University of Lethbridge — Department of Economics
ECON 1012 — Introduction to Microeconomics
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Chapter 30 — Monetary Policy

1) Core inflation is the percentage change in
   A) the Consumer Price Index including the eight most volatile prices.
   B) the target midpoint inflation rate of 2 percent per year.
   C) the Consumer Price Index excluding the eight most volatile prices.
   D) the average of the 8 most volatile prices in the Consumer Price Index.
   E) an inflation rate that ranges between 1 percent and 3 percent annually.

   Topic: Monetary Policy Objective and Framework

2) How is responsibility for monetary policy set forth in Canada?
   A) The Bank of Canada administers monetary policy as directed by the Minister of Finance.
   B) The Bank of Canada Act places responsibility for the conduct of monetary policy on the Bank's Governing Council.
   C) The Prime Minister bears ultimate responsibility for monetary policy.
   D) The Canadian Government administers monetary policy through the office of the Minister of Finance.
   E) Both B and D.

   Topic: Monetary Policy Objective and Framework

3) Which of the following benefits flow from the application of an inflation-control target?
   A) The monetary authorities can change the target range whenever they feel it is appropriate.
   B) If actual inflation exceeds the target range, the Bank of Canada can induce a recession to correct the matter.
   C) People can make decisions with an understanding that inflation rates will remain relatively low.
   D) Financial market traders have a clearer understanding of the Bank of Canada's intentions.
   E) Both C and D.

   Topic: Monetary Policy Objective and Framework

4) Which of the following issues is a concern that critics express about the use of an inflation-control target?
   A) Monetary policy tends to be sensitive to the state of employment while focusing on inflation control targets.
   B) The policy control rests in the hands of elected officials rather than in the hands of civil servants.
   C) It encourages a focus on inflation at the expense of employment and real GDP growth.
   D) It encourages a focus on real GDP growth at the expense of employment and of inflation.
   E) The policy control rests in the hands of civil servants rather than in the hands of elected officials.

   Topic: Monetary Policy Objective and Framework

5) Who are the members of the Bank of Canada's Governing Council?
   A) The Prime Minister, the Minister of Finance, and the Bank's Governor.
   B) The Bank's Governor, Senior Deputy Governor, and four Deputy Governors.
   C) The Ministers of Finance from each province as well as the Federal Minister of Finance.
   D) The Bank's Governor, Senior Deputy Governor, and four Deputy governors who are appointed by the Prime Minister to represent the public interest.
   E) The Minister of Finance, the Governor, and four Deputy Governors.

   Topic: Monetary Policy Objective and Framework

6) How is consultation between the Bank of Canada and the Government of Canada on monetary policy arranged?
A) Consultations are arranged through the Parliamentary Committee on Finance.
B) Consultations are arranged at the discretion of the Minister of Finance.
C) No consultation is required or needed.
D) The Bank of Canada Act requires regular consultations between the Governor and the Minister of Finance.
E) Consultations are arranged at the discretion of the Governor of the Bank of Canada.

Topic: Monetary Policy Objective and Framework

7) Why does the Bank of Canada pay close attention to the core inflation rate in addition to the overall CPI inflation rate?
A) The core rate includes taxes, while the overall CPI rate does not.
B) The core rate has a lower average value and therefore makes the Bank look better.
C) The core rate is more volatile and therefore a better predictor of trend inflation.
D) The core rate excludes eight volatile prices and is therefore more likely to stay within the target band.
E) The core rate is less volatile and a better predictor of future CPI inflation.

Topic: Monetary Policy Objective and Framework

8) One criticism of the Bank of Canada's focus on an inflation control target is that
A) it makes setting expectations of inflation difficult.
B) if inflation falls below the target range a recession will result.
C) the Bank rarely achieves its target.
D) if inflation edges above the target range, the Bank decreases aggregate demand and could create a recession.
E) the Bank pays too much attention to unemployment and real GDP growth and not enough to inflation control.

Topic: Monetary Policy Objective and Framework

9) The objective of the Bank of Canada's monetary policy is
A) to control the quantity of money and interest rates to avoid inflation and when possible prevent excessive swings in real GDP growth and unemployment.
B) to keep the unemployment rate below 5 percent, the inflation rate between 1 and 3 percent a year, and long-term interest rates below 4 percent a year.
C) to keep the unemployment rate below 5 percent, the inflation rate between 1 and 3 percent a year, and long-term real GDP growth above 4 percent a year.
D) to keep the labour force participation rate above 80 percent, the inflation rate below 2 percent a year, and the exchange rate fluctuating by less than 3 percent a year.
E) to keep the overnight loans rate below 2 percent a year and the unemployment rate at its natural rate.

Topic: Monetary Policy Objective and Framework

10) The two parts of the inflation-control target are that the inflation-control target range will be ________ percent a year, and policy will aim at keeping the trend of inflation at ________ percent a year.
A) -1 to 1; 0
B) 1 to 3; 2
C) 3 to 5; 4
D) 0 to 2; 1
E) 2 to 4; 3

Topic: Monetary Policy Objective and Framework

11) All of the following statements are true *except*
A) the Bank of Canada's target is to keep the trend CPI inflation at 2 percent a year.
B) between 1995 and 2000, the core CPI inflation rate and the CPI inflation rate followed the same trends.
C) the core inflation rate excludes the eight most volatile elements of the overall CPI inflation rate.
D) the inflation-control target uses the core CPI inflation rate.
E) since 2000, the core inflation rate has run at about 0.5 percent a year below the overall CPI inflation rate.

Topic: Monetary Policy Objective and Framework

12) As the sole issuer of Canadian money, the Bank of Canada can set any one of three variables:
A) the exchange rate, the interest rate, and the inflation rate.
B) the money base, the interest rate, and the unemployment rate.
C) the monetary base, the exchange rate, and the short term interest rate.
D) the rate of inflation, the interest rate, and the unemployment rate.
E) the inflation rate, the unemployment rate, and the real economic growth rate.

Topic: The Conduct of Monetary Policy

13) What is the overnight loans rate?
A) The volume of loans that take place during the night.
B) The interest rate that the Bank of Canada charges chartered banks.
C) The percentage change in the volume of loans that take place overnight.
D) The interest rate that the Bank of Canada pays when it buys securities from chartered banks.
E) The interest rate on loans that members of the Large Value Transfer System make to each other.

Topic: The Conduct of Monetary Policy

14) How can the Bank of Canada use the bank rate to regulate the overnight loans rate?
A) The overnight loans rate is set at a quarter percentage point above the bank rate, which in turn is set by the Bank of Canada.
B) The bank rate is set at the settlement balances rate plus 0.25 percentage points.
C) The overnight loans rate is set at 25 basis points above the bank rate.
D) The bank rate is set at the target overnight rate plus 0.25 percentage points.
E) The bank rate is set at 0.25 percentage points below the settlement balances rate, which is used to determine the overnight loans rate.

Topic: The Conduct of Monetary Policy

15) 25 basis points is
A) the spread between the savings rate and the lending rate.
B) the gap by which real GDP exceeds potential GDP.
C) a quarter of a percentage point.
D) a quarter of the Bank of Canada's target inflation rate.
E) the spread between the bank rate and the settlement balances rate.

Topic: The Conduct of Monetary Policy

16) An instrument rule is a monetary policy rule that sets the policy instrument
A) based on the current state of the economy.
B) at a rate counter-cyclical to the current inflation rate.
C) at the discretion of the monetary authority.
D) based on the overnight loans rate.
E) at a level that makes the forecast of the policy target equal to the target.

Topic: The Conduct of Monetary Policy

17) A targeting rule is a monetary policy rule that sets the policy instrument
A) based on the current state of the economy.
B) at a rate counter-cyclical to the current inflation rate
C) based on the overnight loans rate.
D) at the discretion of the monetary authority.
E) at a level that makes the forecast of the policy target equal to the target.

Topic: The Conduct of Monetary Policy

18) The operating band is

A) the target inflation rate plus or minus a quarter of a percentage point.
B) the target overnight interest rate plus or minus 25 basis points.
C) the range between the lending rate and the borrowing rate.
D) the interest rate that is established through an open market operation.
E) a half percentage point range in the target inflation rate.

Topic: The Conduct of Monetary Policy

19) The settlement balances rate is the

A) ratio of the value securities sold by the Bank of Canada to securities outstanding.
B) proportion of outstanding loans from chartered banks that are resolved.
C) interest rate paid to chartered banks on their reserves held at the Bank of Canada.
D) proportion of overnight inter-bank loans that are resolved.
E) interest rate that the Bank of Canada charges LVTS-participating banks on loans.

Topic: The Conduct of Monetary Policy

20) The policy tools used by the Bank of Canada include

A) prime rate and bank rate.
B) open market operations and prime rate.
C) the exchange rate and open market operations.
D) prime rate and the exchange rate.
E) the operating band and open market operations.

Topic: The Conduct of Monetary Policy

21) How does the Bank of Canada set the bank rate?

A) The bank rate is set at a quarter percentage point above the overnight loans rate.
B) The Bank of Canada does not determine the bank rate.
C) The bank rate is set at 25 basis points above the operating band.
D) The bank rate is set at a quarter percentage point above the prime lending rate.
E) The bank rate is set at a quarter percentage point below the overnight loans rate.

Topic: The Conduct of Monetary Policy

22) An open market operation

A) refers to the Bank of Canada's sales and purchases of corporate stock.
B) refers to loans made by the Bank of Canada to chartered banks.
C) refers to the purchase or sale of Canadian currency in exchange for foreign currency.
D) can change bank deposits but cannot alter the quantity of money.
E) is the purchase or sale of government of Canada securities by the Bank of Canada from or to a chartered bank or the public.

Topic: The Conduct of Monetary Policy

23) The bank rate is the interest rate

A) banks charge their very best loan customers.
B) banks pay on term deposits.
C) the Bank of Canada pays on reserves held by banks.
D) received for holding Government of Canada Treasury Bills.
E) the Bank of Canada charges when it lends reserves to LVTS-participating banks.

Topic: The Conduct of Monetary Policy

24) The overnight loans rate is the interest rate
A) the Bank of Canada pays on reserves held by banks.
B) on overnight loans that members of the Large Value Transfer System make to each other.
C) banks pay on term deposits.
D) banks charge their best loan customers.
E) the Bank of Canada charges when it lends reserves to banks.

Topic: The Conduct of Monetary Policy

25) The Bank of Canada can lower the overnight loans rate by
A) raising the bank rate.
B) lowering the bank rate.
C) raising the settlement balances rate.
D) lowering the settlement balances rate.
E) both B and D.

Topic: The Conduct of Monetary Policy

26) The sale of government bonds by the Bank of Canada
A) increases the banks' loans to the public.
B) increases bank reserves.
C) increases the quantity of money.
D) lowers interest rates.
E) decreases bank reserves.

Topic: The Conduct of Monetary Policy

27) The purchase of government bonds by the Bank of Canada
A) tightens credit conditions.
B) decreases the price of bonds.
C) fights inflation.
D) decreases bank reserves.
E) increases bank loans.

Topic: The Conduct of Monetary Policy

28) If the Bank of Canada aims to lower the overnight rate, it will
A) lower the bank rate and settlement balances rate, as well as buy government securities.
B) lower the bank rate and settlement balances rate, as well as sell government securities.
C) lower the bank rate, increase the settlement balances rate, as well as buy government securities.
D) raise the bank rate and settlement balances rate, as well as sell government securities.
E) raise the bank rate and settlement balances rate, as well as buy government securities.

Topic: The Conduct of Monetary Policy

29) In an open market operation aimed at increasing expenditure, the Bank of Canada
A) sells government bonds, decreasing bank reserves, increasing lending, increasing the overnight rate.
B) sells government bonds, decreasing bank reserves, decreasing lending, decreasing the overnight rate.
C) buys government bonds, increasing bank reserves, increasing lending, decreasing the overnight rate.
D) sells government bonds, decreasing bank reserves, decreasing lending, increasing the overnight rate.
E) buys government bonds, increasing bank reserves, increasing lending, increasing the overnight rate.

Topic: The Conduct of Monetary Policy

30) The current overnight loans rate is 3 percent, with the Bank of Canada's operating band set at 2.75 to 3.25 percent. If the Bank of Canada lowers their operating band to 2.25 to 2.75 percent, which of the following is one of the reasons the overnight rate will fall to within this new range?

A) Since the banking system can now borrow from the Bank of Canada at 2.75 percent, no bank would borrow on the overnight loan market at 3 percent.
B) Since the banking system can now earn 2.75 percent from the Bank of Canada, no bank would lend on the overnight loan market at 3 percent.
C) Since the banking system can now earn 2.25 percent from the Bank of Canada, no bank would lend on the overnight loan market at 3 percent.
D) Since the banking system can now borrow from the Bank of Canada at 2.25 percent, no bank would borrow on the overnight loan market at 3 percent.
E) There is a legal requirement that the overnight rate must be within the Bank of Canada's operating band.

Topic: The Conduct of Monetary Policy

31) When the Bank of Canada buys securities, reserves ________. The Bank of Canada's assets ________ and its liabilities ________.

A) increase; increase; increase
B) decrease; decrease; decrease
C) increase; increase; decrease
D) decrease; decrease; increase
E) increase; decrease; increase

Topic: The Conduct of Monetary Policy

32) When the Bank of Canada sells securities, the interest rate ________. The Bank of Canada's assets and liabilities ________.

A) rises; decrease
B) falls; increase
C) rises; increase during an expansion and decrease during a recession
D) falls; increase
E) rises; decrease

Topic: The Conduct of Monetary Policy

33) The overnight rate is determined by equilibrium in the market for ________. The overnight rate ________.

A) loanable funds; equals the real interest rate minus the inflation rate
B) reserves; equals the real interest rate minus the inflation rate
C) money; equals the real interest rate
D) loanable funds; equals the real interest rate
E) reserves; is the rate that sets the quantity of reserves demanded equal to the quantity of reserves supplied

Topic: The Conduct of Monetary Policy

34) If the Bank of Canada buys government bonds, all of the following happens *except*

A) the bank rate rises.
B) net exports increase.
C) the supply of money increases.
D) the supply of loanable funds increases.
E) bank reserves increase.

Topic: Monetary Policy Transmission

35) Which of the following quotations *correctly* describes the impact of monetary policy on the economy?
A) "The tightening of money growth is helping sell goods abroad."
B) "Businesses are investing more, now that monetary policy has become less expansionary."
C) "House sales are down lots, due to the higher money growth."
D) "The extra money pumped into the economy by the central bank is creating less exports."
E) "The extra money pumped into the economy by the central bank is creating more jobs."

Topic: Monetary Policy Transmission

36) Which of the following quotations *correctly* describes the impact of monetary policy on the economy?
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B) "Businesses are investing more, now that monetary policy has become less expansionary."
C) "The extra money pumped into the economy by the central bank is creating fewer jobs."
D) "The tightening of money growth is helping sell goods abroad."
E) "House sales are down lots, due to the higher money growth."

Topic: Monetary Policy Transmission

37) Monetary policy is difficult to conduct because
A) the monetary policy transmission process is long and drawn out.
B) the tools available don't work.
C) the interest rate always rises.
D) politicians frequently block the policy's intended outcomes.
E) it takes several years for the real GDP growth rate to respond to a change in the interest rate.

Topic: Monetary Policy Transmission

38) To lower interest rates, the Bank of Canada can
A) raise the exchange rate.
B) raise the bank rate.
C) increase the treasury bill rate.
D) decrease bank reserves.
E) buy government securities.

Topic: Monetary Policy Transmission

39) To decrease aggregate demand, the Bank of Canada can
A) lower the overnight loans rate, which decreases the quantity of money.
B) raise the overnight loans rate, which decreases the quantity of money.
C) raise the overnight loans rate, which decreases the government budget deficit.
D) raise the overnight loans rate, which increases the quantity of money.
E) lower the overnight loans rate, which increases the quantity of money.

Topic: Monetary Policy Transmission

40) Which of the following statements *correctly* describes an anti-inflationary monetary policy?
A) "The Bank of Canada's recent purchases of government securities is stimulating the housing sector."
B) "The Bank of Canada's recent moves to increase the overnight loans rate are leading to less lending and less consumer spending."
C) "The Bank of Canada's recent sales of government securities are stimulating the housing sector."
D) "The Bank of Canada's recent moves to lower interest rates are behind the recent decreases in the value of the Canadian dollar."
E) "The Bank of Canada's recent moves to decrease the value of the Canadian dollar are leading to more spending in the economy."

Topic: Monetary Policy Transmission

41) Which statement below best expresses the relationship between the 3 –month Treasury bill rate and the overnight loans rate? The rates are

A) similar because they are both required to remain with the Bank of Canada's operating band.
B) similar because banks can readily substitute between them.
C) not similar because the treasury bill rate is set by the Government of Canada whereas the overnight loans rate is set by the Bank of Canada.
D) not similar because the treasury bill rate is established through the financial markets whereas the overnight loans rate is set by the Bank of Canada.
E) not similar because banks can not readily substitute between them.

Topic: Monetary Policy Transmission

42) An increase in the quantity of money leads to

A) an increase in short–run aggregate supply.
B) an increase in aggregate demand.
C) a decrease in real GDP.
D) a decrease in the price level.
E) a decrease in net exports.

Topic: Monetary Policy Transmission

43) In a situation of inflationary pressure, an increase in the overnight loans rate results in

A) an increase in real GDP, but a fall in the price level.
B) an increase in real GDP and the price level.
C) a fall in the price level and real GDP.
D) an increase in real GDP, but no change in the price level.
E) a rise in the price level, but no change in real GDP.

Topic: Monetary Policy Transmission

44) The purchase of government bonds by the Bank of Canada

A) decreases the supply of loanable funds.
B) increases aggregate demand.
C) decreases the quantity of money.
D) decreases bank reserves.
E) raises the overnight loans rate.

Topic: Monetary Policy Transmission

Use the figure below to answer the following questions.

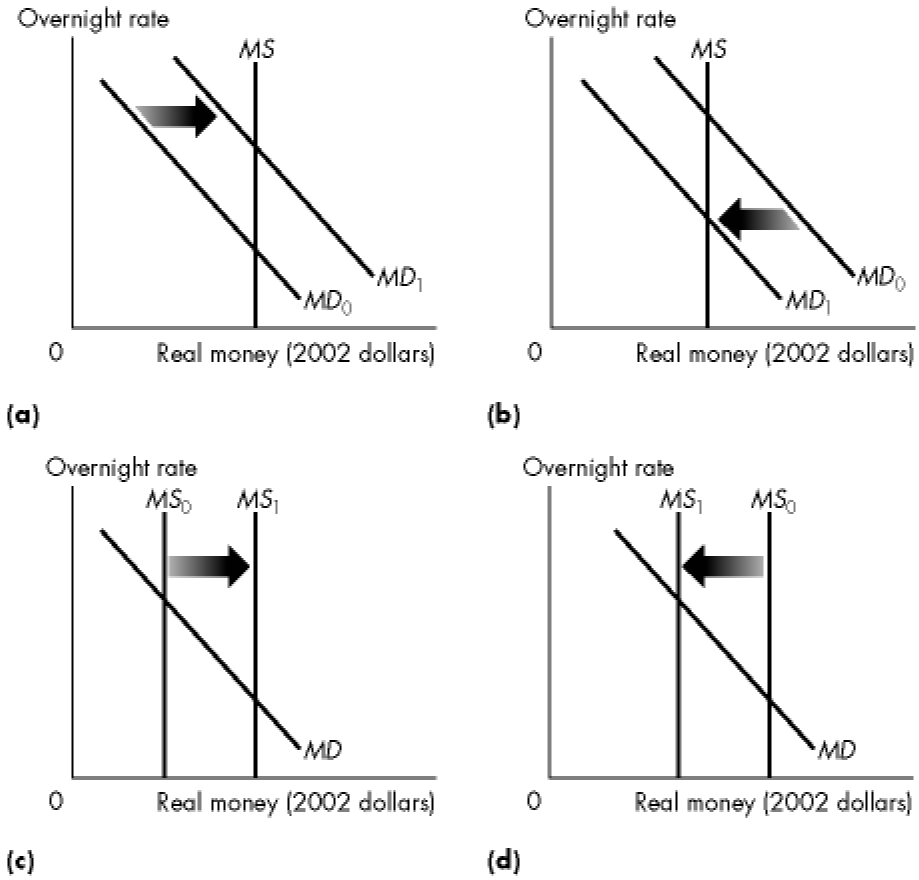

Figure 30.3.1

45) Refer to Figure 30.3.1. Everything else remaining the same, which graph best illustrates the effect of a Bank of Canada open market purchase of government securities?

A) (a)
B) (b)
C) (c)
D) (d)
E) none of the above

Topic: Monetary Policy Transmission

46) Refer to Figure 30.3.1. Everything else remaining the same, which graph best illustrates the effect of a Bank of Canada sale of government securities?

A) (a)
B) (b)
C) (c)
D) (d)
E) none of the above

Topic: Monetary Policy Transmission

47) If the Bank of Canada buys government securities in the open market, the supply curve of real money shifts
A) rightward and the overnight rate remains constant because the demand for money increases at the same time.
B) rightward and the overnight rate rises.
C) leftward and the overnight rate falls.
D) leftward and the overnight rate rises.
E) none of the above.

Topic: Monetary Policy Transmission

48) Which of the following statements about the overnight loans rate is false?
A) The overnight loans rate is never less than the 10-year government bond rate.
B) The higher the overnight loans rate, the greater the quantity of money.
C) The overnight loans rate and the treasury bill rate move closely together.
D) The overnight loans rate and the 10-year government bond rate trend in the same direction.
E) The overnight loans rate is never less than the long-term corporate bond rate.

Topic: Monetary Policy Transmission

49) If the Bank of Canada lowers the overnight loans rate, the exchange rate ________, imports ________, and exports ________.
A) rises; increase; increase
B) falls; increase; decrease
C) falls; decrease; decrease
D) falls; decrease; increase
E) rises; increase; decrease

Topic: Monetary Policy Transmission

50) If Canadian interest rates rise, the exchange rate value of the dollar ________ and net exports ________.
A) falls; increase
B) rises only if the U.S. interest rates fall concurrently; decrease
C) rises; decrease
D) falls; decrease
E) rises; increase

Topic: Monetary Policy Transmission

51) When the Bank of Canada lowers the overnight loans rate, the Canadian dollar ________ on the foreign exchange market and ________.
A) falls; aggregate demand increases
B) falls; the increase in imports is greater than the increase in exports
C) falls; aggregate demand decreases
D) rises; aggregate demand decreases
E) rises; U.S. aggregate demand decreases

Topic: Monetary Policy Transmission

52) The ripple effects that occur when the Bank of Canada sells securities in the open market include ________.
A) an increase in short-run aggregate supply
B) an increase in net exports
C) a decrease in short-run aggregate supply
D) a decrease in consumption expenditure and investment
E) a decrease in short-run interest rates

Topic: Monetary Policy Transmission

53) The Bank of Canada raises the overnight loans rate. In the foreign exchange market people ________ dollars and the price of the dollar ________ because the Canadian interest rate differential ________.

A) buy; falls; rises
B) buy; rises; falls
C) sell; falls; falls
D) buy; rises; rises
E) sell; rises; falls

Topic: Monetary Policy Transmission

54) If the Bank of Canada lowers the overnight loans rate,

A) other short-term interest rates fall.
B) other short-term interest rates rise.
C) the exchange rate falls.
D) the long-term interest rate falls.
E) A, C and D are correct.

Topic: Monetary Policy Transmission

55) When the Bank of Canada lowers the overnight loans rate, the Canadian interest rate differential ________ and the Canadian dollar ________ on the foreign exchange market.

A) rises; appreciates
B) rises; depreciates
C) falls; depreciates
D) falls; changes to equal the value of the U.S. dollar
E) falls; appreciates

Topic: Monetary Policy Transmission

56) If the Bank of Canada lowers the overnight loans rate, other short-term interest rates ________ and the exchange rate ________.

A) fall; does not change
B) fall; rises
C) do not change; falls
D) fall, and the long-term interest rate rises; falls
E) fall; falls

Topic: Monetary Policy Transmission

57) When the Bank of Canada raises the overnight loans rate, other short-term interest rates

A) rise, consumption expenditure, investment and net exports decrease, and the aggregate demand curve shifts leftward.
B) fall, consumption expenditure, investment and net exports increase, and the aggregate demand curve shifts rightward.
C) fall, consumption expenditure, investment and net exports decrease, and the aggregate demand curve shifts leftward.
D) rise, consumption expenditure, investment and net exports increase, and the aggregate demand curve shifts rightward.
E) none of the above.

Topic: Monetary Policy Transmission

58) A decrease in the overnight loans rate
   A) decreases the demand for loanable funds, lowers the real interest rate, and decreases aggregate demand.
   B) lowers the exchange rate, increases the demand for loanable funds, and increases aggregate demand.
   C) increases other short-term interest rates, decreases investment, and decreases aggregate demand.
   D) lowers other short-term interest rates, raises the real interest rate, and increases aggregate demand.
   E) lowers the exchange rate, increases the supply of loanable funds, and increases aggregate demand.

Topic: Monetary Policy Transmission

59) A decrease in the overnight loans rate leads to
   A) an increase in consumption expenditure.
   B) a fall in the exchange rate.
   C) an increase in exports.
   D) an increase in the quantity of money.
   E) all of the above.

Topic: Monetary Policy Transmission

60) If the Bank of Canada is concerned with recession it will ________ the overnight loans rate to ________.
   A) raise; decrease aggregate demand
   B) lower; increase aggregate demand
   C) raise; increase aggregate demand
   D) lower; increase potential GDP
   E) lower; decrease aggregate demand

Topic: Monetary Policy Transmission

61) When the Bank of Canada fights recession by implementing an open market operation, the supply of loanable funds curve shifts ________ and the aggregate demand curve shifts ________.
   A) rightward; leftward
   B) rightward and the demand for loanable funds curve shifts rightward; rightward
   C) leftward; rightward
   D) rightward; rightward
   E) leftward; leftward

Topic: Monetary Policy Transmission

62) If the Bank of Canada wants to stimulate the economy to limit the effects of a recessionary gap, then it ________ the overnight loans rate to ________ the real interest rate and ________ investment.
   A) lowers; lower; decrease
   B) lowers; raise; decrease
   C) lowers; raise; increase
   D) lowers; lower; increase
   E) raises; raise; decrease

Topic: Monetary Policy Transmission

63) When the Bank of Canada lowers the overnight loans rate, there is a ________ shift of the ________ curve.
   A) rightward; *AD*
   B) leftward; *SAS*
   C) leftward; *AD*
   D) rightward; *SAS*
   E) rightward; *LAS*

Topic: Monetary Policy Transmission

64) In the short run, lowering the overnight loans rate shifts the ________ curve ________ and ________ real GDP.
A) aggregate demand; leftward; decreases
B) short-run aggregate supply; rightward; increases
C) aggregate demand; rightward; increases
D) aggregate demand; leftward; increases
E) long-run aggregate supply; rightward; increases

Topic: Monetary Policy Transmission

65) The short-run effect of lowering the overnight loans rate is that the
A) price level rises and real GDP decreases.
B) price level rises and real GDP increases.
C) price level lowers and real GDP decreases.
D) price level lowers and real GDP increases.
E) none of the above.

Topic: Monetary Policy Transmission

66) When the Bank of Canada fights recession by implementing an open market operation, the supply of reserves curve shifts ________ and the supply of money curve shifts ________.
A) rightward; rightward
B) leftward; rightward
C) rightward; rightward, and the demand for loanable funds increases
D) leftward; leftward
E) rightward; leftward

Topic: Monetary Policy Transmission

67) To combat a recession, the Bank of Canada ________ the overnight loans rate, which ________ the quantity of money.
A) lowers; increases
B) raises; increases
C) lowers; decreases the demand for bank reserves and increases
D) raises; decreases
E) lowers; decreases

Topic: Monetary Policy Transmission

68) In response to an inflationary gap, the Bank of Canada
A) raises the overnight loans rate by buying securities.
B) waits until the price level falls before acting.
C) lowers the overnight loans rate by buying securities.
D) raises the overnight loans rate by selling securities.
E) lowers the overnight loans rate by buying securities.

Topic: Monetary Policy Transmission

69) If the Bank of Canada wants to eliminate an inflationary gap, which of the following would be an appropriate policy?
A) Decease the government budget deficit.
B) Lower the exchange rate.
C) Lower the overnight loans rate.
D) Buy government securities.
E) Raise the overnight loans rate.

Topic: Monetary Policy Transmission

70) If the Bank of Canada is concerned with inflation it will ________ the overnight loans rate to ________.
A) lower; decrease aggregate demand
B) raise; increase potential GDP
C) raise; decrease aggregate demand
D) lower; increase aggregate demand
E) raise; increase aggregate demand

Topic: Monetary Policy Transmission

71) If the Bank of Canada fears inflation it will undertake an open market ________ of securities, the overnight loans rate will ________ and the long-term real interest rate will ________.
A) sale; rise; fall
B) purchase; fall; rise
C) sale; rise; rise
D) purchase; rise; fall
E) sale; fall; fall

Topic: Monetary Policy Transmission

72) If a central bank wants to implement a contractionary policy that decreases real GDP, it conducts an open market operation by ________ securities. Bank reserves ________ and the supply of loanable funds ________. The quantity of money ________.
A) purchasing; decrease; decreases; decreases
B) selling; increase; increases; increases
C) purchasing; decrease; increases; decreases
D) selling; decrease; decreases; decreases
E) purchasing; increase; increases; increases

Topic: Monetary Policy Transmission

73) When the Bank of Canada fights inflation by implementing an open market operation, the supply of reserves curve shifts ________ and the supply of money curve shifts ________.
A) leftward; leftward
B) rightward; leftward
C) rightward; rightward
D) leftward; rightward
E) none of the above

Topic: Monetary Policy Transmission

74) When the Bank of Canada fights inflation by implementing open market operations, the supply of loanable funds curve shifts ________ and the aggregate demand curve shifts ________.
A) leftward; leftward
B) rightward; rightward
C) rightward; leftward
D) leftward; leftward, and potential GDP decreases
E) leftward; rightward

Topic: Monetary Policy Transmission

75) The headline "The Bank of Canada Has Cut the Bank Rate" suggests that the Bank of Canada is trying to
A) raise the value of the Canadian dollar.
B) stimulate aggregate demand.
C) help banks make profits.
D) increase the overnight loans rate.
E) lower inflationary pressures.

Topic: Monetary Policy Transmission

76) A monetary policy aimed at increasing domestic expenditure will
A) have no impact on interest rates, but increase the exchange rate.
B) decrease interest rates and increase the exchange rate.
C) have no impact on interest rates nor on the exchange rate.
D) increase interest rates and decrease the exchange rate.
E) decrease interest rates and the exchange rate.
Topic: Monetary Policy Transmission

Use the figure below to answer the following question.

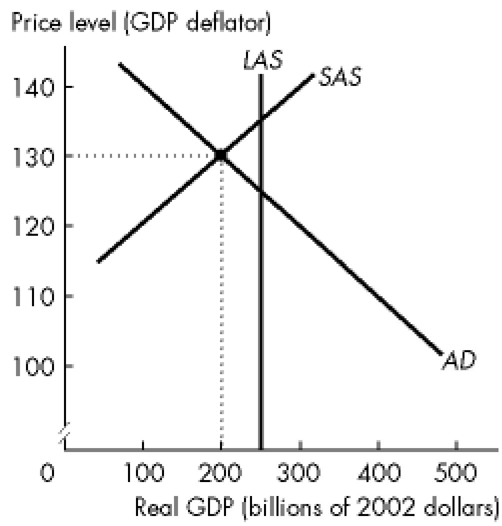

Figure 30.3.2

77) Refer to Figure 30.3.2. The figure shows the economy of Freezone. Potential GDP is $250 billion.
To return the economy to full employment, the central bank can ________ the overnight rate and ________ securities.
A) lower; buy
B) raise; buy
C) lower; not change its holdings of
D) lower; sell
E) raise; sell
Topic: Monetary Policy Transmission

Use the figure below to answer the following question.

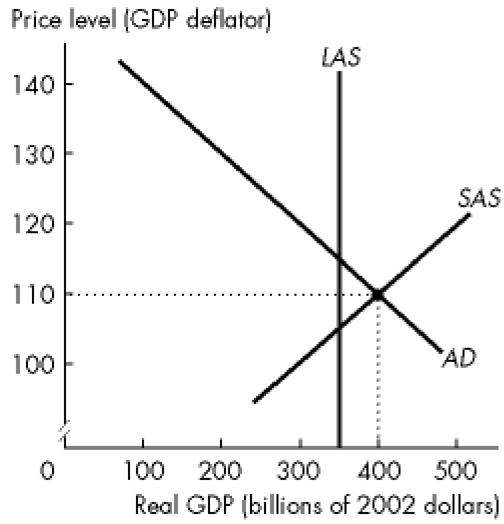

Figure 30.3.3

78) Refer to Figure 30.3.3. The figure shows the economy of Freezone. Potential GDP is $350 billion.
To return the economy to full employment, the central bank can ________ the overnight rate and ________ securities.
A) lower; sell
B) raise; buy
C) lower; buy
D) raise; sell
E) lower; not change its holdings of

Topic: Monetary Policy Transmission

79) Which of the following monetary policies are alternatives to the Bank of Canada's interest rate strategy?
A) Monetary base instrument rule.
B) Overnight rate instrument rule.
C) Exchange rate targeting rule.
D) A and B only.
E) A, B, and C.

Topic: Alternative Monetary Policy Strategies

80) What is the Taylor Rule?
A) The monetary base should grow at a rate equal to the target inflation rate plus the long-term real GDP growth rate minus the medium-term velocity growth rate.
B) The money supply should be regulated by setting the exchange rate equal to purchasing power parity with other countries.
C) The monetary base is set in response to the current inflation rate and to the current estimate of the output gap.
D) The overnight loan rate is set in response to the current inflation rate and to the current estimate of the output gap.
E) The money supply should grow at a rate equal to the long-run real growth rate.

Topic: Alternative Monetary Policy Strategies

81) Suppose the Bank of Canada uses the Taylor rule to set the overnight loans rate. If the neutral real overnight rate is 2 percent, the inflation rate is 3 percent, the target inflation rate is 2 percent, and the output gap is 0 percent, then the Taylor rule sets the overnight rate equal to

A) 5 percent.
B) 6 percent.
C) 5.5 percent.
D) 2.5 percent.
E) 0 percent.

Topic: Alternative Monetary Policy Strategies

82) What is the McCallum Rule for monetary policy?

A) The monetary base is set in response to the current inflation rate and to the current estimate of the output gap.
B) The money supply should be regulated by setting the exchange rate equal to purchasing power parity with other countries.
C) The money supply should grow at a rate equal to the long-run real growth rate.
D) The overnight rate is set in response to the current inflation rate and to the current estimate of the output gap.
E) The growth rate of the monetary base responds to the long-term average growth rate of real GDP and medium-term changes in the velocity of circulation of the monetary base.

Topic: Alternative Monetary Policy Strategies

83) A monetary authority that applies the *money targeting rule* would

A) make the quantity of money grow at a rate equal to the growth rate of potential GDP.
B) set the money supply only in response to the current inflation rate.
C) adapt the money supply according to the goals for inflation, interest rates, and exchange rates.
D) adjust the money supply to regions of the country according to economic circumstance.
E) make the quantity of money grow at a rate equal to the growth rate of potential GDP minus 0.25 percent.

Topic: Alternative Monetary Policy Strategies

84) The *k-percent rule* makes the quantity of money grow at a rate of *k* percent per year, where *k* equals

A) the rate of change in real GDP.
B) the velocity of circulation.
C) the expected rate of inflation.
D) the neutral real overnight rate.
E) the growth rate of potential GDP.

Topic: Alternative Monetary Policy Strategies

85) Money targeting works best when

A) the demand for money is stable and predictable.
B) the demand for money is unstable and difficult to predict.
C) technological change generates changes in the demand for money.
D) the monetary authority correctly estimates the output gap.
E) the monetary authority does not need to estimate the neutral overnight rate.

Topic: Alternative Monetary Policy Strategies

86) Which of the following statements best makes the case for using rules, rather than judgement, to set monetary policy?

A) Rules act as effective substitutes in situations where markets do not function well.
B) Judgments are more prone to error than are rules.
C) Without rules there would be no monetary targets.
D) With rules, inflation is easier to forecast.
E) Both A and D.

Topic: Alternative Monetary Policy Strategies

87) Suppose the neutral real overnight rate is 2 percent per year, inflation is 2.5 percent, the target inflation rate is 2 percent, and the output gap is 1 percent. Using the Taylor rule, the Bank of Canada sets the overnight loans rate equal to

A) 3 percent.
B) 5.75 percent.
C) 5.5 percent.
D) 5.25 percent.
E) 3.5 percent.

Topic: Alternative Monetary Policy Strategies

88) Suppose the inflation rate is 3 percent and the output gap is –1 percent. The neutral real overnight rate is 2 percent, and the target inflation rate is 2 percent. Using the Taylor rule, the Bank of Canada sets the overnight loans rate equal to

A) 6 percent.
B) 4 percent.
C) 1 percent.
D) 5 percent.
E) 5.5 percent.

Topic: Alternative Monetary Policy Strategies

89) The McCallum rule is ________ and the Taylor rule is ________.

A) a monetary base instrument rule; a monetary base
B) an exchange rate targeting rule; a money targeting rule
C) an overnight instrument rule; an overnight instrument rule
D) monetary base instrument rule; an overnight rate instrument rule
E) an overnight rate instrument rule; a monetary base instrument rule

Topic: Alternative Monetary Policy Strategies

90) A rule that requires the quantity of money to grow at a constant rate is

A) an exchange rate rule.
B) the Phillips rule.
C) the McCallum rule.
D) the *k*–percent rule.
E) the Taylor rule.

Topic: Alternative Monetary Policy Strategies

91) The *k*–percent rule works best when the ________ is stable and predictable.

A) overnight loans rate
B) supply of money
C) exchange rate
D) demand for money
E) real interest rate

Topic: Alternative Monetary Policy Strategies

92) The *k*–percent rule makes the quantity of money

A) respond to the state of the economy using all the information available.
B) grow at a decreasing rate.
C) grow at an increasing rate.
D) grow at a rate equal to the growth rate of potential GDP.
E) none of the above.

Topic: Alternative Monetary Policy Strategies

93) Nobel Laureate Milton Friedman proposed ________, which is ________.
A) the Friedman rule; an inflation targeting rule
B) the overnight rate instrument rule; the rule used by the Bank of Canada
C) the exchange rate targeting rule; the rule used by the Bank of Canada
D) the Friedman rule; a money targeting rule
E) the *k*-percent rule; a money targeting rule

Topic: Alternative Monetary Policy Strategies

94) A money targeting rule that keeps the quantity of money growing at a constant rate is
A) the McCallum rule.
B) the rule most often followed by the Bank of Canada.
C) the *k*-percent rule.
D) an inflation rate targeting rule.
E) an exchange rate targeting rule.

Topic: Alternative Monetary Policy Strategies

95) The *k*-percent rule sets the growth rate of the quantity of money equal to
A) the unemployment rate.
B) the growth rate of aggregate demand.
C) the growth rate of potential GDP.
D) the real interest rate.
E) the real GDP growth rate one year earlier.

Topic: Alternative Monetary Policy Strategies

96) Under a *k*-percent rule, if the economy goes into a expansion, the Bank of Canada
A) lowers taxes to keep revenue constant.
B) decreases the growth rate of the quantity of money.
C) increases the quantity of money.
D) raises the overnight loans rate.
E) none of the above.

Topic: Alternative Monetary Policy Strategies

97) An example of the *k*-percent rule occurs when the Bank of Canada implements the following policy:
A) "use all information available to determine the growth rate of the quantity of money each time GDP changes."
B) "do not change the growth rate of the quantity of money."
C) "keep the growth rate of the quantity of money at its current rate equal to the growth rate of potential GDP."
D) "every time GDP decreases, increase the growth rate of the quantity of money."
E) "every time GDP decreases, decrease the growth rate of the quantity of money."

Topic: Alternative Monetary Policy Strategies

98) Which of the following are *true* regarding the *k*-percent money targeting rule?
I. Currently this policy is used by many policy makers.
II. This rule sets the growth rate of the quantity of money independently of the economy's behaviour.
A) I only
B) II only
C) both I and II
D) I only if the world economy is experiencing recession
E) neither I nor II

Topic: Alternative Monetary Policy Strategies

99) As firms expect future profits to increase, they increase their investment. As a result, real GDP rises above potential GDP. If the Bank of Canada follows the *k*-percent rule, the Bank of Canada
A) lowers the overnight loans rate.
B) decreases the quantity of money.
C) continues to allow the quantity of money to grow at "*k*" percent.
D) raises the overnight loans rate.
E) increases the quantity of money more than usual.

Topic: Alternative Monetary Policy Strategies

100) Suppose the Bank of Canada's current monetary policy strategy has the monetary base growing at a target rate. This is an example of
A) a monetary target rule.
B) an exchange rate target rule.
C) the Taylor rule.
D) an inflation targeting rule.
E) the McCallum rule.

Topic: Alternative Monetary Policy Strategies

101) For Friedman's *k*-percent rule to work, it requires
A) a stable demand for money.
B) the real exchange rate to be predictable.
C) good knowledge of the velocity growth rate.
D) a good estimate of the output gap.
E) stable long-term real GDP growth.

Topic: Alternative Monetary Policy Strategies

102) The Bank of Canada rejects ________ because it would bring large fluctuations in the interest rate and in aggregate demand.
The Bank of Canada rejects ________ because fluctuations in the demand for money make the policy unreliable.
A) a money targeting rule; a monetary base instrument rule
B) an exchange rate targeting rule; an overnight rate targeting rule
C) an overnight rate targeting rule; an exchange rate targeting rule
D) a monetary base instrument rule; a money targeting rule
E) none of the above

Topic: Alternative Monetary Policy Strategies

103) The Bank of Canada rejects ________ because changes in the real variable of the policy is difficult to identify.
The Bank of Canada rejects ________ because it uses much more information than just the current inflation rate and the output gap, so it is able to set the overnight rate more intelligently than a rule such as the Taylor rule.
A) a monetary base instrument rule; a money targeting rule
B) exchange rate targeting rule an overnight rate targeting rule
C) an overnight rate targeting rule; exchange rate targeting rule
D) a money targeting rule; a monetary base instrument rule
E) none of the above

Topic: Alternative Monetary Policy Strategies

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