1. The most important, most convenient, and most flexible way in which the Federal Reserve affects the supply of bank reserves is through:
A. conducting open-market operations.
B. changing the Federal Reserve discount rate.
C. changing bank reserve requirement ratios.
D. changing real interest rates.

2. One of the serious drawbacks of the deposit insurance system instituted in the United States is that:
A. bank failures continue to occur regularly.
B. the system took away the Federal Reserve's ability to conduct open-market operations.
C. the system took away the Federal Reserve's ability to change reserve requirements.
D. if insured intermediaries make bad loans, the taxpayers may be responsible for covering the losses.

3. If planned aggregate spending in an economy can be written as PAE = 15,000 + 0.6Y - 20,000r, and potential output equals 36,000, what real interest rate must the Federal Reserve set to bring the economy to full employment?
A. 0.02
B. 0.03
C. 0.04
D. 0.05

$Y = 15000 + 0.6Y - 20000r$ Y needs to equal Y^*
$0.4Y = 15000 - 20000r$
$Y = \frac{15000 - 20000r}{0.4} = 36000$ $r = 0.03$

4. If the income-expenditure multiplier equals 4 and a 1 percentage point increase in the real interest rate reduces autonomous spending by 100 units, then a 1,000 unit recessionary gap can be eliminated by _____ the real interest rate by _____ percentage points.
A. increasing; 10
B. increasing; 4
C. increasing; 2.5
D. decreasing; 2.5

$x(0.01) = 100$ $x = 10,000$
Increase PAE by 250
10,000r
$\frac{250}{100} = 2.5$

5. Federal Reserve actions that increase nominal interest rates and decrease the money supply
A. close a recessionary gap.
B. close an expansionary gap.
C. raise the monetary policy rule.
D. raise bond prices.

6. Changes in consumption and planned investment spending resulting from changes in the real interest rate alter:
A. the money supply.
B. money demand.
C. autonomous expenditures.
D. induced expenditures.

7. To close a recessionary gap, the Fed ____ interest rates which ______ planned aggregate spending and _____ short-run equilibrium output.
A. lowers; increases; increases
B. raises; decreases; increases
C. raises; decreases; decreases
D. lowers; increases; decreases

8. In an economy where planned aggregate spending is given by PAE = 5,500 + .6Y - 20,000 r, the central bank is currently setting the interest rate at 0.06 (6 percent). If potential output equals 11,250, the central bank must _____ the interest rate to close the __________ gap.
A. lower; expansionary
B. lower; recessionary
C. raise; recessionary
D. raise; expansionary

$Y = 5500 + 0.6Y - 20,000r$
$0.4Y = 5500 - 20,000(0.06)$
$Y = 10750$

9. The following table shows Alex's estimated annual benefits of holding different amounts of money.

Average money holdings ($)	Total benefit ($)	
700	50	9
800	59	7
900	66	
1000	71	
1100	74	

How much money will Alex hold if the nominal interest rate is 8 percent? (Assume she wants her money holdings to be in multiples of $100.)

A. 700
B. 800
C. 900
D. 1000

10. Which of the following would be expected to increase the U.S. demand for money?

A. Financial investors become concerned about increasing riskiness of stocks.
B. The economy enters a recession.
C. Political instability decreases dramatically in developing nations.
D. On-line banking allows customers to transfer funds between checking and stock mutual funds 24 hours a day.

11. If the money supply exceeds money demand, people will ____ bonds which will cause bond prices to ____ and the nominal interest rate to _____ until money demand equals money supply.

A. buy; rise; fall
B. sell; fall; fall
C. sell; rise; fall
D. buy; fall; rise

12. Prior to January 2000, the demand for money increased as people anticipated Y2K problems. If the Fed took no actions to offset this increase in money demand and assuming that the anticipated Y2K problems did not change money supply, then nominal interest rates would _____.
A. increase
B. decrease
C. remain constant
D. equal the real interest rates

13. The Federal Reserve can:
A. simultaneously set any money supply and any nominal interest rate target.
B. set the target money supply and target nominal interest rate independently.
C. only set a money supply target that is consistent with the target nominal interest rate.
D. only target the money supply, not the nominal interest rate.

14. If commercial banks are maintaining a 4 percent reserve/deposit ratio and the Fed raises the required reserve ratio to 6 percent, then banks will see a _____ in their deposits and the money supply will _____.
A. increase; increase
B. increase; decrease
C. decrease; increase
D. decrease; decrease

15. In the long-run, the real interest rate is determined by ______, and in the short-run, the Federal Reserve can control the real interest rate by setting the nominal interest rate if inflation adjusts _____.
A. saving and investment; slowly
B. saving and investment; quickly
C. the Federal Reserve; quickly
D. the Federal Reserve; slowly