Chapter 13
Multiple Deposit Creation and the Money Supply Process

13.1 Four Players in the Money Supply Process

1) The government agency that oversees the banking system and is responsible for the conduct of monetary policy in the United States is

   A) the Federal Reserve System.
   B) the United States Treasury.
   C) the U.S. Gold Commission.
   D) the House of Representatives.

   Answer: A
   Ques Status: Revised

2) Individuals that lend funds to a bank by opening a checking account are called

   A) policyholders.
   B) partners.
   C) depositors.
   D) debt holders.

   Answer: C
   Ques Status: Revised

3) The four players in the money supply process include

   A) banks, depositors, borrowers, and the U.S. Treasury.
   B) banks, depositors, the central bank, and the U.S. Treasury.
   C) banks, depositors, the central bank, and borrowers.
   D) banks, borrowers, the central bank, and the U.S. Treasury.

   Answer: C
   Ques Status: Previous Edition

4) Of the four players in the money supply process, most observers agree that the most important player is

   A) the United States Treasury.
   B) the Federal Reserve System.
   C) the FDIC.
   D) the Office of Thrift Supervision.

   Answer: B
   Ques Status: Previous Edition
13.2 The Fed’s Balance Sheet

1) Both ______ and ______ are Federal Reserve assets.
   A) currency in circulation; reserves
   B) currency in circulation; government securities
   C) government securities; discount loans
   D) government securities; reserves

   Answer: C
   *Ques Status: Revised*

2) The monetary liabilities of the Federal Reserve include
   A) government securities and discount loans.
   B) currency in circulation and reserves.
   C) government securities and reserves.
   D) currency in circulation and discount loans.

   Answer: B
   *Ques Status: Revised*

3) Both ______ and ______ are monetary liabilities of the Fed.
   A) government securities; discount loans
   B) currency in circulation; reserves
   C) government securities; reserves
   D) currency in circulation; discount loans

   Answer: B
   *Ques Status: Revised*

4) The sum of the Fed’s monetary liabilities and the U.S. Treasury’s monetary liabilities is called
   A) the money supply.
   B) currency in circulation.
   C) bank reserves.
   D) the monetary base.

   Answer: D
   *Ques Status: Previous Edition*
5) The monetary base consists of
   A) currency in circulation and Federal Reserve notes.
   B) currency in circulation and the U.S. Treasury’s monetary liabilities.
   C) currency in circulation and reserves.
   D) reserves and Federal Reserve Notes.

   Answer: C
   Ques Status: Revised

6) Total reserves minus bank deposits with the Fed equals
   A) vault cash.
   B) excess reserves.
   C) required reserves.
   D) currency in circulation.

   Answer: A
   Ques Status: Revised

7) Reserves are equal to the sum of
   A) required reserves and excess reserves.
   B) required reserves and vault cash reserves.
   C) excess reserves and vault cash reserves.
   D) vault cash reserves and total reserves.

   Answer: A
   Ques Status: Revised

8) Total reserves are the sum of _______ and _______.
   A) excess reserves; borrowed reserves.
   B) required reserves; currency in circulation
   C) vault cash; excess reserves
   D) excess reserves; required reserves

   Answer: D
   Ques Status: Revised
9) Excess reserves are equal to
   A) total reserves minus discount loans.
   B) vault cash plus deposits with Federal Reserve banks minus required reserves.
   C) vault cash minus required reserves.
   D) deposits with the Fed minus vault cash plus required reserves.

   Answer: B
   *Ques Status: Previous Edition*

10) Total Reserves minus vault cash equals
    A) bank deposits with the Fed.
    B) excess reserves.
    C) required reserves.
    D) currency in circulation.

    Answer: A
    *Ques Status: New*

11) The amount of deposits that banks must hold in reserve is
    A) excess reserves.
    B) required reserves.
    C) total reserves.
    D) vault cash.

    Answer: B
    *Ques Status: Revised*

12) The percentage of deposits that banks must hold in reserve is the
    A) excess reserve ratio.
    B) required reserve ratio.
    C) total reserve ratio.
    D) currency ratio.

    Answer: B
    *Ques Status: Revised*
13) 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 has ________ million dollars in excess reserves.

A) three  
B) nine  
C) ten  
D) eleven

Answer: B  
_Ques Status: New_

14) 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

Answer: A  
_Ques Status: New_

15) 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 nine million dollars in excess reserves. Given this information, we can say First National Bank has ________ million dollars in required reserves.

A) one  
B) two  
C) eight  
D) ten

Answer: A  
_Ques Status: New_
16) 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 nine million dollars in excess 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

Answer: A

Ques Status: New

17) Suppose that from a new checkable deposit, First National Bank holds eight million dollars on deposit with the Federal Reserve, one million dollars in required reserves, and faces a required reserve ratio of ten percent. Given this information, we can say First National Bank has _______ million dollars in excess reserves.

A) two
B) eight
C) nine
D) ten

Answer: C

Ques Status: New

18) Suppose that from a new checkable deposit, First National Bank holds eight million dollars on deposit with the Federal Reserve, one million dollars in required 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) two
B) eight
C) nine
D) ten

Answer: A

Ques Status: New
19) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, 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 required reserves.

A) one  
B) two  
C) eight  
D) ten

Answer: A  
Ques Status: New

20) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, 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 on deposit with the Federal Reserve.

A) one  
B) two  
C) nine  
D) ten

Answer: C  
Ques Status: New

21) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, one million dollars in required reserves, and faces a required reserve ratio of ten percent. Given this information, we can say First National Bank has _______ million dollars in excess reserves.

A) one  
B) two  
C) nine  
D) ten

Answer: C  
Ques Status: New
22) Suppose that from a new checkable deposit, First National Bank holds two million dollars in vault cash, one million dollars in required reserves, and faces a required reserve ratio of ten percent. Given this information, we can say First National Bank has _______ million dollars on deposit with the Federal Reserve.

A) one  
B) two  
C) eight  
D) ten  

Answer: C  
Ques Status: New

23) 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 required reserves.

A) one  
B) two  
C) nine  
D) ten  

Answer: A  
Ques Status: New

24) 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  

Answer: B  
Ques Status: New

25) The interest rate the Fed charges banks borrowing from the Fed is the

A) federal funds rate.  
B) Treasury bill rate.  
C) discount rate.  
D) prime rate.  

Answer: C  
Ques Status: Revised
26) When banks borrow money from the Federal Reserve, these funds are called
   A) federal funds.
   B) discount loans.
   C) federal loans.
   D) Treasury funds.

   Answer: B  
   Ques Status: New

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

   Answer: D  
   Ques Status: New

### 13.3 Control of the Monetary Base

1) The monetary base minus currency in circulation equals
   A) reserves.
   B) the borrowed base.
   C) the nonborrowed base.
   D) discount loans.

   Answer: A  
   Ques Status: Previous Edition

2) The monetary base minus reserves equals
   A) currency in circulation.
   B) the borrowed base.
   C) the nonborrowed base.
   D) discount loans.

   Answer: A  
   Ques Status: New
3) High-powered money minus reserves equals
   A) reserves.
   B) currency in circulation.
   C) the monetary base.
   D) the nonborrowed base.

   Answer: B
   Ques Status: Revised

4) High-powered money minus currency in circulation equals
   A) reserves.
   B) the borrowed base.
   C) the nonborrowed base.
   D) discount loans.

   Answer: A
   Ques Status: New

5) Purchases and sales of government securities by the Federal Reserve are called
   A) discount loans.
   B) federal fund transfers.
   C) open market operations.
   D) swap transactions.

   Answer: C
   Ques Status: New

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

   Answer: A
   Ques Status: Revised
7) When the Federal Reserve sells a government bond to a bank, reserves in the banking system ______ and the monetary base ______, everything else held constant.
   A) increase; increases
   B) increase; decreases
   C) decrease; increases
   D) decrease; decreases
   Answer: D
   Ques Status: New

8) When a bank sells a government bond to the Federal Reserve, reserves in the banking system ______ and the monetary base ______, everything else held constant.
   A) increase; increases
   B) increase; decreases
   C) decrease; increases
   D) decrease; decreases
   Answer: A
   Ques Status: New

9) When a bank buys a government bond from the Federal Reserve, reserves in the banking system ______ and the monetary base ______, everything else held constant.
   A) increase; increases
   B) increase; decreases
   C) decrease; increases
   D) decrease; decreases
   Answer: D
   Ques Status: New

10) When the Fed buys $100 worth of bonds from First National Bank, reserves in the banking system
    A) increase by $100.
    B) increase by more than $100.
    C) decrease by $100.
    D) decrease by more than $100.
    Answer: A
    Ques Status: Previous Edition
11) When the Fed sells $100 worth of bonds to First National Bank, reserves in the banking system
   A) increase by $100.
   B) increase by more than $100.
   C) decrease by $100.
   D) decrease by more than $100.

   Answer: C

Ques Status: Previous Edition

12) 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; declines
   B) remain unchanged; increases
   C) decline; remains unchanged
   D) increase; remains unchanged

   Answer: B

Ques Status: Revised

13) The effect of an open market purchase on reserves differs depending on how the seller of the bonds keeps the proceeds. If the proceeds are kept in _______, the open market purchase has no effect on reserves; if the proceeds are kept as _______, reserves increase by the amount of the open market purchase.
   A) deposits; deposits
   B) deposits; currency
   C) currency; deposits
   D) currency; currency

   Answer: C

Ques Status: Previous Edition

14) The effect of an open market purchase on reserves differs depending on how the seller of the bonds keeps the proceeds. If the proceeds are kept in currency, the open market purchase ______ reserves; if the proceeds are kept as deposits, the open market purchase ______ reserves.
   A) has no effect on; has no effect on
   B) has no effect on; increases
   C) increases; has no effect on
   D) decreases; increases

   Answer: B

Ques Status: Previous Edition
15) 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) reserves increase.
   B) high-powered money increases.
   C) reserves decrease.
   D) high-powered money decreases.
   Answer: B
   Ques Status: Previous Edition

16) If a member of the nonbank public sells a government bond to the Federal Reserve in exchange for currency, the monetary base will ______, but ______.
   A) remain unchanged; reserves will fall
   B) remain unchanged; reserves will rise
   C) rise; currency in circulation will remain unchanged
   D) rise; reserves will remain unchanged
   Answer: D
   Ques Status: Revised

17) If a member of the nonbank public purchases a government bond from the Federal Reserve in exchange for currency, the monetary base will ______, but reserves will ______.
   A) remain unchanged; rise
   B) remain unchanged; fall
   C) rise; remain unchanged
   D) fall; remain unchanged
   Answer: D
   Ques Status: Revised

18) For which of the following is the change in reserves necessarily different from the change in the monetary base?
   A) Open market purchases from a bank
   B) Open market purchases from an individual who deposits the check in a bank
   C) Open market purchases from an individual who cashes the check
   D) Open market sale to a bank
   Answer: C
   Ques Status: Previous Edition
19) When a member of the nonbank public withdraws currency from her bank account,
   A) both the monetary base and bank reserves fall.
   B) both the monetary base and bank reserves rise.
   C) the monetary base falls, but bank reserves remain unchanged.
   D) bank reserves fall, but the monetary base remains unchanged.

Answer: D

20) When a member of the nonbank public deposits currency into her bank account,
   A) both the monetary base and bank reserves fall.
   B) both the monetary base and bank reserves rise.
   C) the monetary base falls, but bank reserves remain unchanged.
   D) bank reserves rise, but the monetary base remains unchanged.

Answer: D

21) When the Fed extends a $100 discount loan to the First National Bank, reserves in the banking system
   A) increase by $100.
   B) increase by more than $100.
   C) decrease by $100.
   D) decrease by more than $100.

Answer: A

22) All else the same, when the Fed calls in a $100 discount loan previously extended to the First National Bank, reserves in the banking system
   A) increase by $100.
   B) increase by more than $100.
   C) decrease by $100.
   D) decrease by more than $100.

Answer: C
23) When the Federal Reserve extends a discount loan to a bank, the monetary base ______ and reserves ______.
   A) remains unchanged; decrease
   B) remains unchanged; increase
   C) increases; increase
   D) increases; remain unchanged

   Answer: C
   Ques Status: Previous Edition

24) When the Federal Reserve calls in a discount loan from a bank, the monetary base ______ and reserves ______.
   A) remains unchanged; decrease
   B) remains unchanged; increase
   C) decreases; decrease
   D) decreases; remains unchanged

   Answer: C
   Ques Status: New

25) If the Fed decides to reduce bank reserves, it can
   A) purchase government bonds.
   B) extend discount loans to banks.
   C) sell government bonds.
   D) print more currency.

   Answer: C
   Ques Status: Revised

26) 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

   Answer: C
   Ques Status: Previous Edition
27) A decrease in _______ leads to an equal _______ in the monetary base in the short run.
   A) float; increase
   B) float; decrease
   C) Treasury deposits at the Fed; decrease
   D) discount loans; increase
   Answer: B
   Ques Status: Revised

28) The monetary base declines when
   A) the Fed extends discount loans.
   B) Treasury deposits at the Fed decrease.
   C) float increases.
   D) the Fed sells securities.
   Answer: D
   Ques Status: Revised

29) An increase in _______ leads to an equal _______ in the monetary base in the short run.
   A) float; decrease
   B) float; increase
   C) discount loans; decrease
   D) Treasury deposits at the Fed; increase
   Answer: B
   Ques Status: Revised

30) A decrease in _______ leads to an equal _______ in the monetary base in the long run.
   A) float; increase
   B) float; decrease
   C) securities; increase
   D) securities; decrease
   Answer: D
   Ques Status: Revised
31) An increase in _______ leads to an equal _______ in the monetary base in the long run.
   A) float; increase
   B) float; decrease
   C) securities; increase
   D) securities; decrease

   Answer: C
   Ques Status: Revised

32) Suppose a person cashes his payroll check and holds all the funds in the form of currency. Everything else held constant, total reserves in the banking system ________ and the monetary base ________.
   A) remain unchanged; increases
   B) decrease; increases
   C) decrease; remains unchanged
   D) decrease; decreases

   Answer: C
   Ques Status: New

33) Suppose your payroll check is directly deposited to your checking account. Everything else held constant, total reserves in the banking system ________ and the monetary base ________.
   A) remain unchanged; remains unchanged
   B) remain unchanged; increases
   C) decrease; increases
   D) decrease; decreases

   Answer: A
   Ques Status: New

34) Explain two ways by which the Federal Reserve System can increase the monetary base. Why is the effect of Federal Reserve actions on bank reserves less exact than the effect on the monetary base?

   Answer: The Fed can increase the monetary base by purchasing government bonds and by extending discount loans. If the person selling the security chooses to keep the proceeds in currency, bank reserves do not increase. Because the Fed cannot control the distribution of the monetary base between reserves and currency, it has less control over reserves than the base.

   Ques Status: Revised
13.4 Multiple Deposit Creation

1) When the Fed supplies the banking system with an extra dollar of reserves, deposits increase by more than one dollar—a process called

A) extra deposit creation.
B) multiple deposit creation.
C) expansionary deposit creation.
D) stimulative deposit creation.

Answer: B

2) When the Fed supplies the banking system with an extra dollar of reserves, deposits ______ by ______ than one dollar—a process called multiple deposit creation.

A) increase; less
B) increase; more
C) decrease; less
D) decrease; more

Answer: B

3) If the required reserve ratio is equal to 10 percent, a single bank can increase its loans up to a maximum amount equal to

A) its excess reserves.
B) 10 times its excess reserves.
C) 10 percent of its excess reserves.
D) its total reserves.

Answer: A

4) In the simple deposit expansion model, if the Fed purchases $100 worth of bonds from a bank that previously had no excess reserves, the bank can now increase its loans by

A) $10.
B) $100.
C) $100 times the reciprocal of the required reserve ratio.
D) $100 times the required reserve ratio.

Answer: B
5) In the simple deposit expansion model, if the Fed purchases $100 worth of bonds from a bank that previously had no excess reserves, deposits in the banking system can potentially increase by
   A) $10.
   B) $100.
   C) $100 times the reciprocal of the required reserve ratio.
   D) $100 times the required reserve ratio.

Answer: C
Ques Status: Revised

6) In the simple deposit expansion model, if the Fed extends a $100 discount loan to a bank that previously had no excess reserves, the bank can now increase its loans by
   A) $10.
   B) $100.
   C) $100 times the reciprocal of the required reserve ratio.
   D) $100 times the required reserve ratio.

Answer: B
Ques Status: Previous Edition

7) In the simple deposit expansion model, if the Fed extends a $100 discount loan to a bank that previously had no excess reserves, deposits in the banking system can potentially increase by
   A) $10.
   B) $100.
   C) $100 times the reciprocal of the required reserve ratio.
   D) $100 times the required reserve ratio.

Answer: C
Ques Status: Revised

8) The formula for the simple deposit multiplier can be expressed as
   A) $\Delta R = \frac{1}{r} \times \Delta T$
   B) $\Delta D = \frac{1}{r} \times \Delta R$
   C) $\Delta r = \frac{1}{R} \times \Delta T$
   D) $\Delta R = \frac{1}{r} \times \Delta D$

Answer: B
Ques Status: Revised
9) In the simple model of multiple deposit creation in which banks do not hold excess reserves, the increase in checkable deposits equals the product of the change in excess reserves and the
   A) reciprocal of the excess reserve ratio.
   B) simple deposit expansion multiplier.
   C) reciprocal of the simple deposit multiplier.
   D) discount rate.
   Answer: B

10) The simple deposit multiplier can be expressed as the ratio of the
   A) change in reserves in the banking system divided by the change in deposits.
   B) change in deposits divided by the change in reserves in the banking system.
   C) required reserve ratio divided by the change in reserves in the banking system.
   D) change in deposits divided by the required reserve ratio.
   Answer: B

11) If reserves in the banking system increase by $100, then checkable deposits will increase by $1000 in the simple model of deposit creation when the required reserve ratio is
   A) 0.01.
   B) 0.10.
   C) 0.05.
   D) 0.20.
   Answer: B

12) If reserves in the banking system increase by $100, then checkable deposits will increase by $500 in the simple model of deposit creation when the required reserve ratio is
   A) 0.01.
   B) 0.10.
   C) 0.05.
   D) 0.20
   Answer: D
13) If the required reserve ratio is 10 percent, the simple deposit multiplier is
   A) 5.0.
   B) 2.5.
   C) 100.0.
   D) 10.0

   Answer: D
   *Ques Status: Previous Edition*

14) If the required reserve ratio is 15 percent, the simple deposit multiplier is
   A) 15.0.
   B) 1.5.
   C) 6.67.
   D) 3.33.

   Answer: C
   *Ques Status: Revised*

15) If the required reserve ratio is 20 percent, the simple deposit multiplier is
   A) 5.0.
   B) 2.5.
   C) 4.0.
   D) 10.0.

   Answer: A
   *Ques Status: Previous Edition*

16) If the required reserve ratio is 25 percent, the simple deposit multiplier is
   A) 5.0.
   B) 2.5.
   C) 4.0.
   D) 10.0.

   Answer: C
   *Ques Status: Previous Edition*
17) A simple deposit multiplier equal to one implies a required reserve ratio equal to
   A) 100 percent.
   B) 50 percent.
   C) 25 percent.
   D) 0 percent.
   Answer: A
   Ques Status: Previous Edition

18) A simple deposit multiplier equal to two implies a required reserve ratio equal to
   A) 100 percent.
   B) 50 percent.
   C) 25 percent.
   D) 0 percent.
   Answer: B
   Ques Status: Previous Edition

19) A simple deposit multiplier equal to four implies a required reserve ratio equal to
   A) 100 percent.
   B) 50 percent.
   C) 25 percent.
   D) 0 percent.
   Answer: C
   Ques Status: Previous Edition

20) In the simple deposit expansion model, if the banking system has excess reserves of $75, and the required reserve ratio is 20%, the potential expansion of checkable deposits is
   A) $75.
   B) $750.
   C) $37.50.
   D) $375.
   Answer: D
   Ques Status: Revised
21) In the simple deposit expansion model, if the required reserve ratio is 20 percent and the Fed increases reserves by $100, checkable deposits can potentially expand by

A) $100.
B) $250.
C) $500.
D) $1,000.

Answer: C

Ques Status: Revised

22) In the simple deposit expansion model, if the required reserve ratio is 10 percent and the Fed increases reserves by $100, checkable deposits can potentially expand by

A) $100.
B) $250.
C) $500.
D) $1,000.

Answer: D

Ques Status: Revised

23) In the simple deposit expansion model, an expansion in checkable deposits of $1,000 when the required reserve ratio is equal to 20 percent implies that the Fed

A) sold $200 in government bonds.
B) sold $500 in government bonds.
C) purchased $200 in government bonds.
D) purchased $500 in government bonds.

Answer: C

Ques Status: Previous Edition

24) In the simple deposit expansion model, an expansion in checkable deposits of $1,000 when the required reserve ratio is equal to 10 percent implies that the Fed

A) sold $1,000 in government bonds.
B) sold $100 in government bonds.
C) purchased $1000 in government bonds.
D) purchased $100 in government bonds.

Answer: D

Ques Status: Previous Edition
25) In the simple deposit expansion model, a decline in checkable deposits of $1,000 when the required reserve ratio is equal to 20 percent implies that the Fed
   A) sold $200 in government bonds.
   B) sold $500 in government bonds.
   C) purchased $200 in government bonds.
   D) purchased $500 in government bonds.

   Answer: A
   Ques Status: Previous Edition

26) In the simple deposit expansion model, a decline in checkable deposits of $1,000 when the required reserve ratio is equal to 10 percent implies that the Fed
   A) sold $1,000 in government bonds.
   B) sold $100 in government bonds.
   C) purchased $1,000 in government bonds.
   D) purchased $100 in government bonds.

   Answer: B
   Ques Status: Previous Edition

27) In the simple deposit expansion model, a decline in checkable deposits of $500 when the required reserve ratio is equal to 10 percent implies that the Fed
   A) sold $500 in government bonds.
   B) sold $50 in government bonds.
   C) purchased $50 in government bonds.
   D) purchased $500 in government bonds.

   Answer: B
   Ques Status: Previous Edition

28) In the simple deposit expansion model, a decline in checkable deposits of $500 when the required reserve ratio is equal to 20 percent implies that the Fed
   A) sold $250 in government bonds.
   B) sold $100 in government bonds.
   C) sold $50 in government bonds.
   D) purchased $100 in government bonds.

   Answer: B
   Ques Status: Previous Edition
29) If reserves in the banking system increase by $100, then checkable deposits will increase by $400 in the simple model of deposit creation when the required reserve ratio is

A) 0.01.
B) 0.10.
C) 0.20.
D) 0.25.

Answer: D

30) If reserves in the banking system increase by $100, then checkable deposits will increase by $667 in the simple model of deposit creation when the required reserve ratio is

A) 0.01.
B) 0.05.
C) 0.15.
D) 0.20.

Answer: C

31) If reserves in the banking system increase by $100, then checkable deposits will increase by $100 in the simple model of deposit creation when the required reserve ratio is

A) 0.01.
B) 0.10.
C) 0.20.
D) 1.00.

Answer: D

32) If reserves in the banking system increase by $100, then checkable deposits will increase by $2,000 in the simple model of deposit creation when the required reserve ratio is

A) 0.01.
B) 0.05.
C) 0.10.
D) 0.20.

Answer: B
33) If reserves in the banking system increase by $200, then checkable deposits will increase by $500 in the simple model of deposit creation when the required reserve ratio is
   A) 0.04.
   B) 0.25.
   C) 0.40.
   D) 0.50.
   Answer: C
   Ques Status: Previous Edition

34) If a bank has excess reserves of $10,000 and demand deposit liabilities of $80,000, and if the reserve requirement is 20 percent, then the bank has actual reserves of
   A) $16,000.
   B) $20,000.
   C) $26,000.
   D) $36,000.
   Answer: C
   Ques Status: Previous Edition

35) If a bank has excess reserves of $20,000 and demand deposit liabilities of $80,000, and if the reserve requirement is 20 percent, then the bank has total reserves of
   A) $16,000.
   B) $20,000.
   C) $26,000.
   D) $36,000.
   Answer: D
   Ques Status: Previous Edition

36) If a bank has excess reserves of $5,000 and demand deposit liabilities of $80,000, and if the reserve requirement is 20 percent, then the bank has actual reserves of
   A) $11,000.
   B) $20,000.
   C) $21,000.
   D) $26,000.
   Answer: C
   Ques Status: Previous Edition
37) If a bank has excess reserves of $15,000 and demand deposit liabilities of $80,000, and if the reserve requirement is 20 percent, then the bank has total reserves of

A) $11,000.
B) $21,000.
C) $31,000.
D) $41,000.

Answer: C

38) If a bank has excess reserves of $4,000 and demand deposit liabilities of $100,000, and if the reserve requirement is 15 percent, then the bank has actual reserves of

A) $17,000.
B) $19,000.
C) $24,000.
D) $29,000.

Answer: B

39) If a bank has excess reserves of $4,000 and demand deposit liabilities of $100,000, and if the reserve requirement is 10 percent, then the bank has actual reserves of

A) $14,000.
B) $19,000.
C) $24,000.
D) $29,000.

Answer: A

40) If a bank has excess reserves of $7,000 and demand deposit liabilities of $100,000, and if the reserve requirement is 15 percent, then the bank has actual reserves of

A) $17,000.
B) $22,000.
C) $27,000.
D) $29,000.

Answer: B
41) If a bank has excess reserves of $7,000 and demand deposit liabilities of $100,000, and if the reserve requirement is 10 percent, then the bank has actual reserves of

A) $14,000.
B) $17,000.
C) $22,000.
D) $27,000.

Answer: B

Ques Status: Previous Edition

42) A bank has excess reserves of $6,000 and demand deposit liabilities of $100,000 when the required reserve ratio is 20 percent. If the reserve ratio is raised to 25 percent, the bank’s excess reserves will be

A) -$5,000.
B) -$1,000.
C) $1,000.
D) $5,000.

Answer: C

Ques Status: Previous Edition

43) A bank has excess reserves of $4,000 and demand deposit liabilities of $100,000 when the required reserve ratio is 20 percent. If the reserve ratio is raised to 25 percent, the bank’s excess reserves will be

A) -$5,000.
B) -$1,000.
C) $1,000.
D) $5,000.

Answer: B

Ques Status: Previous Edition

44) A bank has excess reserves of $10,000 and demand deposit liabilities of $100,000 when the required reserve ratio is 20 percent. If the reserve ratio is raised to 25 percent, the bank’s excess reserves will be

A) -$5,000.
B) -$1,000.
C) $1,000.
D) $5,000.

Answer: D

Ques Status: Previous Edition
45) A bank has no excess reserves and demand deposit liabilities of $100,000 when the required reserve ratio is 20 percent. If the reserve ratio is raised to 25 percent, the bank’s excess reserves will now be
   A) -$5,000.
   B) -$1,000.
   C) $1,000.
   D) $5,000.

   Answer: A
   Ques Status: Previous Edition

46) A bank has excess reserves of $1,000 and demand deposit liabilities of $80,000 when the reserve requirement is 20 percent. If the reserve requirement is lowered to 10 percent, the bank’s excess reserves will be
   A) $1,000.
   B) $8,000.
   C) $9,000.
   D) $17,000.

   Answer: C
   Ques Status: Previous Edition

47) A bank has excess reserves of $1,000 and demand deposit liabilities of $80,000 when the reserve requirement is 25 percent. If the reserve requirement is lowered to 20 percent, the bank’s excess reserves will be
   A) $1,000.
   B) $5,000.
   C) $8,000.
   D) $9,000.

   Answer: B
   Ques Status: Previous Edition

48) Decisions by depositors to increase their holdings of ________, or of banks to hold ________ will result in a smaller expansion of deposits than the simple model predicts.
   A) deposits; required reserves
   B) deposits; excess reserves
   C) currency; required reserves
   D) currency; excess reserves

   Answer: D
   Ques Status: Previous Edition
49) Decisions by depositors to increase their holdings of ________, or of banks to hold excess reserves will result in a ________ expansion of deposits than the simple model predicts.

A) deposits; smaller  
B) deposits; larger  
C) currency; smaller  
D) currency; larger

Answer: C  
Ques Status: Previous Edition

50) Decisions by ________ about their holdings of currency and by ________ about their holdings of excess reserves affect the money supply.

A) borrowers; depositors  
B) banks; depositors  
C) depositors; borrowers  
D) depositors; banks

Answer: D  
Ques Status: Previous Edition

51) Assume that no banks hold excess reserves, and the public holds no currency. If a bank sells a $100 security to the Fed, explain what happens to this bank and two additional steps in the deposit expansion process, assuming a 10% reserve requirement. How much do deposits and loans increase for the banking system when the process is completed?

Answer: Bank A first changes a security for reserves, and then lends the reserves, creating loans. It receives $100 in reserves from the sale of securities. Since all of these reserve will be excess reserves (there was no change in checkable deposits), the bank will loan out all $100. The $100 will then be deposited into Bank B. This bank now has a change in reserves of $100, of which $90 is excess reserves. Bank B will loan out this $90, which will be deposited into Bank C. Bank C now has an increase in reserves of $90, $81 of which is excess reserves. Bank C will loan out this $81 dollars and the process will continue until there are no more excess reserves in the banking system.

For the banking system, both loans and deposits increase by $1000.  
Ques Status: Revised

52) Explain two reasons why the Fed does not have complete control over the level of bank deposits and loans. Explain how a change in either factor affects the deposit expansion process.

Answer: The Fed does not completely control the level of bank deposits and loans because banks can hold excess reserves and the public can change its currency holdings. A change in either factor changes the deposit expansion process. An increase in either excess reserves or currency reduces the amount by which deposits and loans are increased.  
Ques Status: Previous Edition
53) Explain why the simple deposit multiplier overstates the true deposit multiplier.

Answer: The simple model ignores the role banks and their customers play in the creation process. The bank’s customers can decide to hold currency and the bank can decide to hold excess reserves. Both of these will restrict the banking system’s ability to create deposits. Thus, the true multiplier is less than the prediction of the simple deposit multiplier.

Ques Status: New

13.5 Web Appendix: The Fed’s Balance Sheet and the Monetary Base

1) Which is the most important category of Fed assets?
   A) Securities
   B) Discount loans
   C) Gold and SDR certificates
   D) Cash items in the process of collection

Answer: A
Ques Status: Previous Edition

2) The two most important categories of assets on the Fed’s balance sheet are _______ and _______ because they earn interest.
   A) discount loans; coins
   B) securities; discount loans
   C) gold; coins
   D) cash items in the process of collection; SDR certificate accounts

Answer: B
Ques Status: Revised

3) The Fed’s holdings of securities consist primarily of _______, but also in the past have included _______.
   A) Treasury securities; bankers’ acceptances
   B) municipal securities; bankers’ acceptances.
   C) bankers’ acceptances; Treasury securities.
   D) Treasury securities; municipal securities.

Answer: A
Ques Status: Revised
4) The volume of loans that the Fed makes to banks is affected by the Fed’s setting of the interest rate on these loans, called the
A) federal funds rate.
B) prime rate.
C) discount rate.
D) interbank rate.
Answer: C
Ques Status: Previous Edition

5) Special Drawing Rights (SDRs) are issued to governments by the _______ to settle international debts and have replaced _______ in international transactions.
A) Federal Reserve System; gold
B) Federal Reserve System; dollars
C) International Monetary Fund; gold
D) International Monetary Fund; dollars
Answer: C
Ques Status: Previous Edition

6) When the Treasury acquires gold or SDRs, it issues certificates to the _______, which are a claim on the gold or SDRs, and in turn is credited with deposit balances at the _______.
A) Federal Reserve System; Fed
B) Federal Reserve System; IMF
C) International Monetary Fund; Fed
D) International Monetary Fund; IMF
Answer: A
Ques Status: Previous Edition

7) Which of the following are not assets on the Fed’s balance sheet?
A) Discount loans
B) U.S. Treasury deposits
C) Cash items in the process of collection
D) U.S. Treasury bills
Answer: B
Ques Status: Previous Edition
8) Which of the following are not assets on the Fed’s balance sheet?
   A) Securities
   B) Discount loans
   C) Cash items in the process of collection
   D) Deferred availability cash items

   Answer: D
   Ques Status: Previous Edition

9) Which of the following are not liabilities on the Fed’s balance sheet?
   A) Discount loans
   B) Bank deposits
   C) Deferred availability cash items
   D) U.S. Treasury deposits

   Answer: A
   Ques Status: Previous Edition

10) When the Fed purchases artwork to decorate the conference room at the Federal Reserve Bank of Kansas City,
   A) reserves rise, but the monetary base falls.
   B) reserves fall.
   C) currency in circulation falls.
   D) the monetary base rises.

   Answer: D
   Ques Status: Previous Edition

11) A Fed purchase of gold, SDRs, a deposit denominated in a foreign currency or any other asset is just an open market ______ of these assets, ______ the monetary base.
   A) purchase; raising
   B) sale; raising
   C) purchase; lowering
   D) sale; lowering

   Answer: A
   Ques Status: Revised
12) An increase in Treasury deposits at the Fed causes
   A) the monetary base to increase.
   B) the monetary base to decrease.
   C) Fed assets to increase but has no effect on the monetary base.
   D) Fed assets to decrease but has no effect on the monetary base.

   Answer: B

Ques Status: Previous Edition

13) An increase in U.S. Treasury deposits at the Fed reduces both _______ and the ________.
   A) reserves; monetary base
   B) Fed liabilities; money multiplier
   C) Fed assets; monetary base
   D) Fed assets; money multiplier

   Answer: A

Ques Status: Previous Edition

14) U.S. Treasury deposits at the Fed are _______ for the Fed but _______ for the Treasury. Thus
    an increase in U.S. Treasury deposits _______ the monetary base.
    A) a liability; an asset; increases
    B) a liability; an asset; decreases
    C) an asset; a liability; increases
    D) an asset; a liability; decreases

   Answer: B

Ques Status: Revised

15) An increase in which of the following leads to a decline in the monetary base?
   A) Float
   B) Discount loans
   C) Foreign deposits at the Fed
   D) SDRs

   Answer: C

Ques Status: Previous Edition
16) Suppose, while cleaning out its closets, a worker at the Federal Reserve bank branch in Memphis discovers a painting of Elvis (medium: acrylic on velvet) that used to grace the walls of the conference room. Suppose further that, at a public auction, the bank sells the painting for $19.95. This sale will cause _______ in the monetary base, everything else held constant.

A) an increase of $19.95
B) an increase of more than $19.95
C) a decrease of $19.95
D) a decrease of more than $19.95

Answer: C  
Ques Status: New

17) Suppose the Bank of China permanently decreases its purchases of U.S. government bonds and, instead, holds more dollars on deposit at the Federal Reserve. Everything else held constant, a open market ______ would be the appropriate monetary policy action for the Fed to take to offset the expected ______ in the monetary base in the United States.

A) purchase; decrease
B) purchase; increase
C) sale; decrease
D) sale; increase

Answer: A  
Ques Status: New