Chapter 10

Multiple Choice questions

1. If there is an improvement in consumer confidence (increase in expected future income) the central bank will probably \_\_\_\_\_\_\_\_\_\_\_?

1. reduce the interest rate
2. raise the interest rate
3. keep the interest rate unchanged

2. If there is an increase inflation the central bank will probably \_\_\_\_\_\_\_\_\_\_\_?

1. reduce the interest rate
2. raise the interest rate
3. keep the interest rate unchanged

3. If there is a decrease in the output gap the central bank will probably \_\_\_\_\_\_\_\_\_\_\_?

1. reduce the interest rate
2. raise the interest rate
3. keep the interest rate unchanged

4. If there is a decrease in money demand the central bank will probably \_\_\_\_\_\_\_\_\_\_\_?

1. reduce the interest rate
2. raise the interest rate
3. keep the interest rate unchanged

5. In the US and the UK inflation had an upward trend after 1960 and peaked around \_\_\_\_\_\_\_\_\_\_\_?

1. 1960
2. 1970
3. 1980
4. 1990
5. 2000

6. Some economists have suggested that it would be a good idea to increase the money supply at a constant rate. What might be a problem with such a policy?

1. If money grows at a constant rate this will limit the real growth of GDP
2. If there are shocks to the velocity of money, this will lead to fluctuations in interest rates and production
3. If there are shocks to consumption and investment, interest rates will not adjust in a way that helps to stabilize aggregate demand
4. The central bank cannot control the money supply that well, at least not the monetary base

7. The Taylor rule says that the interest rate is a linear function of inflation and the output gap. What are the coefficients of the original Taylor rule?

1. 1.5 for inflation and 1.5 for the output gap
2. 1.5 for inflation and 0.5 for the output gap
3. 0.5 for inflation and 1.5 for the output gap
4. 0.5 for inflation and 0.5 for the output gap

8. What is the idea of rational expectations?

1. Expectations are always correct
2. Expected inflation next year is equal to inflation this year
3. Individuals know everything about the current economic situation
4. Individuals make the best prediction with the information that they have

9. Several operations can be seen as short term lending by the central bank. Which of the following is not a form of short-term lending by the central bank?

1. The central bank buys a government bond in a one-week repurchase agreement
2. The central bank buys a 3 month treasury bill
3. Commercial banks borrow overnight from the central bank
4. The central bank issues its own certificates

10. Consider a central bank with an explicit inflation target. If inflation has recently been above the target level, there may be several reasons. In which of the following cases would the central bank be *less likely* to raise the interest rate?

1. The was a permanent increase in the value added tax
2. Expected inflation is above the target level
3. Aggregate demand is high and expected to remain strong
4. Raw material prices have increased and are expected to continue rising