

Name _____

Student ID _____

Section Number _____

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

- 1) Over the long run the primary determinant of movements in the money supply is the _____
A) required reserve ratio. B) currency ratio.
C) excess reserves ratio. D) nonborrowed base.
- 2) The relationship between borrowed reserves, the nonborrowed monetary base, and the monetary base is _____
A) $BR = MB - MB_n$. B) $MB = MB_n - BR$.
C) $BR = MB_n - MB$. D) $MB = BR - MB_n$.
- 3) 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
- 4) 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.
- 5) Which of the following statements are true? _____
A) A bank's balance sheet shows that total assets equal total liabilities plus equity capital.
B) A bank's liabilities are its uses of funds.
C) A bank's assets are its sources of funds.
D) A bank's balance sheet indicates whether or not the bank is profitable.
- 6) If the required reserve ratio is 15 percent, currency in circulation is \$400 billion, checkable deposits are \$800 billion, and excess reserves total \$0.8 billion, then the M1 money multiplier is _____
A) 0.651. B) 2.5. C) 1.67. D) 2.3.
- 7) Total Reserves minus vault cash equals _____
A) bank deposits with the Fed. B) excess reserves.
C) currency in circulation. D) required reserves.

- 8) Everything else held constant, in the market for reserves, when the federal funds rate is 3%, lowering the discount rate from 5% to 4% 8) _____
 A) raises the federal funds rate
 B) has no effect on the federal funds rate.
 C) has an indeterminate effect on the federal funds rate.
 D) lowers the federal funds rate.
- 9) 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. 9) _____
 A) sell; extend
 B) sell; call in
 C) purchase; call in
 D) purchase; extend
- 10) If the required reserve ratio is 10 percent, currency in circulation is \$400 billion, checkable deposits are \$1000 billion, and excess reserves total \$1 billion, then the monetary base is 10) _____
 A) \$400 billion.
 B) \$401 billion.
 C) \$500 billion.
 D) \$501 billion.
- 11) 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. 11) _____
 A) more; decline; rise
 B) more; rise; decline
 C) fewer; decline; decline
 D) fewer; rise; rise
- 12) When you deposit a \$50 bill in the Security Pacific National Bank, 12) _____
 A) its cash items in the process of collection increase by \$50.
 B) its liabilities decrease by \$50.
 C) its reserves decrease by \$50.
 D) its assets increase by \$50.
- 13) 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. 13) _____
 A) one
 B) two
 C) nine
 D) ten
- 14) The sum of the Fed's monetary liabilities and the U.S. Treasury's monetary liabilities is called 14) _____
 A) bank reserves.
 B) currency in circulation.
 C) the monetary base.
 D) the money supply.
- 15) High-powered money minus currency in circulation equals 15) _____
 A) the borrowed base.
 B) reserves.
 C) the nonborrowed base.
 D) discount loans.
- 16) A bank with insufficient reserves can increase its reserves by 16) _____
 A) calling in loans.
 B) buying municipal bonds.
 C) buying short-term Treasury securities.
 D) lending federal funds.

- 32) Both _____ and _____ are Federal Reserve assets. 32) _____
 A) currency in circulation; government securities
 B) currency in circulation; reserves
 C) government securities; reserves
 D) government securities; discount loans
- 33) If, after a deposit outflow, a bank has a reserve deficiency of \$ 3 million, 33) _____
 it can meet its reserve requirements by
 A) increasing loans by \$3 million.
 B) selling \$3 million of securities.
 C) reducing deposits by \$3 million.
 D) repaying its discount loans from the Fed.
- 34) The formula for the simple deposit multiplier can be expressed as 34) _____
 A) $\Delta D = \frac{1}{r} \times \Delta R$ B) $\Delta r = \frac{1}{R} \times \Delta T$
 C) $\Delta R = \frac{1}{r} \times \Delta T$ D) $\Delta R = \frac{1}{r} \times \Delta D$
- 35) If a banker expects interest rates to fall in the future, her best strategy for 35) _____
 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 buy short-term bonds.
 D) to sell long-term certificates of deposit.
- 36) Duration analysis involves comparing the average duration of the 36) _____
 bank's _____ to the average duration of its _____.
 A) assets; liabilities
 B) loan portfolio; deposit liabilities
 C) securities portfolio; non-deposit liabilities
 D) assets; deposit liabilities
- 37) The most common definition that central bankers use for price stability 37) _____
 is
 A) high and stable inflation.
 B) low and stable inflation.
 C) an inflation rate of zero percent.
 D) low and stable deflation.
- 38) Property promised to the lender as compensation if the borrower 38) _____
 defaults is called _____.
 A) deductibles B) contingencies
 C) restrictive covenants D) collateral
- 39) If the required reserve ratio is 10 percent, currency in circulation is \$400 39) _____
 billion, checkable deposits are \$800 billion, and excess reserves total \$0.8
 billion, then the money supply is
 A) \$8000. B) \$8400. C) \$1200. D) \$1200.8.

- 40) The formula for the M1 money multiplier is 40) _____
 A) $M = (1 + c)/(r + e + c)$. B) $m = [1/(r + e + c)] \times MB$.
 C) $m = (1 + c)/(r + e + c)$. D) $M = 1/(r + e + c)$.
- 41) The excess reserves ratio is _____ related to expected deposit outflows, 41) _____
 and is _____ related to the market interest rate.
 A) negatively; positively B) positively; negatively
 C) positively; positively D) negatively; negatively
- 42) If a bank has \$10 million of checkable deposits, a required reserve ratio of 10 percent, and it holds \$2 million in reserves, then it will not have enough reserves to support a deposit outflow of 42) _____
 A) \$1.2 million. B) \$1.1 million.
 C) \$1 million. D) \$900,000.
- 43) In order to reduce the _____ problem in loan markets, bankers collect 43) _____
 information from prospective borrowers to screen out the bad credit risks from the good ones.
 A) moral suasion B) moral hazard
 C) adverse lending D) adverse selection
- 44) Recognizing the distinction between borrowed reserves and the nonborrowed monetary base, the money supply model is specified as 44) _____
 A) $M = m + (MB_n - BR)$. B) $M = m \times (MB_n - BR)$.
 C) $M = m - (MB_n + BR)$. D) $M = m \times (MB_n + BR)$.
- 45) The _____ problem of discretionary policy arises because economic 45) _____
 behavior is influenced by what firms and people expect the monetary authorities to do in the future.
 A) nominal-anchor B) moral hazard
 C) time-inconsistency D) rational-expectation
- 46) The four players in the money supply process include 46) _____
 A) banks, borrowers, the central bank, and the U.S. Treasury.
 B) banks, depositors, the central bank, and the U.S. Treasury.
 C) banks, depositors, borrowers, and the U.S. Treasury.
 D) banks, depositors, the central bank, and borrowers.
- 47) Bankers' concerns regarding the optimal mix of excess reserves, secondary reserves, borrowings from the Fed, and borrowings from other banks to deal with deposit outflows is an example of 47) _____
 A) managing interest rate risk. B) liability management.
 C) liquidity management. D) managing credit risk.
- 48) The difference of rate-sensitive liabilities and rate-sensitive assets is known as the 48) _____
 A) gap. B) interest-sensitivity index.
 C) duration. D) rate-risk index.

49) When \$1 million is deposited at a bank, the required reserve ratio is 20 percent, and the bank chooses not to hold any excess reserves but makes loans instead, then, in the bank's final balance sheet, 49) _____

- A) reserves increase by \$160,000.
- B) the liabilities of the bank increase by \$800,000.
- C) the liabilities of the bank increase by \$1,000,000.
- D) the assets at the bank increase by \$800,000.

50) 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 _____. 50) _____

- A) monetary base; monetary base; money multiplier
- B) monetary base; money multiplier; monetary base
- C) money multiplier; monetary base; monetary base
- D) money multiplier; money multiplier; monetary base

Answer key for Midterm 2 (Spring 2010)

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|----|---|----|---|
| 1 | D | 40 | C |
| 2 | A | 41 | B |
| 3 | A | 42 | A |
| 4 | B | 43 | D |
| 5 | A | 44 | D |
| 6 | D | 45 | C |
| 7 | A | 46 | D |
| 8 | B | 47 | C |
| 9 | D | 48 | A |
| 10 | D | 49 | C |
| 11 | A | 50 | A |
| 12 | D | | |
| 13 | B | | |
| 14 | C | | |
| 15 | B | | |
| 16 | A | | |
| 17 | A | | |
| 18 | B | | |
| 19 | A | | |
| 20 | D | | |
| 21 | C | | |
| 22 | C | | |
| 23 | C | | |
| 24 | C | | |
| 25 | C | | |
| 26 | C | | |
| 27 | A | | |
| 28 | A | | |
| 29 | C | | |
| 30 | A | | |
| 31 | A | | |
| 32 | D | | |
| 33 | B | | |
| 34 | A | | |
| 35 | A | | |
| 36 | A | | |
| 37 | B | | |
| 38 | D | | |
| 39 | C | | |