ECN2102_241129–5_Training (Chapter 14)

Choose the one alternative that best completes the statement or answers the question.

1) When the output gap is positive, it represents ________ gap, and when it is negative, it represents ________ gap. 1) ________

A) an inflationary; an employment
B) an inflationary;a recessionary
C) a recessionary; an inflationary
D) an employment;an unemployment

2) The output gap is the 2) ________

A) percentage deviation of real GDP from potential GDP.
B) percentage increase in the economic growth rate of real GDP.
C) difference in graduation levels between high school and college.
D) difference between actual inflation and core inflation.

3) Equilibrium in the market for bank reserves determines the 3) ________

A) federal funds rate.
B) exchange rate.
C) 30–year Treasury bond rate.
D) inflation rate.

4) By using open market operations, the Federal Reserve 4) ________

A) adjusts the supply *and* demand of reserves to keep the federal funds interest rate equal to its target.
B) controls banks' demand for reserves, thereby keeping the federal funds rate equal to its target.
C) adjusts the supply of reserves to keep the federal funds interest rate equal to its target.
D) adjusts the demand of reserves to keep bank rates in line with the federal funds rate target.

5) To increase the quantity of money in the economy, the Federal Reserve is likely to 5) ________

A) sell government securities in an open market operation.
B) lower tax rates
C) buy government securities in an open market operation.
D) print more money and give it to the banks.

6) If the Fed wants to increase the quantity of money, it can 6) ________

A) increase the government budget deficit.
B) purchase U.S. government securities.
C) lower income tax rates.
D) raise the exchange rate.

7) When the Fed raises the federal funds rate, 7) ________

A) consumption increases.
B) net exports increase.
C) the value of the dollar rises on the foreign exchange market.
D) the value of the dollar falls on the foreign exchange market.

8) Suppose that initially real GDP equals potential GDP. Then an increase in aggregate demand occurs. According to the Taylor rule, the Fed should ________ the federal funds rate by ________ government securities in the open market. 8) ________

A) raise; selling
B) lower; selling
C) lower; buying
D) raise; buying

9) A rise in the federal funds rate 9) ________

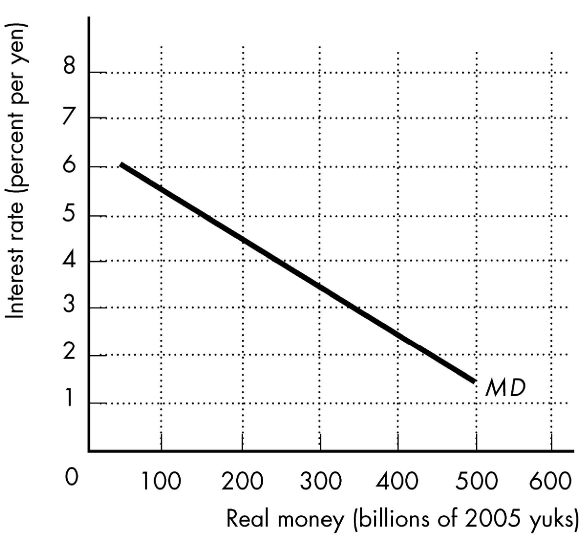
A) lowers the long–term real interest rate.
B) does not change the long–term real interest rate.
C) may raise or lower the long–term real interest rate, depending on whether the demand for loanable funds curve has a negative or a positive slope.
D) raises the long–term real interest rate.

10) The Taylor rule 10) _______
A) ignores price level stability to focus on responding to fluctuations in real GDP.
B) focuses on only fluctuations in real GDP.
C) is the rule actually followed by the Fed.
D) shows how the Fed could set the federal funds rate.

11) Suppose the equilibrium real interest rate is 2 percent per year, inflation is 2.5 percent and the output gap is 1 percent. Using the Taylor rule, what is the federal funds rate? 11) _______
A) 3.5 percent B) 3 percent C) 5.5 percent D) 5.25 percent

12) Suppose the inflation rate is 3 percent and the output gap is –1 percent. Assuming the equilibrium real interest rate is 2 percent, using the Taylor rule, what target should the Fed set for the federal funds rate? 12) _______
A) 1 percent B) 4 percent C) 5 percent D) 6 percent

Write your answer in the space provided or on a separate sheet of paper.



13) The figure above shows the demand for money in Kiteland.
a) If the Kiteland Central Bank has set the quantity of money so that the equilibrium interest rate is 4 percent, draw the supply of money curve.
b) Suppose that Kiteland's Central Bank wants to raise the interest rate by 1 percentage point. By how much must it change the quantity of real money?
c) In order to change the quantity of money to raise the interest rate by one percentage point, if the Central Bank uses an open market operation, does it make an open market purchase or an open market sale? Explain your answer.