Chapter 15
Tools of Monetary Policy

15.1 The Market for Reserves and the Federal Funds Rate

1) The Fed uses three policy tools to manipulate the money supply: ________, which affect reserves and the monetary base; changes in ________, which affect the monetary base; and changes in ________, which affect the money multiplier.
   A) open market operations; borrowed reserves; margin requirements
   B) open market operations; borrowed reserves; reserve requirements
   C) borrowed reserves; open market operations; margin requirements
   D) borrowed reserves; open market operations; reserve requirements

   Answer: B
   Ques Status: Revised

2) The Fed uses three policy tools to manipulate the money supply: open market operations, which affect the ________; changes in borrowed reserves, which affect the ________; and changes in reserve requirements, which affect the ________.
   A) money multiplier; monetary base; monetary base
   B) monetary base; money multiplier; monetary base
   C) monetary base; monetary base; money multiplier
   D) money multiplier; money multiplier; monetary base

   Answer: C
   Ques Status: Previous Edition

3) The interest rate charged on overnight loans of reserves between banks is the
   A) prime rate.
   B) discount rate.
   C) federal funds rate.
   D) Treasury bill rate.

   Answer: C
   Ques Status: Revised
4) The primary indicator of the Fed’s stance on monetary policy is
   A) the discount rate.
   B) the federal funds rate.
   C) the growth rate of the monetary base.
   D) the growth rate of M2.
   Answer: B  
   Ques Status: Revised

5) The quantity of reserves demanded equals
   A) required reserves plus borrowed reserves.
   B) excess reserves plus borrowed reserves.
   C) required reserves plus excess reserves.
   D) total reserves minus excess reserves.
   Answer: C  
   Ques Status: Revised

6) The quantity of reserves demanded rises when the
   A) discount rate rises.
   B) discount rate falls.
   C) federal funds rate rises.
   D) federal funds rate falls.
   Answer: D  
   Ques Status: Revised

7) The opportunity cost of holding excess reserves is
   A) the discount rate.
   B) the prime rate.
   C) the Treasury bill rate.
   D) the federal funds rate.
   Answer: D  
   Ques Status: Revised
8) The quantity of reserves supplied equals
   A) nonborrowed reserves minus borrowed reserves.
   B) nonborrowed reserves plus borrowed reserves.
   C) required reserves plus borrowed reserves.
   D) total reserves minus required reserves.

   Answer: B
   Ques Status: New

9) In the market for reserves, when the federal funds interest rate is below the discount rate, the supply curve of reserves is
   A) vertical.
   B) horizontal.
   C) positively sloped.
   D) negatively sloped.

   Answer: A
   Ques Status: Revised

10) When the federal funds rate equals the discount rate
    A) the supply curve of reserves is vertical.
    B) the supply curve of reserves is horizontal.
    C) the demand curve for reserves is vertical.
    D) the demand curve for reserves is horizontal.

    Answer: B
    Ques Status: Revised

11) In the market for reserves, an open market ________ the supply of reserves, raising the federal funds interest rate, everything else held constant.
    A) sale decreases
    B) sale increases
    C) purchase increases
    D) purchase decreases

    Answer: A
    Ques Status: Revised
12) In the market for reserves, an open market purchase ______ the ______ of reserves which causes the federal funds rate to fall, everything else held constant.

A) increases; supply
B) increases; demand
C) decreases; supply
D) decreases; demand

Answer: A

Ques Status: New

13) Suppose on any given day there is an excess demand of reserves in the federal funds market. If the Federal Reserve wishes to keep the federal funds rate at its current level, then the appropriate action for the Federal Reserve to take is a ______ open market ______, everything else held constant.

A) defensive; sale
B) defensive; purchase
C) dynamic; sale
D) dynamic; purchase

Answer: B

Ques Status: New

14) In the market for reserves, an open market purchase ______ the supply of reserves and causes the federal funds interest rate to ______, everything else held constant.

A) decreases; fall
B) increases; fall
C) increases; rise
D) decreases; rise

Answer: B

Ques Status: Revised

15) Suppose on any given day the prevailing equilibrium federal funds rate is above the Federal Reserve’s federal funds target rate. If the Federal Reserve wishes for the federal funds rate to be at their target level, then the appropriate action for the Federal Reserve to take is a ______ open market ______, everything else held constant.

A) defensive; sale
B) defensive; purchase
C) dynamic; sale
D) dynamic; purchase

Answer: D

Ques Status: New
16) In the market for reserves, an open market sale _______ the supply of reserves causing the federal funds rate to _______, everything else held constant.

A) decreases; decrease
B) increases; decrease
C) increases; increase
D) decreases; increase

Answer: D
Ques Status: Revised

17) Suppose on any given day there is an excess supply of reserves in the federal funds market. If the Federal Reserve wishes to keep the federal funds rate at its current level, then the appropriate action for the Federal Reserve to take is a _______ open market _______, everything else held constant.

A) defensive; sale
B) defensive; purchase
C) dynamic; sale
D) dynamic; purchase

Answer: A
Ques Status: New

18) Suppose on any given day the prevailing equilibrium federal funds rate is below the Federal Reserve's federal funds target rate. If the Federal Reserve wishes for the federal funds rate to be at their target level, then the appropriate action for the Federal Reserve to take is a _______ open market _______, everything else held constant.

A) defensive; sale
B) defensive; purchase
C) dynamic; sale
D) dynamic; purchase

Answer: C
Ques Status: New

19) In the market for reserves, an open market sale _______ the _______ of reserves, causing the federal funds rate to increase, everything else held constant.

A) increases; supply
B) increases; demand
C) decreases; supply
D) decreases; demand

Answer: C
Ques Status: New
20) In the market for reserves, a lower discount rate
   A) decreases the supply of reserves.
   B) increases the supply of reserves.
   C) lengthens the vertical section of the supply curve of reserves.
   D) shortens the vertical section of the supply curve of reserves.

   Answer: D
   Ques Status: Revised

21) Everything else held constant, in the market for reserves, when the federal funds rate is 3%,
    lowering the discount rate from 5% to 4%
    A) lowers the federal funds rate.
    B) raises the federal funds rate
    C) has no effect on the federal funds rate.
    D) has an indeterminate effect on the federal funds rate.

   Answer: C
   Ques Status: Revised

22) Everything else held constant, in the market for reserves, when the federal funds rate is 5%,
    lowering the discount rate from 5% to 4%
    A) lowers the federal funds rate.
    B) raises the federal funds rate.
    C) has no effect on the federal funds rate.
    D) has an indeterminate effect on the federal funds rate.

   Answer: A
   Ques Status: Revised

23) 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) lowers the federal funds rate.
    B) raises the federal funds rate.
    C) has no effect on the federal funds rate.
    D) has an indeterminate effect on the federal funds rate.

   Answer: C
   Ques Status: Revised
24) 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) lowers the federal funds rate.
   C) has no effect on the federal funds rate.
   D) has an indeterminate effect of the federal funds rate.

   Answer: B
   Ques Status: Revised

25) Everything else held constant, in the market for reserves, when the demand for federal funds intersects the reserve supply curve along the horizontal section, increasing the discount rate
   A) increases the federal funds rate.
   B) lowers the federal funds rate.
   C) has no effect on the federal funds rate.
   D) has an indeterminate effect of the federal funds rate.

   Answer: A
   Ques Status: Revised

26) Everything else held constant, in the market for reserves, when the demand for federal funds intersects the reserve supply curve on the vertical section, increasing the discount rate
   A) increases the federal funds rate.
   B) lowers the federal funds rate.
   C) has no effect on the federal funds rate.
   D) has an indeterminate effect on the federal funds rate.

   Answer: C
   Ques Status: Revised

27) Everything else held constant, in the market for reserves, increases in the discount rate affect the federal funds rate
   A) when the funds rate is below the discount rate.
   B) when the funds rate equals the discount rate.
   C) when the demand for federal funds intersects the vertical section of the reserve supply curve.
   D) when the demand for federal funds equals zero.

   Answer: B
   Ques Status: Revised
28) The Federal Reserve usually keeps the discount rate
   A) above the target federal funds rate.
   B) equal to the target federal funds rate.
   C) below the target federal funds rate.
   D) equal to zero.

   Answer: A
   Ques Status: Revised

29) Everything else held constant, the vertical section of the supply curve of reserves is shortened when the
   A) discount rate increases.
   B) discount rate decreases.
   C) federal funds rate rises.
   D) federal funds rate falls.

   Answer: B
   Ques Status: Revised

30) Everything else held constant, the vertical section of the supply curve of reserves is lengthened when the
   A) discount rate increases.
   B) discount rate decreases.
   C) federal funds rate rises.
   D) federal funds rate falls.

   Answer: A
   Ques Status: New

31) In the market for reserves, an increase in the reserve requirement _______ the demand for reserves, _______ the federal funds rate, everything else held constant.

   A) decreases; lowering
   B) increases; lowering
   C) increases; raising
   D) decreases; raising

   Answer: C
   Ques Status: Revised
32) In the market for reserves, a _______ in the reserve requirement _______ the demand for reserves, raising the federal funds interest rate, everything else held constant.

   A) rise; decreases  
   B) rise; increases  
   C) decline; increases  
   D) decline; decreases  

   Answer: B  
   Ques Status: Revised

33) In the market for reserves, a _______ in the reserve requirement increases the demand for reserves, _______ the federal funds interest rate, everything else held constant.

   A) rise; lowering  
   B) decline; raising  
   C) decline; lowering  
   D) rise; raising  

   Answer: D  
   Ques Status: Revised

34) In the market for reserves, an increase in the reserve requirement _______ the demand of reserves and causes the federal funds interest rate to _______, everything else held constant.

   A) decreases; fall  
   B) increases; fall  
   C) increases; rise  
   D) decreases; rise  

   Answer: C  
   Ques Status: Revised

35) In the market for reserves, an increase in the reserve requirement _______ the _______ for reserves and causes the federal funds interest rate to rise, everything else held constant.

   A) decreases; demand  
   B) increases; demand  
   C) increases; supply  
   D) decreases; supply  

   Answer: B  
   Ques Status: Revised
36) 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; decreases  
   B) rise; increases  
   C) decline; increases  
   D) decline; decreases
   Answer: D  
   Ques Status: Revised

37) In the market for reserves, a _______ in the reserve requirement decreases the demand for reserves, _______ the federal funds interest rate, everything else held constant.
   A) rise; lowering  
   B) decline; raising  
   C) decline; lowering  
   D) rise; raising
   Answer: C  
   Ques Status: Revised

38) In the market for reserves, a decline in the reserve requirement _______ the _______ curve of reserves and causes the federal funds interest rate to fall, everything else held constant.
   A) decreases; demand  
   B) increases; demand  
   C) increases; supply  
   D) decreases; supply
   Answer: A  
   Ques Status: Revised

39) In the market for reserves, a decline in the reserve requirement _______ the demand of reserves, _______ the federal funds rate, everything else held constant.
   A) decreases; lowering  
   B) increases; lowering  
   C) increases; raising  
   D) decreases; raising
   Answer: A  
   Ques Status: Revised
40) 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) sale; increase
   B) purchase; increase
   C) sale; decrease
   D) purchase; decrease

Answer: B  
Ques Status: New

41) Suppose, at a given federal funds rate, there is an excess supply of 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) sale; increase
   B) purchase; increase
   C) sale; decrease
   D) purchase; decrease

Answer: C  
Ques Status: New

42) Explain the Fed’s three tools of monetary policy and how each is used to change the money supply. Does each tool affect the monetary base or the money multiplier?

Answer: The three tools are open market operations, the purchase and sale of government securities; discount policy, controlling the price and quantity of discount loans to banks; and reserve requirements, setting the percentage of deposits that banks must hold in reserve. Open market operations and the discount rate affect the monetary base, and reserve requirements affect the money multiplier.

Ques Status: Previous Edition

43) State whether the following statement is true or false AND explain why: "A decrease in the discount rate will always cause a decrease in the federal reserve funds rate."

Answer: False. Since the discount rate is set above the federal funds rate, a decrease in the discount rate will only cause a decrease in the federal funds rate if the discount rate is decreased below the original federal funds rate level. If the decrease in the discount rate is such that the new rate is still above the federal funds rate, then the federal funds rate does not change, everything else held constant.

Ques Status: New
15.2 Open Market Operations

1) ______ are the most important monetary policy tool because they are the primary determinant of changes in the ______, the main source of fluctuations in the money supply.
   A) Open market operations; monetary base
   B) Open market operations; money multiplier
   C) Changes in reserve requirements; monetary base
   D) Changes in reserve requirements; money multiplier

Answer: A
Ques Status: Revised

2) Open market purchases raise the ______ thereby raising the ______.
   A) money multiplier; money supply
   B) money multiplier; monetary base
   C) monetary base; money supply
   D) monetary base; money multiplier

Answer: C
Ques Status: Previous Edition

3) Open market purchases ______ reserves and the monetary base thereby ______ the money supply.
   A) raise; lowering
   B) raise; raising
   C) lower; lowering
   D) lower; raising

Answer: B
Ques Status: Previous Edition

4) Open market sales shrink ______ thereby lowering ______.
   A) the money multiplier; the money supply
   B) the money multiplier; reserves and the monetary base
   C) reserves and the monetary base; the money supply
   D) the money base; the money multiplier

Answer: C
Ques Status: Previous Edition
5) Open market sales ______ reserves and the monetary base thereby ______ the money supply.
   A) raise; lowering
   B) raise; raising
   C) lower; lowering
   D) lower; raising

Answer: C
Ques Status: Previous Edition

6) The two types of open market operations are
   A) offensive and defensive.
   B) dynamic and reactionary.
   C) active and passive.
   D) dynamic and defensive.

Answer: D
Ques Status: Revised

7) There are two types of open market operations: ______ open market operations are intended to change the level of reserves and the monetary base, and ______ open market operations are intended to offset movements in other factors that affect the monetary base.
   A) defensive; dynamic
   B) defensive; static
   C) dynamic; defensive
   D) dynamic; static

Answer: C
Ques Status: Previous Edition

8) Open market operations intended to offset movements in noncontrollable factors (such as float) that affect reserves and the monetary base are called
   A) defensive open market operations.
   B) dynamic open market operations.
   C) offensive open market operations.
   D) reactionary open market operations.

Answer: A
Ques Status: Previous Edition
9) When the Federal Reserve engages in a repurchase agreement to offset a withdrawal of Treasury funds from the Federal Reserve, the open market operation is said to be
   A) defensive.
   B) offensive.
   C) dynamic.
   D) reactionary.
Answer: A

Ques Status: Previous Edition

10) The Federal Open Market Committee makes the Fed’s decisions on the purchase or sale of government securities, but these purchases or sales are executed by the Federal Reserve Bank of
   A) Chicago.
   B) Boston.
   C) New York.
   D) San Francisco.
Answer: C

Ques Status: Previous Edition

11) The actual execution of open market operations is done at
   A) the Board of Governors in Washington, D.C.
   B) the Federal Reserve Bank of New York.
   C) the Federal Reserve Bank of Philadelphia.
   D) the Federal Reserve Bank of Boston.
Answer: B

Ques Status: Previous Edition

12) If float is predicted to decrease because of unseasonably good weather, the manager of the trading desk at the Federal Reserve Bank of New York will likely conduct a _______ open market _______ of securities.
   A) defensive; sale
   B) defensive; purchase
   C) dynamic; sale
   D) dynamic; purchase
Answer: B

Ques Status: Previous Edition
13) When bad storms slow the check-clearing process, float tends to _______ causing the Fed to initiate defensive open market _______.
   A) decrease; sales
   B) decrease; purchases
   C) increase; sales
   D) increase; purchases
Answer: C

Ques Status: Previous Edition

14) When good weather speeds the check-clearing process, float tends to _______ causing the Fed to initiate defensive open market _______.
   A) decrease; sales
   B) decrease; purchases
   C) increase; sales
   D) increase; purchases
Answer: B

Ques Status: Previous Edition

15) When bad storms slow the check-clearing process, float tends to _______ causing the Fed to initiate _______ open market _______.
   A) decrease; defensive; sales
   B) decrease; dynamic; purchases
   C) increase; defensive; sales
   D) increase; dynamic; purchases
Answer: C

Ques Status: Previous Edition

16) When good weather speeds the check-clearing process, float tends to _______ causing the Fed to initiate _______ open market _______.
   A) decrease; defensive; sales
   B) decrease; dynamic; sales
   C) decrease; defensive; purchases
   D) increase; dynamic; purchases
Answer: C

Ques Status: Revised
17) If float is predicted to increase because of bad weather, the manager of the trading desk at the New York Fed bank will likely conduct ______ open market operations to ______ reserves.
   A) defensive; inject
   B) defensive; drain
   C) dynamic; inject
   D) dynamic; drain
   Answer: B
   Ques Status: Previous Edition

18) If float is predicted to decrease because of good weather, the manager of the trading desk at the New York Fed bank will likely conduct ______ open market operations to ______ reserves.
   A) defensive; inject
   B) defensive; drain
   C) dynamic; inject
   D) dynamic; drain
   Answer: A
   Ques Status: Previous Edition

19) If Treasury deposits at the Fed are predicted to increase, the manager of the trading desk at the New York Fed bank will likely conduct ______ open market operations to ______ reserves.
   A) defensive; inject
   B) defensive; drain
   C) dynamic; inject
   D) dynamic; drain
   Answer: A
   Ques Status: Previous Edition

20) If Treasury deposits at the Fed are predicted to ______, the manager of the trading desk at the New York Fed bank will likely conduct ______ open market operations to ______ reserves.
   A) increase; defensive; inject
   B) decrease; defensive; drain
   C) increase; dynamic; inject
   D) decrease; dynamic; drain
   Answer: A
   Ques Status: Previous Edition
21) If Treasury deposits at the Fed are predicted to fall, the manager of the trading desk at the New York Fed bank will likely conduct _______ open market operations to _______ reserves.
   A) defensive; inject
   B) defensive; drain
   C) dynamic; inject
   D) dynamic; drain

   Answer: B
   Ques Status: Previous Edition

22) If Treasury deposits at the Fed are predicted to _______, the manager of the trading desk at the New York Fed bank will likely conduct _______ open market operations to _______ reserves.
   A) rise; defensive; drain
   B) fall; defensive; drain
   C) rise; dynamic; inject
   D) fall; dynamic; drain

   Answer: B
   Ques Status: Previous Edition

23) If the Fed expects currency holdings to rise, it conducts open market _______ to offset the expected _______ in reserves.
   A) purchases; increase
   B) purchases; decrease
   C) sales; increase
   D) sales; decrease

   Answer: B
   Ques Status: Revised

24) If the Fed expects currency holdings to fall, it conducts open market _______ to offset the expected _______ in reserves.
   A) purchases; increase
   B) purchases; decrease
   C) sales; increase
   D) sales; decrease

   Answer: C
   Ques Status: Revised
25) If the banking system has a large amount of reserves, many banks will have excess reserves to lend and the federal funds rate will probably _______; if the level of reserves is low, few banks will have excess reserves to lend and the federal funds rate will probably _______.

A) fall; fall  
B) fall; rise  
C) rise; fall  
D) rise; rise

Answer: B  
Ques Status: Previous Edition

26) The Federal Reserve will engage in a repurchase agreement when it wants to _______ reserves _______ in the banking system.

A) increase; permanently  
B) increase; temporarily  
C) decrease; temporarily  
D) decrease; permanently

Answer: B  
Ques Status: Previous Edition

27) If the Fed wants to temporarily inject reserves into the banking system, it will engage in

A) a repurchase agreement.  
B) a matched sale-purchase transaction.  
C) reverse repurchase agreement.  
D) an open market sale.

Answer: A  
Ques Status: Revised

28) The Fed can offset the effects of an increase in float by engaging in

A) a repurchase agreement.  
B) a matched sale-purchase transaction.  
C) an interest rate swap.  
D) an open market purchase.

Answer: B  
Ques Status: Revised
29) The Federal Reserve will engage in a matched sale-purchase transaction when it wants to _______ reserves _______ in the banking system.
   A) increase; permanently
   B) increase; temporarily
   C) decrease; temporarily
   D) decrease; permanently

   Answer: C
   Ques Status: Previous Edition

30) Explain dynamic and defensive open market operations. What is the purpose of each type? Describe two situations when defensive open market operations are used. How are defensive open market operations typically conducted?

   Answer: Dynamic OMOs are used to permanently change the monetary base and money supply. Defensive operations are used to offset temporary changes in the monetary base and/or money supply. Defensive operations are used to offset float, shifts in Treasury balances into or out of the Fed, and temporary changes in currency. Defensive purchases are typically conducted by using repurchase agreements, while reverse repos or matched sale-purchase transactions are used to conduct defensive open market sales.
   Ques Status: Previous Edition

15.3 Discount Policy

1) Discount policy affects the money supply by affecting the volume of _______ and the _______.
   A) excess reserves; monetary base
   B) borrowed reserves; monetary base
   C) excess reserves; money multiplier
   D) borrowed reserves; money multiplier

   Answer: B
   Ques Status: Revised

2) The discount rate is
   A) the interest rate the Fed charges on loans to banks.
   B) the price the Fed pays for government securities.
   C) the interest rate that banks charge their most preferred customers.
   D) the price banks pay the Fed for government securities.

   Answer: A
   Ques Status: Previous Edition
3) The most common type of discount lending that the Fed extends to banks is called
   A) seasonal credit.
   B) secondary credit.
   C) primary credit.
   D) installment credit.
Answer: C

4) The most common type of discount lending, _______ credit loans, are intended to help healthy banks with short-term liquidity problems that often result from temporary deposit outflows.
   A) secondary
   B) primary
   C) temporary
   D) seasonal
Answer: B

5) When the Fed acts as a lender of last resort, the type of lending it provides is
   A) primary credit.
   B) seasonal credit.
   C) secondary credit.
   D) installment credit.
Answer: C

6) The Fed’s discount lending is of three types: _______ is the most common category; _______ is given to a limited number of banks in vacation and agricultural areas; _______ is given to banks that have experienced severe liquidity problems.
   A) seasonal credit; secondary credit; primary credit
   B) secondary credit; seasonal credit; primary credit
   C) primary credit; seasonal credit; secondary credit
   D) seasonal credit; primary credit; secondary credit
Answer: C
7) The discount rate is _______ kept _______ the federal funds rate.
   A) always; below
   B) typically; below
   C) typically; equal to
   D) typically; above

   Answer: D
   Ques Status: Revised

8) The discount rate refers to the interest rate on
   A) primary credit.
   B) secondary credit.
   C) seasonal credit.
   D) federal funds.

   Answer: A
   Ques Status: New

9) The interest rate on secondary credit is set _______ basis points _______ the primary credit rate.
   A) 100; above
   B) 100; below
   C) 50; above
   D) 50; below

   Answer: C
   Ques Status: Revised

10) The interest rate for primary credit is set _______ basis points _______ the federal funds rate.
    A) 50; below
    B) 100; above
    C) 100; below
    D) 50; above

    Answer: B
    Ques Status: Revised
11) The interest rate on seasonal credit equals
   A) the federal funds rate.
   B) the primary credit rate.
   C) the secondary credit rate.
   D) an average of the federal funds rate and rates on certificates of deposits.

   Answer: D
   Ques Status: Revised

12) The Fed is considering eliminating
   A) primary credit lending,
   B) secondary credit lending.
   C) seasonal credit lending.
   D) its lender of last resort function.

   Answer: C
   Ques Status: Revised

13) At its inception, the Federal Reserve was intended to be
   A) the Treasury’s banker.
   B) the issuer of government debt.
   C) a lender-of-last-resort.
   D) a regulator of bank holding companies.

   Answer: C
   Ques Status: Previous Edition

14) Much of the credit for prevention of a financial market meltdown after "Black Monday" (October 19, 1987) must be given to the Federal Reserve System and its chairman
   A) Paul Volker.
   B) Alan Blinder.
   C) Arthur Burns.
   D) Alan Greenspan.

   Answer: D
   Ques Status: Previous Edition
15) A financial panic was averted in October 1987 following "Black Monday" when the Fed announced that
   A) it was lowering the discount rate.
   B) it would provide discount loans to any bank that would make loans to the security industry.
   C) it stood ready to purchase common stocks to prevent a further slide in stock prices.
   D) it was raising the discount rate.

   Answer: B
   Ques Status: Revised

16) The Fed's lender-of-last-resort function
   A) has proven to be ineffective.
   B) cannot prevent runs by large depositors.
   C) is no longer necessary due to FDIC insurance.
   D) creates a moral hazard problem.

   Answer: D
   Ques Status: Revised

17) The most important advantage of discount policy is that the Fed can use it to
   A) precisely control the monetary base.
   B) perform its role as lender of last resort.
   C) control the money supply.
   D) punish banks that have deficient reserves.

   Answer: B
   Ques Status: Previous Edition

15.4 Reserve Requirements

1) An increase in _______ reduces the money supply since it causes the _______ to fall.
   A) reserve requirements; monetary base
   B) reserve requirements; money multiplier
   C) margin requirements; monetary base
   D) margin requirements; money multiplier

   Answer: B
   Ques Status: Previous Edition
2) A decrease in _______ increases the money supply since it causes the _______ to rise.
   A) reserve requirements; monetary base
   B) reserve requirements; money multiplier
   C) margin requirements; monetary base
   D) margin requirements; money multiplier

   Answer: B
   Ques Status: Previous Edition

3) The Federal Reserve has had the authority to vary reserve requirements since the
   A) 1920’s.
   B) 1930’s.
   C) 1940’s.
   D) 1950’s.

   Answer: B
   Ques Status: New

4) Since 1980, _______ are subject to reserve requirements.
   A) only commercial banks
   B) only the member institutions of the Federal Reserve
   C) only nationally chartered depository institutions
   D) all depository institutions

   Answer: D
   Ques Status: New

5) Funds held in _______ are subject to reserve requirements.
   A) all checkable deposits
   B) all checkable and time deposits
   C) all checkable, time, and money market fund deposits
   D) all time deposits

   Answer: A
   Ques Status: New
6) The policy tool of changing reserve requirements is
   A) the most widely used.
   B) the preferred tool from the bank’s perspective.
   C) no longer used.
   D) still used, even with its disadvantages.

   Answer: C
   Ques Status: New

7) In the channel-corridor system
   A) control of the overnight interest rate is impossible.
   B) reserve requirements are essential for monetary control.
   C) the overnight rate always equals the Lombard rate.
   D) monetary control can be exercised with no required reserves.

   Answer: D
   Ques Status: Revised

15.5 Monetary Policy Tools of the European Central Bank

1) The European System of Central Banks signals the stance of its monetary policy by setting a target for the
   A) federal funds rate.
   B) overnight cash rate.
   C) lombard rate.
   D) reserve rate.

   Answer: B
   Ques Status: New

2) When the European System of Central Banks uses main refinancing operations, it is similar to the Federal Reserve using
   A) dynamic open market operations.
   B) defensive open market operations.
   C) discount policy.
   D) reserve requirements.

   Answer: B
   Ques Status: New
3) When the European System of Central Banks uses long-term refinancing operations, it is similar to the Federal Reserve using
   A) dynamic open market operations.
   B) defensive open market operations.
   C) discount policy.
   D) reserve requirements.

   Answer: A  
   Ques Status: New

4) The equivalent to the Federal Reserve’s discount rate in the European System of Central Banks is the
   A) federal funds rate.
   B) marginal lending rate.
   C) deposit facility rate.
   D) lombard rate.

   Answer: B  
   Ques Status: New

5) The Federal Reserve ______ pay interest on reserves held on deposit. The European System of Central Banks ______ pay interest on reserves held on deposit.
   A) does; does
   B) does; does not
   C) does not; does
   D) does not; does not

   Answer: C  
   Ques Status: New

6) Since the European Central Bank ______ interest on reserves, banks have a ______ cost of complying with reserve requirements when compared to banks complying with the reserve requirements of the Federal Reserve.
   A) pays; lower
   B) pays; higher
   C) does not pay; lower
   D) does not pay; higher

   Answer: A  
   Ques Status: New