ECO202 Spring 2003
Quiz 6

Name (please print) ___________________________________________

Assigned seat __________

Place all answers to your quiz in the space provided at the end of the quiz. No credit will be given for misplaced answers. All answers must be recorded in ink.

1. When people used gold dust to make purchases in the early history of the U.S., the gold dust served as
   a. commodity money.
   b. fiat money.
   c. legal tender.
   d. all of the above.

2. Bank panics in the U.S. were most often caused by:
   a. news that led depositors to believe that the bank had loans that would not be paid back.
   b. a string of bank robberies.
   c. rapid increases in the money supply caused by the government printing large amounts of new currency.
   d. fraudulent activities by the FDIC.

3. Which of the following is FALSE?
   a. members of the board of governors are appointed for 14 year terms.
   b. there are 12 districts in the federal reserve bank.
   c. the Federal Reserve was created in the 1860s.
   d. FDIC was created in the 1930s.

4. According to the "Economic Week in Review: Feb. 24-28, 2003", in the U.S.,
   a. real GDP grew in the fourth quarter of 2002.
   b. residential real estate sales have been very strong recently.
   c. sales of consumer durables rose in January.
   d. all of the above.

5. Which of the following is TRUE?
   a. the monetary base equals bank reserves and bank deposits with the Federal Reserve.
   b. M1 equals demand deposits plus nonbank cash plus bank cash.
   c. bank reserves equal bank cash plus government securities.
   d. none of the above.

6. If the federal reserve wants to increase the money supply, which of the following combination of policies would be most appropriate?
   a. a cut in the reserve ratio, a cut in the discount rate, and Fed purchases of government securities.
   b. a cut in the reserve ratio, an increase in the discount rate, and Fed purchases of government securities.
   c. an increase in the reserve ratio, a cut in the discount rate, and Fed sales of government securities.
   d. an increase in the reserve ratio, an increase in the discount rate, and Fed sales of government securities.
To answer the next 2 questions, assume that the banking system starts with the following "base case" balance sheet and that
* the public initially holds $10 of cash outside the bank.
* the reserve ratio is 20%
* banks always loan out the maximum amount allowed.

**BALANCE SHEET**

<p>| | | | | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Reserves</td>
<td>$2000</td>
<td>Demand Dep.'s</td>
<td>$10,000</td>
<td></td>
</tr>
<tr>
<td>Loans</td>
<td>$5000</td>
<td>Govt. Secur.'s</td>
<td>$5000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Owner's Equity</td>
<td>2000</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>$12,000</td>
<td></td>
</tr>
</tbody>
</table>

7. **Start with the base case balance sheet.** If the Fed sells the banking system $500 of government securities and the banking system completely adjusts to this change in their balance sheet, the monetary base will ______ and M1 will ______.
   a. increase by $500; increase by $500.
   b. not change; increase by $5000.
   c. decrease by $500; decrease by $5000.
   d. none of the above.

8. **Start with the base case balance sheet.** If the Fed cuts the reserve ratio from 20% to 10% and the bank system completely adjusts to this change,
   a. loans will decrease to $2500 and demand deposits will decrease to $7500.
   b. loans will increase to $15,000 and demand deposits will increase to $20,000.
   c. loans will increase to $10,000 and demand deposits will increase to $15,000.
   d. none of the above.

9. If customers choose to hold more of their money as cash and less as checking accounts,
   a. M1 will shrink.
   b. banks will have to reduce the amount of loans.
   c. interest rates will rise.
   d. all of the above.

10. Which of the following is FALSE?
   a. the Federal Reserve has greater control over short term than long term interest rates.
   b. a purchase of government securities by the Federal Reserve will increase loan supply and put downward pressure on interest rates.
   c. the Federal Reserve sets a lower reserve ratio for demand deposits than for certificates of deposit.
   d. the discount rate is the interest rate that the Federal Reserve charges banks for a loan of reserves.

<table>
<thead>
<tr>
<th>1a</th>
<th>2a</th>
<th>3c</th>
<th>4d</th>
<th>5d</th>
</tr>
</thead>
<tbody>
<tr>
<td>6a</td>
<td>7d</td>
<td>8b</td>
<td>9d</td>
<td>10c</td>
</tr>
</tbody>
</table>