CHAPTER 14

Monetary Policy

1. What does the Federal Reserve do?

2. How is monetary policy set?

3. What are the tools of monetary policy?

4. What role do central banks play in the foreign exchange market?

5. What are the determinants of the demand for money?

6. How does monetary policy affect the equilibrium level of real GDP?

DEFINE

Federal Open Market Committee (FOMC)

equation of exchange

velocity of money

quantity theory of money

FOMC directive

federal funds rate

legal reserves

discount rate

open market operations

foreign exchange market intervention

sterilization

transactions demand for money

precautionary demand for money

1. There are several tools that the Fed uses to implement monetary policy. Briefly describe each tool, and how the Fed would use each if it wanted to increase the money supply.

2. Draw a graph showing the equilibrium in the money market. Carefully label all curves and axes, and explain why the curves have the slopes that they do.

3. If the Fed increases the money supply, what will happen to each of the following?

   a. Interest rates

   b. Money demand

   c. Investment spending

   d. Aggregate demand

Assume that an initial savings of $250 occurs and the reserve ratio is 5%. Calculate the Deposit, Reserve and Loan for each of the 5 next potential transactions.

	Deposit	Reserve	Loan
Loan 1	250		
Loan 2			
Loan 3			
Loan 4			
Loan 5			
		Total Amount Loaned	

Assume that an initial savings of $50,000 occurs and the reserve ratio is 10%. Calculate the Deposit, Reserve and Loan for each of the 5 next potential transactions.

	Deposit	Reserve	Loan
Loan 1	50000		
Loan 2			
Loan 3			
Loan 4			
Loan 5			
		Total Amount Loaned	