

## Chapter 13 End of Chapter Quiz

1. Suppose the federal funds rate is 3 percent. Bond traders expect it to remain at that level for 3 months and then rise to 3.5 percent for nine months. The three-month rate, six-month rate and one-year rate are:
- A. three-month: 3% + three-month term premium, six-month: 3.5% + six-month term premium , one-year: 3.5% + one-year term premium.
  - B. three-month: 3% + three-month term premium, six-month: 3.25% + six-month term premium, one-year: 3.5% + one-year term premium.
  - C. three-month: 3% + three-month term premium, six-month: 3.25% + six-month term premium, one-year: 3.375% + one-year term premium.
  - D. three-month: 3.25% + three-month term premium, six-month: 3.5% + six-month term premium, one-year: 3.375% + one-year term premium.

**Answer: C**

2. Suppose that bond traders expect an increase in the federal funds rate, but the FOMC surprises them by keeping it constant. What happens to longer-term rates?
- A. Since rates stay constant today, the longer-term rate will not change.
  - B. Since the constant rate today is a surprise, the longer-term rate will not change.
  - C. Since the constant rate today is a surprise, the longer-term rate will have to increase.
  - D. Since the constant rate today is a surprise, the longer-term rate will have to decrease.

**Answer: D**

3. How does a rise in the stock market compare to a rise in housing prices in terms of their impact on aggregate expenditures?
- A. The rise in the housing market will increase  $C$ : the rise in the stock market will increase  $I$ .
  - B. The rise in the housing market will increase  $I$ : the rise in the stock market will increase  $I$ .
  - C. Therise in the stock market will increase  $C$  by more than the rise in the housing market.
  - D. The rise in the housing market will increase  $C$  and  $I$ : the rise in the stock market will increase  $C$  and  $I$ .

**Answer: D**

4. Recent earnings have larger effects on investment for \_\_\_ firms than for \_\_\_ firms.
- A. financial sector; manufacturing sector
  - B. manufacturing sector; financial sector
  - C. small; large
  - D. large; small

**Answer: C**

5. Figure 13.12 shows what happens if the  $AE$  curve shifts out temporarily and the central bank raises the real interest rate. Now suppose the same shock occurs but the central bank keeps the interest rate constant. Assume lags in the  $AE$  and Phillips curves. With constant real interest rates:
- A. output will temporarily increase and inflation will be temporarily higher.
  - B. output will temporarily increase and inflation will be permanently higher.
  - C. output will stay constant and inflation will be permanently higher.
  - D. output will stay constant and inflation will be temporarily higher.

**Answer: B**

6. Consider the expenditure shock in Figure 13.12: the  $AE$  curve shifts to the right in 2020 and returns to its initial position in 2021. Suppose the central bank anticipates the shock: in 2019, it knows what will

happen in the following two years. Assuming lags in the *AE* and Phillips curves, can the central bank keep output and inflation constant?

- A. Output and inflation can be kept constant if the central bank correctly anticipates the *AE* shock.
- B. Only output can be kept constant if the central bank correctly anticipates the *AE* shock.
- C. Only inflation can be kept constant if the central bank correctly anticipates the *AE* shock.
- D. Neither inflation, nor output can be kept constant if the central bank correctly anticipates the *AE* shock.

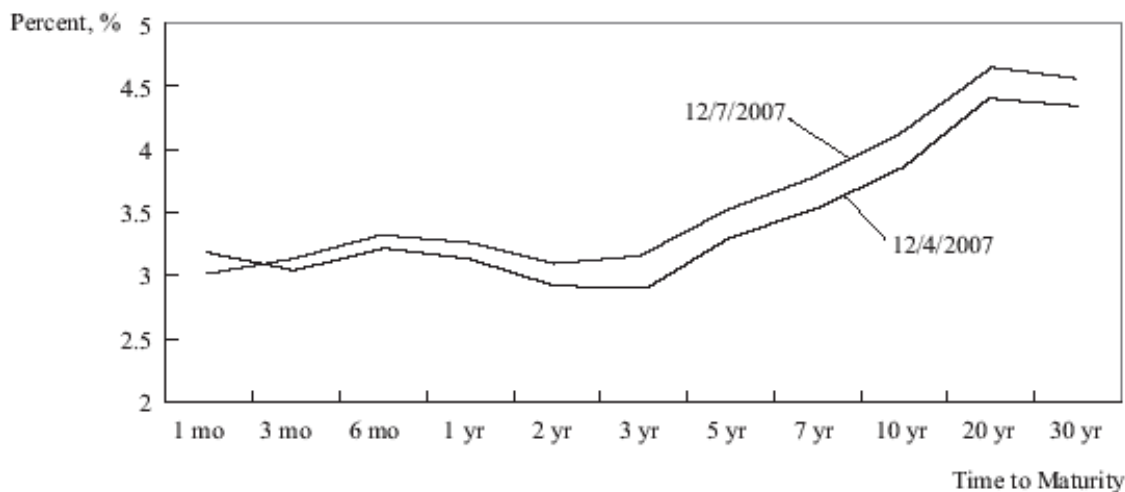
**Answer: A**

7. Consider the *AE/PC* model with time lags. Suppose the economy starts in 2019 with output at potential and constant inflation. In 2020, an adverse supply shock occurs, shifting the Phillips curve up. What are the paths of output and inflation over time if the central bank keeps the real interest rate constant?

- A. Output will temporarily fall and inflation will temporarily rise.
- B. Output will remain constant, but inflation will temporarily rise.
- C. Output will remain constant, but inflation will be permanently higher.
- D. Output will temporarily fall and inflation will be permanently higher.

**Answer: C**

### 8. Figure 13.1: Yield Curves



Reference: Ref 13-1

(Figure 13.1: Yield Curves) Consider the yield curves for December 4 and December 7, 2007. What do you expect happened between these dates?

- A. There was a decrease in the demand for loanable funds.
- B. The FOMC raised the federal funds rate as expected.
- C. There was a decline in expected inflation.
- D. The FOMC unexpectedly raised the federal funds rate.

**Answer: D**

9. According to the \_\_\_\_\_, when the Fed lowers the federal funds rate, longer-term interest rates will \_\_\_\_\_.

- A. expectations theory; rise
- B. liquidity preference model; rise
- C. expectations theory; fall
- D. loanable funds model; fall

**Answer: C**

10. Interest rates that affect aggregate expenditure are mainly:

- A. intermediate rates.
- B. short-term rates.
- C. very short-term rates.
- D. intermediate and long-term rates.

**Answer: D**

11. Empirical evidence that measured the effects of monetary policy on the term structure of interest rates concluded that:

- A. the FOMC's actions had no effect on short- and intermediate-term interest rates.
- B. changes to the federal funds rate had a larger effect on longer-term rates when the change was unexpected.
- C. the expectations theory of the term structure does not provide a good theoretical framework to explain this link.
- D. the FOMC's actions were effective only when intended to increase interest rates.

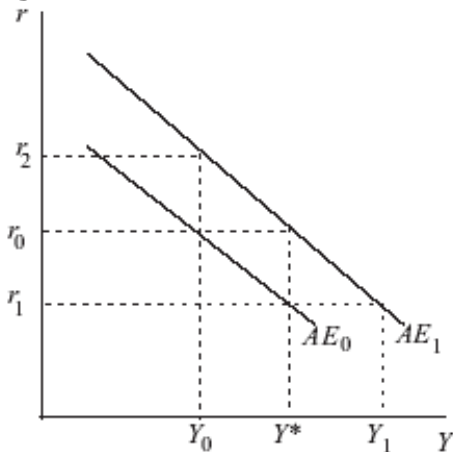
**Answer: B**

12. If stock prices begin to rise:

- A. aggregate household expenditure will rise.
- B. firms will increase their investment expenditures.
- C. banks will be willing to give more loans.
- D. All of the answers are correct.

**Answer: D**

13. Figure 13.2



Reference: Ref 13-2

(Figure 13.2) An increase in home values and stocks will \_\_\_\_\_, because \_\_\_\_\_.

- A. shift the  $AE_0 \rightarrow AE_1$ ; banks are willing to offer more loans
- B. shift the  $AE_0 \rightarrow AE_1$ ; households feel wealthier and increase consumption
- C. shift the  $AE_0 \rightarrow AE_1$ ; firms issue new stock to finance investment
- D. All of the answers are correct.

**Answer: D**

14. (Figure 13.3)

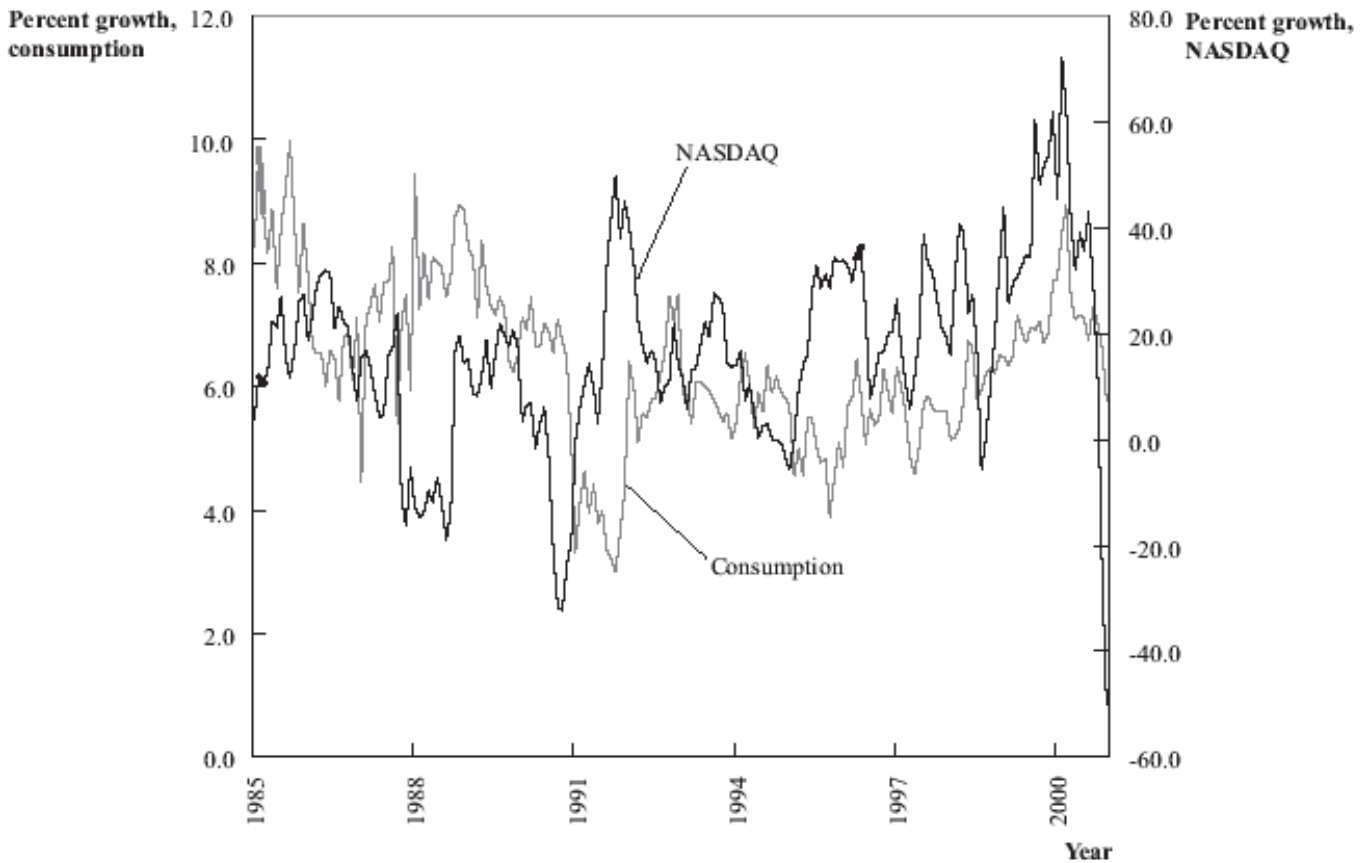


Figure 13.3 shows the annual return to NASDAQ and household consumption growth. This graph shows the \_\_\_\_\_, and in the model of aggregate expenditure an increase in NASDAQ would \_\_\_\_\_.

- A. positive relationship between wealth and consumption; shift the *AE* curve to the right
- B. negative relationship between savings and consumption; shift the *AE* curve to the right
- C. positive relationship between wealth and savings; be a movement along the *AE* to the left
- D. lack of relationship between wealth and consumption; be a movement along the *AE* to the right

**Answer: A**

**15.** A rise in aggregate expenditure \_\_\_\_\_ firms' earnings, which pushes \_\_\_\_\_, which \_\_\_\_\_.

- A. increases; investment down; reduces aggregate expenditure
- B. increases; investment up; increases aggregate expenditure
- C. increases; household income down; reduces aggregate expenditure
- D. reduces; household income down; reduces aggregate expenditure

**Answer: B**

**16.** During the financial crisis that began in 2007, banks reduced their amount of loans because:

- A. the value of borrowers' collateral had fallen.
- B. banks became more conservative.
- C. homeowners began to default on their mortgages.
- D. All of the answers are correct.

**Answer: D**

**17.** In general, an increase in asset prices \_\_\_\_\_ aggregate expenditure: output is \_\_\_\_\_ for any given real interest rate.

- A. raises; higher

- B. lowers; higher
- C. raises; lower
- D. lowers; lower

**Answer: A**

**18.** Which of the following are reasons why banks might change their lending policies?

- A. risk perception
- B. changes in weather
- C. an increase in the price of oil
- D. a decrease in the price of raw materials

**Answer: A**

**19.** The monetary transmission mechanism can be summarized by which of the following?

- A. Federal funds rate  $\downarrow \Rightarrow$  Wealth  $\uparrow \Rightarrow$  Consumption  $\uparrow \Rightarrow AE \uparrow$
- B. Federal funds rate  $\uparrow \Rightarrow$  Longer-term interest rates  $\uparrow \Rightarrow$  Savings  $\uparrow \Rightarrow AE \uparrow$
- C. Federal funds rate  $\uparrow \Rightarrow$  Exchange rate  $\downarrow \Rightarrow$  Net exports  $\uparrow \Rightarrow AE \uparrow$
- D. Federal funds rate  $\downarrow \Rightarrow$  Moral hazard  $\downarrow \Rightarrow$  Investment  $\uparrow \Rightarrow AE \downarrow$

**Answer: A**

**20.** A lesson we get from studying the monetary transmission mechanism is that:

- A. monetary policy only impacts bank lending.
- B. fiscal policy affects expenditures through many different channels.
- C. monetary policy affects expenditures through many different channels.
- D. the monetary policy impacts all sectors of the economy the same.

**Answer: C**

**21.** The monetary transmission mechanism shows:

- A. how changes in the federal funds rate affect output.
- B. how increases in reserve requirements affect loans.
- C. how the Fed conducts open-market operations.
- D. how changes in the money supply affect inflation.

**Answer: A**

**22.** Consider the monetary transmission mechanism. When the federal funds rate increases:

- A. asymmetric information problems are reduced.
- B. the exchange rate increases.
- C. bank lending increases.
- D. capital inflows decrease.

**Answer: B**

**23.** Changes in monetary policy first impact:

- A. output.
- B. financial markets.
- C. inflation.
- D. unemployment.

**Answer: B**

**24.** When the Fed lowers the federal funds rate, the impact on inflation lags output because:

- A. it is difficult for firms to figure out what is happening to demand.
- B. they all must convene and discuss how much to raise prices.
- C. there is no effect of monetary policy on prices.
- D. firms fear they will lose market share when they raise their prices.

**Answer: D**

**25.** The Federal Reserve has announced that it will raise the federal funds rate to slow economic growth and the rate of price increases. When will this change affect output and inflation?

- A. Both output and inflation will start to slow almost immediately.
- B. Inflation will immediately slow as firms scale back their price increases; output will eventually also slow.
- C. Output should start to fall within about 18 months, while it will take about twice as long for inflation to start to fall.
- D. Neither output nor inflation will change because investors anticipate the Fed's moves; only unexpected moves from the Fed can affect the economy.

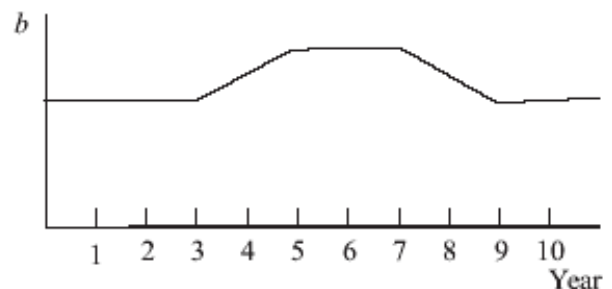
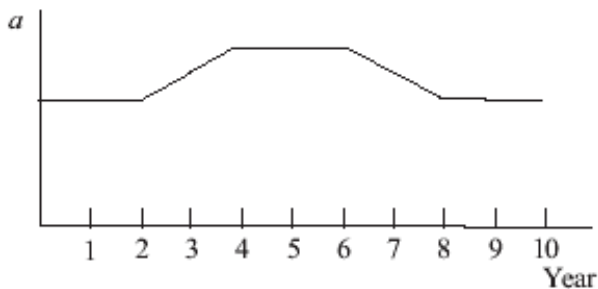
**Answer: C**

**26.** Monetary policy affects firstly financial variables, like \_\_\_\_\_ and then it affects aggregate spending.

- A. technology
- B. the unemployment rate
- C. asset prices
- D. the output gap

**Answer: C**

**27. Figure 13.5**



Reference: Ref 13-3

(Figure 13.5) Given what you know about the impacts of lags associated with monetary policy, and assuming the federal funds rate \_\_\_\_\_ in year 1, the axis labeled *a* is \_\_\_\_\_ and the one labeled *b* is \_\_\_\_\_.

- A. is lowered; inflation; output
- B. is lowered; output; inflation
- C. is raised; the nominal interest rate; output
- D. remains the same; inflation; unemployment

**Answer: B**

**28.** According to the money transmission model introduced in Chapter 13, a decrease in the federal funds rate in the year 2013 will cause output to \_\_\_\_\_ in \_\_\_\_\_ and inflation to rise in \_\_\_\_\_.

- A. rise; 2014; 2015
- B. fall; 2015; 2014

- C. remain unchanged; the future; 2015
- D. There is not enough information provided to answer the question.

**Answer: A**

29. The time between the policy response and the effects on the economy is called the \_\_\_\_\_ lag.
- A. inside
- B. outside
- C. policy
- D. effectiveness

**Answer: B**

30. The subprime mortgage crisis became apparent to policymakers in \_\_\_\_\_ and the president and Congress didn't enact a fiscal stimulus until \_\_\_\_\_. This is an example of a long \_\_\_\_\_.
- A. Summer 2007; February 2008; inside lag
- B. Summer 2007; Fall 2007; outside lag
- C. January 2008; May 2008; inside lag
- D. Summer 2007; October 2008; outside lag

**Answer: A**

31. When considering monetary policy, the inside lag is:
- A. as lengthy as the outside lag.
- B. shorter than the outside lag.
- C. lengthier than the outside lag.
- D. 3 months.

**Answer: B**

32. Which of the following actions are considered instruments of monetary policy?
- A. a decrease in government spending
- B. changes in the federal funds rate
- C. an increase in income taxes
- D. a decrease in labor income taxes

**Answer: B**

33. The federal funds rate has no impact on longer-term interest rates.

**Answer: False**

34. You read in the paper that bond rates have fallen; from this you deduce that traders expect the Fed to raise the federal funds rate.

**Answer: False**

35. Interest rates that affect aggregate expenditure are mainly intermediate and long-term interest rates.

**Answer: True**

36. Longer-term rates always respond to changes in the federal funds rate announced by the Fed, even if

the announcement is not a surprise.

**Answer:** False

**37.** Consider an unexpected change in the federal funds rate target. The effects of the change in the federal funds rate die out for longer maturities rates.

**Answer:** True

**38.** An increase in stock market values leads to an increase in aggregate expenditure.

**Answer:** True

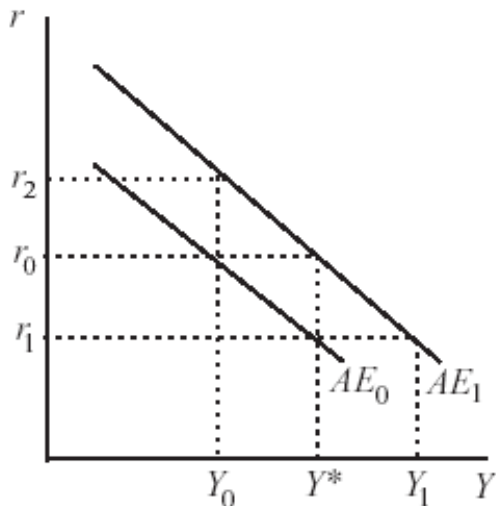
**39.** If stock prices rise, banks would prefer to lend less in favor of buying Treasury bills.

**Answer:** False

**40.** A fall in the Dow Jones industrial index will lead to a rightward shift in the aggregate expenditure function.

**Answer:** False

**41. Figure 13.6**

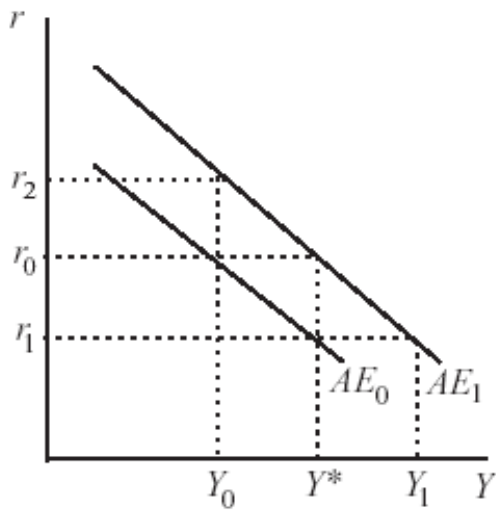


Reference: Ref 13-1

(Figure 13.6) A decline in stock markets will shift the  $AE_0 \rightarrow AE_1$ .

**Answer:** False

**42. Figure 13.6**



Reference: Ref 13-1

(Figure 13.6) An increase in the nominal interest rate will shift the  $AE_1 \rightarrow AE_0$ .

**Answer:** True

43. In general, an increase in asset prices raises aggregate expenditure.

**Answer:** True

44. An increase in asset prices increases net worth and the value of collateral, thereby making banks more willing to lend.

**Answer:** True

45. According to the investment multiplier concept, as aggregate expenditure rises, firms can finance their investments more cheaply, thereby amplifying the original increase in aggregate expenditure.

**Answer:** True

46. Two broad lessons come from examining the monetary transmission mechanism:

- monetary policy affects aggregate spending through only one channel; and
- policy impacts all sectors of the economy identically.

**Answer:** False

47. One version of the monetary transmission mechanism can be summarized as:  
Federal funds rate  $\uparrow \Rightarrow$  Wealth  $\uparrow \Rightarrow$  Consumption  $\uparrow \Rightarrow$   $AE \uparrow$ .

**Answer:** False

48. According to the consumption multiplier, lower spending means higher income for consumers, which results in more consumption.

**Answer:** False

49. According to the consumption multiplier, lower spending means higher income for consumers, which results in more consumption.

**Answer:** False

50. Monetary policy affects aggregate expenditure only through changes in investment.

**Answer:** False

51. Monetary policy affects all sectors of the economy equally.

**Answer:** False

52. A tightening of monetary policy generally impacts output first, then inflation.

**Answer:** True

53. Firms may be reluctant to raise their prices immediately when output rises because they don't want to lose market share.

**Answer:** True

54. A change in the federal funds rate affects spending directly, which in turn affects financial variables.

**Answer:** False

55. The time between an economic shock and the policy response is the outside lag.

**Answer:** False

56. The inside lag for monetary policy's response to a shock is shorter than it is for fiscal policy's response.

**Answer:** True

57. If the Fed conducts countercyclical policy during an economic downturn, it may cause a recession, because of rational expectations.

**Answer:** False

58. The outside lag is the time it takes the policy response to affect the economy.

**Answer:** True

59. Changes in government spending or taxes must be introduced in Congress, slowing down the inside lag for fiscal policy.

**Answer:** True

60. In addition to changes in asset prices, which of the following may also *discourage* bank lending?

- I. Risk perceptions
- II. Changes in regulation
- III. A reduction in capital requirements

A. I

- B. II
- C. I and II
- D. II and III

**Answer: C**

- 61.** If a change in the target interest rate is expected, actual interest rates will change:
- A. immediately following the announcement of the change.
  - B. gradually over the week following the announcement of the change.
  - C. before the announcement of the change.
  - D. beginning two hours before the announcement and continuing for 37 hours after the announcement.

**Answer: C**

- 62.** A major cause of the time lag of monetary policy is:
- A. it takes weeks for financial asset prices and interest rates to adjust to a change in the target interest rate.
  - B. interest rate changes generally affect the economy by altering investment spending. Investment projects require months of planning, delaying the impact of the interest rate changes.
  - C. it takes months for the Treasury to print new currency and even longer for the Fed to get the new currency into circulation.
  - D. banks need months to evaluate loan applications. Until those loans are approved, investment projects cannot be started.

**Answer: B**

- 63.** One of the major routes for monetary policy to influence the economy is via impacts on investment spending. There are several ways monetary policy affects investment. Which of the following is *not* one of those routes?
- A. Higher interest rates increase the attractiveness of financial assets. Households purchase more of those assets, increasing investment.
  - B. Higher long-term interest rates increase the cost of investment. This causes a reduction in the quantity of investment demanded.
  - C. Higher interest rates cause asset prices to fall. Therefore the value of loan collateral falls, meaning the volume of loans shrinks. Fewer loans mean less investment spending.
  - D. Higher long-term interest rates make the problems of adverse selection and moral hazard worse. The volume of loans shrinks, causing investment spending to fall.

**Answer: A**

- 64.** A tightening of monetary policy by the Fed reduces investment because
- A. banks reduce lending.
  - B. reduced asset prices reduce consumers' wealth.
  - C. the exchange rate appreciates.
  - D. firms' earnings increase.

**Answer: A**

- 65.** A countercyclical policy response to a positive expenditure shock when there are time lags
- A. keeps output from fluctuating.
  - B. will reduce output in a future year.
  - C. keeps inflation constant.
  - D. requires a reduction of inflation to keep the inflation rate from permanently increasing.

**Answer: B**

66. If market interest rates do not change when a change in the target federal funds rate is announced, the likely explanation is that
- A. the markets expects the Fed to reverse the interest rate change at its next meeting, since the Fed frequently reverse its monetary policy.
  - B. the federal funds rate change was expected.
  - C. the federal funds rate change was a surprise.
  - D. changes in the federal funds rate have no effect on other interest rates.

**Answer: B**

67. Investment will increase when
- A. banks' perceptions of the risk of lending increase.
  - B. regulators discourage banks from taking too much risk.
  - C. banks experience a capital crunch.
  - D. asset prices increase firms' net worth.

**Answer: D**