2.04 Monetary Policy

Question 1
Open market purchases of government securities by a central bank are *most likely*:
A. neutral.
B. expansionary.
C. contractionary.

Question 2
In an economy that operates under an exchange rate targeting policy, which of the following conditions is *most likely*?
A. The central bank is required to maintain a fixed policy interest rate.
B. Monetary policy can focus on internal rather than external considerations.
C. Target country inflation (deflation) is imported regardless of the effect on the domestic economy.

Question 3
A developing economy has a target exchange rate for its currency. The inflation rate in the developing economy drops below the inflation rate in the target currency. Central bank action to defend the target exchange rate is *most likely* to result in a decrease in the developing economy's:
A. money supply.
B. short-term interest rates.
C. balance of payments surplus.

Question 4
Which of the following is *most likely* a role of a central bank?
A. Issues national debt
B. Sets long-term interest rates
C. Acts as lender of last resort to banks

Question 5
Which of the following *best* characterizes the approach most central banks take regarding inflation?
A. Minimize inflation rates
B. Maintain targeted inflation rates
C. Accept market-determined inflation rates

Question 6
Which of the following *best* describes a contractionary fiscal policy?
A. A decrease in the government budget surplus
B. A reduction in export subsidies to manufacturers
C. An expansion of eligibility for unemployment benefits

Question 7
If a central bank wants to increase the money supply, the *most appropriate* action it can take is to:
A. increase the policy rate.
B. reduce the reserve requirements.
C. sell government bonds to commercial banks.

Question 8
Which of the following is *least likely* a quality of an effective central bank?
A. Transparency
B. Independence
C. Creditworthiness

Question 9
An increase in which of the following would *most appropriately* be considered expansionary fiscal policy?
A. New excise taxes on vehicle motor fuel
B. Infrastructure spending on highways and bridges
C. Reducing budget deficits by raising corporate income taxes

Question 10
Which of the following monetary policy actions is *most likely* expansionary?
A. Selling government securities through open market operations
B. Lowering the policy rate to a level below the neutral interest rate
C. Raising reserve requirements to reduce the amount of excess reserves

Question 11
If the inflation rate is expected to rise above a central bank's inflation target, that central bank's *most appropriate* action would be to:
A. increase the policy rate above the neutral rate.
B. buy government bonds from commercial banks.
C. lower the reserve requirement for commercial banks.

Question 12
When the central bank sells securities to banks via open market operations, which of the following is the *most likely* result?
A. An increase in bank reserves
B. A decrease in base lending rates
C. A decrease in banks' capacity to lend

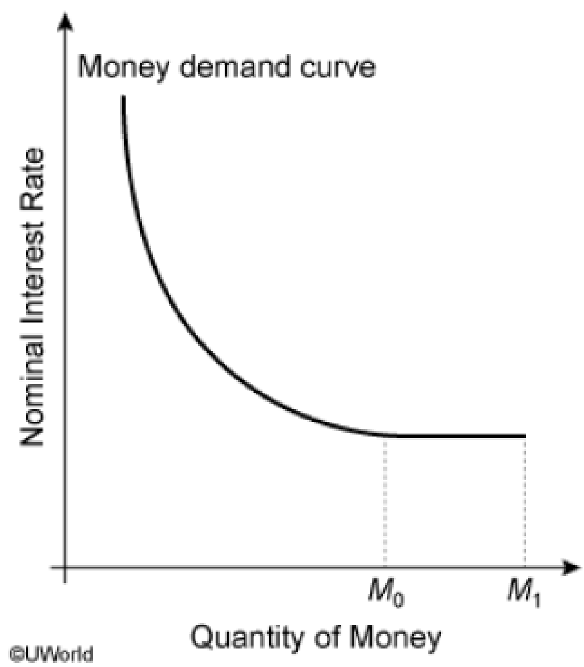
Question 13
Most central banks with an inflation-targeting policy aim for an inflation rate of about 2%. Which of the following *best* describes a reason why this level has become the prevailing standard?

A. A lower rate would risk deflation
B. To adhere to a neutral policy rate
C. To keep the country's borrowing costs low

Question 14
If a monetary system has a fractional reserve banking system and the central bank changes the reserve requirement from 10% to 12%, it is *most likely* that:
A. the money multiplier decreases.
B. money supply growth increases.
C. interest rates on bank deposits decrease.

Question 15
When the commercial banking system holds significant excess reserves, which of the following central bank actions is *most likely* to affect commercial banks' base lending rates?
A. Changing the official policy rate
B. Changing the reserve requirement
C. Buying or selling securities in the open market

Question 16
A demand curve for money is depicted in the graph below:



Which of the following *best* explains the shape of the curve between M and M ?
A. Liquidity trap
B. Policy rate of zero
C. Neutral rate of interest

Question 17
Quantitative easing is operationally similar to which monetary policy tool?

A. Changing the reserve requirement
B. Conducting open market operations
C. Increasing or decreasing the policy rate

Question 18
Large open market purchases of government securities by a central bank are used to decrease:
A. real GDP growth rates.
B. domestic inflation rates.
C. domestic currency's exchange value.

Question 19
Which of the following is *least accurate* regarding monetary policy tools?
A. Bank reserve requirements are independent of the central bank policy rate.
B. Banks typically increase base rates when the central bank increases the policy rate.
C. Bank reserve requirements increase when the central bank buys securities from banks.

Question 20
A country pursues tight fiscal policy and easy monetary policy for several years. Which of the following are the *most likely* consequences for the size of the public and private sectors relative to the country's GDP?
A. Larger public sector and smaller private sector
B. Smaller public sector and larger private sector
C. No change in their relative sizes as both sectors would be equally affected

Question 21
Which of the following is *least likely* a function of a central bank?
A. Regulate the payment system
B. Determine infrastructure spending
C. Manage foreign exchange and gold reserves

Question 22
Which of the following factors may limit the impact of expansionary monetary policy in a deflationary economy?
A. Short-term interest rates cannot be reduced to 0% by central banks.
B. Central bank policy may fail to induce banks to increase lending activity.
C. Central bank open market operations may be unable to sufficiently expand bank reserves.

Question 23
Which of the following *most likel*y limits a central bank's ability to implement effective expansionary monetary policy? The central bank is unable to:
A. reduce the policy interest rate below the neutral rate.
B. increase the amount of excess reserves held by commercial banks.
C. increase businesses and consumers' willingness to hold bank deposits.

Question 24
Which of the following is *least likely* a transmission mechanism of central bank policy?
A. Gold prices
B. Asset prices
C. Exchange rates

Question 25
All else being equal, which of the following central bank actions is *most appropriate* to reduce interest rates?
A. Sell government securities
B. Reduce reserve requirements
C. Increase prudential regulation of banks

Question 26
Which of the following central bank actions is *most likely* considered expansionary monetary policy?
A. Reducing the reserve requirement
B. Selling government bonds through open market operations
C. Holding the policy rate constant as the neutral rate falls below it