of $3 million,
    it can meet its reserve requirements by
    A) selling $3 million of securities.
    B) repaying its discount loans from the Fed.
    C) increasing loans by $3 million.
    D) reducing deposits by $3 million.

21) Each governor on the Board of Governors can serve
    A) only one nonrenewable fourteen-year term.
    B) one full nonrenewable eight-year term plus part of another term.
    C) only one nonrenewable eight-year term.
    D) one full nonrenewable fourteen-year term plus part of another
        term.

22) When a $10 check written on the First National Bank of Chicago is
    deposited in an account at Citibank, then
    A) the reserves of the First National Bank increase by $10.
    B) the liabilities of Citibank increase by $10.
    C) the assets of Citibank fall by $10.
    D) the liabilities of the First National Bank increase by $10.

23) If a banker expects interest rates to fall in the future, her best strategy for
    the present is
    A) to increase the duration of the bank’s assets.
    B) to increase the duration of the bank’s liabilities.
    C) to sell long-term certificates of deposit.
    D) to buy short-term bonds.

24) Having interest rate stability
    A) guarantees full employment.
    B) allows for less uncertainty about future planning.
    C) leads to demands to curtail the Fed’s power.
    D) leads to problems in financial markets.
25) Which of the following bank assets is the most liquid?
   A) Consumer loans
   B) Cash items in process of collection
   C) Reserves
   D) U.S. government securities

26) What makes the Federal Reserve so unique compared to other central banks around the world is its
   A) decentralized structure.
   B) regulatory functions.
   C) centralized structure.
   D) monetary policy functions.

27) The relationship between borrowed reserves, the nonborrowed monetary base, and the monetary base is
   A) \( BR = MB - MB_R \)
   B) \( MB = BR - MB_R \)
   C) \( MB = MB_R - BR \)
   D) \( BR = MB_R - MB \)

28) In the market for reserves, a ________ in the reserve requirement ________ the demand for reserves, lowering the federal funds interest rate, everything else held constant.
   A) rise; increases
   B) rise; decreases
   C) decline; decreases
   D) decline; increases

29) Banks that actively manage liabilities will most likely meet a reserve shortfall by
   A) calling in loans.
   B) borrowing federal funds.
   C) selling municipal bonds.
   D) seeking new deposits.

30) When the Federal Reserve purchases a government bond from a bank, reserves in the banking system ________, and the monetary base ________, everything else held constant.
   A) decrease; decreases
   B) increase; increases
   C) decrease; increases
   D) increase; decreases

31) Because of an expected rise in interest rates in the future, a banker will likely
   A) buy long-term rather than short-term bonds.
   B) buy short-term rather than long-term bonds.
   C) make either short or long-term loans; expectations of future interest rates are irrelevant.
   D) make long-term rather than short-term loans.

32) Banks earn profits by selling ________ with attractive combinations of liquidity, risk, and return, and using the proceeds to buy ________ with a different set of characteristics.
   A) loans; deposits
   B) assets; liabilities
   C) liabilities; assets
   D) securities; deposits
33) All _______ are required to be members of the Fed.
   A) banks with assets less than $100 million
   B) nationally chartered banks
   C) banks with assets less than $500 million
   D) state chartered banks

34) The Federal Reserve Bank of ________ plays a special role in the Federal Reserve System because it houses the open market desk.
   A) San Francisco    B) New York
   C) Boston           D) Chicago

35) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, eight million dollars on deposit with the Federal Reserve, and one million dollars in required reserves. Given this information, we can say First National Bank faces a required reserve ratio of ________ percent.
   A) ten    B) twenty    C) eighty    D) ninety

36) ________ the Federal Reserve earn income while ________ the Federal Reserve cost nothing.
   A) Reserves of; assets of
   B) Assets of; liabilities of
   C) Liabilities of; assets of
   D) Currency in circulation by; assets of

37) The fraction of checkable deposits that banks are required by regulation to hold are ________.
   A) excess reserves.
   B) total reserves.
   C) required reserves.
   D) vault cash.

38) During the bank panics of the Great Depression the currency ratio ________.
   A) increased sharply.
   B) increased slightly.
   C) decreased sharply.
   D) decreased slightly.

39) Everything else held constant, in the market for reserves, when the federal funds rate equals the discount rate, lowering the discount rate ________.
   A) increases the federal funds rate.
   B) has no effect on the federal funds rate.
   C) lowers the federal funds rate.
   D) has an indeterminate effect of the federal funds rate.

40) Bank loans from the Federal Reserve are called ________ and represent a ________ of funds.
    A) fed funds; source
    B) discount loans; use
    C) fed funds; use
    D) discount loans; source

41) Large-denomination CDs are ________, so that like a bond they can be resold in a ________ market before they mature.
    A) nonnegotiable; primary
    B) nonnegotiable; secondary
    C) negotiable; primary
    D) negotiable; secondary
42) There are two ways in which the Fed can provide additional reserves to the banking system: it can _______ government bonds or it can _______ discount loans to commercial banks.
   A) sell; extend       B) sell; call in
   C) purchase; extend   D) purchase; call in

43) When Jane Brown writes a $100 check to her nephew (who lives in another state), Ms. Brown’s bank _______ assets of $100 and _______ liabilities of $100.
   A) loses; loses       B) gains; gains
   C) gains; loses       D) loses; gains

44) Assuming initially that r = 10%, c = 40%, and e = 0, a decrease in c to 30% causes the M1 money multiplier to _______ everything else held constant.
   A) increase from 2.8 to 3.25   B) decrease from 3.25 to 2.8
   C) increase from 2.8 to 3.5    D) decrease from 3.5 to 2.8

45) In the model of the money supply process, the bank’s role in influencing the money supply process is represented by
   A) only the excess reserve ratio.
   B) only borrowed reserves.
   C) only the currency ratio.
   D) both the excess reserve ratio and the market interest rate.

46) Excess reserves are equal to
   A) vault cash plus deposits with Federal Reserve banks minus required reserves.
   B) vault cash minus required reserves.
   C) deposits with the Fed minus vault cash plus required reserves.
   D) total reserves minus discount loans.

47) Even if the Fed could completely control the money supply, monetary policy would have critics because
   A) the Fed is asked to achieve many goals, some of which are incompatible with others.
   B) the Fed’s primary goal is exchange rate stability, causing it to ignore domestic economic conditions.
   C) it is required to keep Treasury security prices high.
   D) the Fed’s goals do not include high employment, making labor unions a critic of the Fed.

48) When an individual sells a $100 bond to the Fed, she may either deposit the check she receives or cash it for currency. In both cases
   A) high-powered money increases.
   B) high-powered money decreases.
   C) reserves decrease.
   D) reserves increase.
49) Using Taylor’s rule, when the equilibrium real federal funds rate is 2 percent, there is no output gap, the actual inflation rate is zero, and the target inflation rate is 2 percent, the nominal federal funds rate should be
   A) 0 percent.  
   B) 1 percent.  
   C) 2 percent.  
   D) 3 percent.

50) The money supply is ______ related to the nonborrowed monetary base, and ______ related to the level of borrowed reserves.
   A) negatively; negatively  
   B) positively; negatively  
   C) positively; positively  
   D) negatively; not
1. B
2. B
3. A
4. B
5. D
6. B
7. D
8. B
9. B
10. B
11. B
12. B
13. A
14. D
15. A
16. B
17. C
18. A
19. A
20. A
21. D
22. B
23. A
24. B
25. C
26. A
27. A
28. C
29. B
30. B
31. B
32. C
33. B
34. B
35. A
36. B
37. C
38. A
39. C
40. D
41. D
42. C
43. A
44. A
45. D
46. A
47. A
48. A
49. B
50. C