Monetary Policy

Name: ______________________________
Per: ____

Consolidated Balance Sheet of the Federal Reserve Banks

1. What are the two main assets of the Federal Reserve Banks?
2. The securities consist largely of what two things?
3. Why does the U.S. government issue securities?
4. Why are loans to commercial banks assets to the Fed?
5. What are the three items listed as liabilities of the Fed?
6. When are commercial bank reserves liabilities of the Fed?
7. Why does the U.S. Treasury keep deposits in the Fed?
8. Why are Federal Reserve Notes in circulation outside the Fed liabilities to the Fed?

Tools of Monetary Policy

9. What are the Fed's three tools of monetary control?

Open-Market Operations

10. The Fed's open-market operations consist of what?
11. What do commercial banks give up when they sell securities to the Fed?
12. How does the Fed pay for the securities they buy from commercial banks?
13. Why does the purchase by the Fed of government securities from commercial banks increase the money supply? [Read and understand the 2nd paragraph in the right column on page 284.]
14. What does a private seller (such as the Gristly Meat Packing Company) give up when they sell a security to the Fed?
15. What does that private seller get in payment when they sell a security to the Fed?
16. What does the private seller do with that payment?
17. How does the purchase of securities from the public increase commercial bank reserves?
18. How does the purchase of securities from the public increase the money supply?

[No questions about the "selling securities" section. This is just reversing the process of buying securities.]

19. What makes commercial banks and the public willing to sell government securities to, or buy them from, Federal Reserve Banks? [See the right column of page 287.]

The Reserve Ratio

20. Why does raising the reserve ratio reduce checkable deposits and therefore the money supply?

21. Lowering the reserve ratio transforms required reserves into what?

22. What are two ways in which a change in the reserve ratio affects the money-creating ability of the banking system?

23. How frequently does the Fed change the reserve ratio?

The Discount Rate

24. What does the Fed do as a "lender of last resort?"

25. What does a commercial bank give to the Fed when it borrows money from it?

26. What is the interest rate that the Fed charges to commercial banks called?

27. Why are 100% of Fed loans to commercial banks "excess reserves" to the banks?

28. What does lowering the discount rate encourage commercial banks to do?

29. How does lowering the discount rate increase the money supply?

Easy Money and Tight Money

30. In the face of a recession, what are three things the Fed can do to increase the supply of money?

31. What is the purpose of an "easy money" policy?

32. What is the objective of a "tight money" policy?

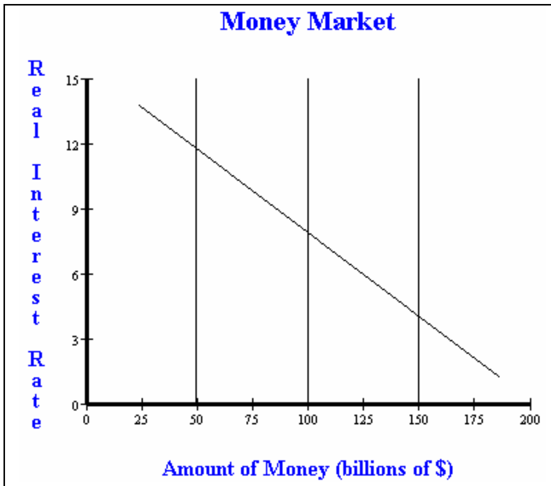
Relative Importance

33. What is the most important instrument of monetary control?

34. Why are open market operations more flexible than changing the discount rate or the reserve ratio?

Monetary Policy, Real GDP, and the Price level

[Note that the actual money supply is many times greater than the fictional amounts presented below!]



Assume that the graph above is similar to Figure 15.2 (a) on page 290.

If the Fed sets the money supply at $50 billion,

35. what will be the equilibrium interest rate?

36. how much money will be borrowed?

If the Fed sets the money supply at $100 billion,

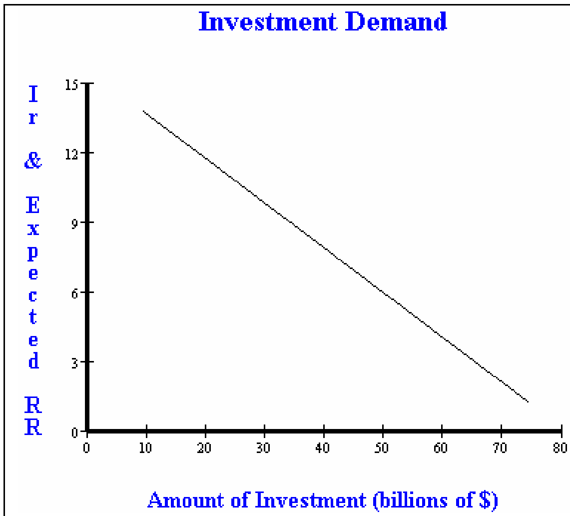
37. what will be the equilibrium interest rate?

38. how much money will be borrowed?

If the Fed sets the money supply at $150 billion,

39. what will be the equilibrium interest rate?

40. how much money will be borrowed?



Assume that the graph above is similar to Figure 15.2 (b) on page 290.

If the Fed sets the money supply at $50 billion, given the graph of the money market above,

41. how much money will be invested?

If the Fed sets the money supply at $100 billion, given the graph of the money market above,

42. how much money will be invested?

If the Fed sets the money supply at $150 billion, given the graph of the money market above,

43. how much money will be invested?

Use Figure 15.2 (c) on page 291 to guide you in answering questions 44-48.

44. What will happen to aggregate demand (AD) if the Fed increases the money supply from $50 to $100 and then to $150 billion dollars?

45. What is the effect on GDP of the Fed increasing the money supply?

46. How does the size of this affect change depending on what phase of the AS curve the economy is operating in?

47. What is the effect on the price level of the Fed increasing the money supply?

48. How does the size of this affect change depending on what phase of the AS curve the economy is operating in?

Monetary Policy and Aggregate Supply

49. Why is an easy money policy inappropriate if the economy is already achieving full employment? [page 294]

Effectiveness of Monetary Policy

Changes in Velocity

50. What is meant by the velocity of money?

51. How can changes in velocity frustrate the Fed's monetary policy?

Cyclical Asymmetry

52. What is the problem of cyclical asymmetry?

53. What is the Fed's "You can lead a horse to water, but you cannot make it drink" problem?

54. What did we learn from Japan's problem of the late 1990s?

Targeting the Federal Funds Rate

55. To stabilize the economy the Fed currently focuses on what?

56. What is the Federal Funds Rate?

57. What does the Fed's announcement of an increase in the Federal Funds Rate signal?

58. What does the Fed's changing of the Federal Funds Rate, in effect, change?

59. How does the Fed actually increase the Federal Funds Rate?

Net Export Effect

60. What is the direction of the net export effect of an easy money policy?

61. Explain the process through which this happens.