1. The money supply is ________ related to the nonborrowed monetary base, and ________ related to the level of borrowed reserves.
   A) positively; negatively
   B) negatively; not
   C) positively; positively
   D) negatively; negatively

2. Over the long run the primary determinant of movements in the money supply is the
   A) currency ratio.
   B) excess reserves ratio.
   C) required reserve ratio.
   D) nonborrowed base.

3. 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 ________.
   A) money multiplier; monetary base; monetary base
   B) monetary base; money multiplier; monetary base
   C) monetary base; monetary base; money multiplier
   D) money multiplier; money multiplier; monetary base

4. Everything else held constant, in the market for reserves, when the federal funds rate is 3%, raising the discount rate from 5% to 6%
   A) lowers the federal funds rate.
   B) raises the federal funds rate.
   C) has no effect on the federal funds rate.
   D) has an indeterminate effect on the federal funds rate.

5. In the market for reserves, an increase in the reserve requirement ________ the demand for reserves, ________ the federal funds rate, everything else held constant.
   A) decreases; lowering
   B) increases; lowering
   C) increases; raising
   D) decreases; raising

6. In the channel-corridor system
   A) control of the overnight interest rate is impossible.
   B) reserve requirements are essential for monetary control.
   C) the overnight rate always equals the Lombard rate.
   D) monetary control can be exercised with no required reserves.
7. There are two types of open market operations: ________ open market operations are intended to change the level of reserves and the monetary base, and ________ open market operations are intended to offset movements in other factors that affect the monetary base.
   A) defensive; dynamic
   B) defensive; static
   C) dynamic; defensive
   D) dynamic; static

8. The Fed's discount lending is of three types: ________ is the most common category; ________ is given to a limited number of banks in vacation and agricultural areas; ________ is given to banks that have experienced severe liquidity problems.
   A) seasonal credit; secondary credit; primary credit
   B) secondary credit; seasonal credit; primary credit
   C) primary credit; seasonal credit; secondary credit
   D) seasonal credit; primary credit; secondary credit

9. The theory that monetary policy conducted on a discretionary, day-by-day basis leads to poor long-run outcomes is referred to as the
   A) adverse selection problem.
   B) moral hazard problem.
   C) time-inconsistency problem.
   D) nominal-anchor problem.

10. Which of the following is an advantage of using an implicit nominal anchor for monetary policy?
    A) It does not rely on the money-inflation relationship.
    B) It is simplistic and has clarity.
    C) There is increased accountability of central bankers.
    D) There is an immediate signal if the target has been achieved.

11. Which of the following is not a requirement in selecting an intermediate target?
    A) Measurability
    B) Controllability
    C) Flexibility
    D) Predictability
12. The monetary base increased by 20% during the contraction of 1929-1933, but the money supply fell by 25%. Explain why this occurred. How can the money supply fall when the base increases?

**Answer:** The banking crisis caused the public to fear for the safety of their deposits, increasing both the currency ratio and bank holdings of excess reserves in anticipation of deposit outflows. Both of these changes reduce the money multiplier and the money supply. In this case, the fall in the multiplier due to increases of currency and excess reserves more than offset the increase in the base, causing the money supply to fall.

13. Explain what inflation targeting is. What are the advantages and disadvantages of this type of monetary policy strategy?

**Answer:** There are five main elements to inflation targeting: 1. a public announcement of a medium-term target for the inflation rate; 2. a commitment to price stability as the primary long-term goal of policy; 3. many variables are used in making decisions about policy moves; 4. increased transparency about policy strategy with the public; 5. the central bank has increased accountability for attaining policy goals.

The advantages of inflation targeting include: 1. the simplicity and clarity of a numerical target for the inflation rate; 2. does not rely on a stable money-inflation relationship; 3. there is increased accountability of the central bank; 4. reduces the effects of inflationary shocks.

The disadvantages of inflation targeting include: 1. there is a delayed signal about the achievement of the target; 2. it could lead to a rigid rule where the only focus is the inflation rate (has not happened in practice); 3. if sole focus is the inflation rate, larger output fluctuations can occur (has not happened in practice).