

**ECO 301: Money and Banking**

Practice Exam 1, Spring 2026

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Name: \_\_\_\_\_

**Multiple choice:** Choose the best response to each prompt.

1. Which of the following is a financial security?
  - (a) Mortgage loan
  - (b) House
  - (c) Money
  - (d) Stock in a firm
  
2. Which of the following is *\*not\** included in the M1 money supply?
  - (a) Physical currency such as coins and paper bills
  - (b) Savings account balances
  - (c) Checking account balances
  - (d) Balances in time deposits, such as Certificates of Deposits (CDs)
  
3. What distinguishes M1 money supply from M2 money supply?
  - (a) M2 money supply includes stocks and bonds and M1 does not
  - (b) M1 money can be used as an immediate means of payment and M2 can be converted to a means of payment.
  - (c) Nothing. They are the same thing.
  - (d) M1 money supply includes all of M2 plus other items
  
4. Which of the following functions are *\*not\** carried out by Federal Reserve District Banks?
  - (a) Approve government spending decisions authorized by the U.S. President
  - (b) Make discount loans to banks in their district
  - (c) Provide data analysis and research on business, economics, and financial conditions in their district.
  - (d) Serve on the Federal Open Market Committee to make decisions about U.S. monetary policy
  
5. What is the Federal Reserve Board of Governors?
  - (a) The twelve presidents of the Federal Reserve district banks that oversee monetary policy
  - (b) Governors of the 50 U.S. States that oversee the Federal Reserve System.
  - (c) The twelve members of the Federal Open Market Committee
  - (d) Seven leaders appointed by the U.S. President and approved by the Senate to oversee the Federal Reserve System.

6. The seven members of the Federal Reserve Board of Governors and five presidents of the Federal Reserve District Banks make up what policy making body?
- (a) Federal Reserve Monetary Policy Committee
  - (b) Federal Reserve Open Market Committee
  - (c) Federal Reserve Board of Directors
  - (d) Federal Reserve Oversight Committee
7. What group oversees an individual Federal Reserve District bank?
- (a) Federal Reserve Open Market Committee
  - (b) Federal Reserve Board of Governors
  - (c) Federal Reserve Oversight Committee
  - (d) Federal Reserve District Board of Directors
8. Which of the following characteristics allow the Federal Reserve to act somewhat independently from elected officials?
- (a) Each Board of Governors is appointed to a 14-year term, significantly longer terms than elected officials.
  - (b) Each Federal Reserve District bank president is appointed to a 14-year term.
  - (c) It takes a super-majority of the U.S. Senate to veto the budget for the Federal Reserve system.
  - (d) Every Federal Reserve Open Market Committee member is elected to an eight year term, longer than the terms for most elected officials.
9. What is a responsibility of the Federal Open Market Committee?
- (a) Make decisions for the level of borrowing by member banks.
  - (b) Make decisions for open market operations.
  - (c) Approve bank mergers.
  - (d) Make decisions for the level of government borrowing.
10. Which of the following is part of the monetary base?
- (a) Money market mutual funds
  - (b) Currency
  - (c) Demand deposits
  - (d) Certificates of Deposit

11. Which of the following is an asset of the Federal Reserve System?
- (a) M1 money supply
  - (b) Treasury bills owned by the Federal Reserve
  - (c) M2 money supply
  - (d) Currency in circulation
12. Which of the following is a liability of a commercial bank?
- (a) Reserves held at the Federal Reserve
  - (b) Deposits
  - (c) M1 money supply
  - (d) Loans the bank made to individuals and businesses
13. Which of the following is a result of an open market purchase of bonds?
- (a) Deposits at financial institutions decrease.
  - (b) The required reserve ratio increases.
  - (c) Bonds held by financial institutions increase.
  - (d) Reserves increase.
14. Which of the following is true following an open market sale of bonds by the Federal Reserve?
- (a) The monetary base and the money supply decreases.
  - (b) The monetary base and the money supply increases.
  - (c) The monetary base increases and the money supply decreases.
  - (d) The monetary base decreases and the money supply increases.
15. Which of the following is a discount loan?
- (a) A Federally-subsidized loan with a lower interest rate
  - (b) A loan made by the Federal Reserve to a commercial bank
  - (c) A loan made between banks to help the borrowing bank meet their depositors needs
  - (d) A commercial loan at an interest rate below the Federal Funds rate

16. Which of the following leads to a larger money multiplier?
- (a) An increase in the ratio of currency to total deposits in the banking system.
  - (b) An open market sale of bonds.
  - (c) An open market purchase of bonds.
  - (d) A decrease in the required reserve ratio.
17. Which of the following occurred during the 2008-2009 financial crisis?
- (a) There was an increase in the required reserve ratio.
  - (b) There was an increase in the currency ratio.
  - (c) There was an increase in excess reserves.
  - (d) There was a decrease in the required reserve ratio.
18. Which of the following occurred during the 2008-2009 financial crisis?
- (a) There was a decrease in the monetary base and an increase in the money supply.
  - (b) There was a moderate increase in the monetary base, but a much larger increase in the money supply.
  - (c) There was a large increase in the monetary base, but a more moderate increase in the money supply.
  - (d) There was an increase in the monetary base, but a decrease in the money supply.
19. Which of the following would cause aggregate demand to shift to the right?
- (a) A decrease in demand for exports.
  - (b) An improvement in the consumer confidence, leading to an increase in consumption demand.
  - (c) An increase in taxes, leading to a decrease in government borrowing.
  - (d) A decrease in the aggregate price level.
20. Which of the following would cause the short-run aggregate supply to shift to the right?
- (a) An increase in demand for consumption.
  - (b) An increase in the global price of energy.
  - (c) An improvement in technology.
  - (d) A decrease in demand for exports.

21. Suppose there is a decrease in global energy prices which makes it less costly to produce goods and services. What is the short-run impact on the market for final goods and services?
- (a) Increase in the aggregate price level and an increase in real GDP.
  - (b) Increase in the aggregate price level and a decrease in real GDP.
  - (c) Decrease in the aggregate price level and an increase in real GDP.
  - (d) Decrease in the aggregate price level and a decrease in real GDP.
22. Suppose business confidence improves, leading to an increase in investment spending. What is the short-run equilibrium impact on real GDP and price level?
- (a) Decrease in the aggregate price level and a decrease in real GDP.
  - (b) Decrease in the aggregate price level and an increase in real GDP.
  - (c) Increase in the aggregate price level and an increase in real GDP.
  - (d) Increase in the aggregate price level and a decrease in real GDP.
23. Suppose there is a decrease in the interest rate. What is the impact on the market for final goods and services?
- (a) Consumption demand and investment demand both decrease, causing the aggregate demand curve to shift to the left.
  - (b) There is no effect on the market for final goods and services
  - (c) Consumption demand and investment demand both decrease, causing the aggregate supply curve to shift to the left.
  - (d) Consumption demand and investment demand both increase, causing the AD curve to shift to the right.
24. If the central bank wanted to stimulate the economy in order to increase real GDP, which policy should it take?
- (a) Increase the currency requirement
  - (b) Decrease the interest rate
  - (c) Increase the interest rate
  - (d) Increase the reserve requirement
25. Which of the following monetary policies lead to a rightward shift in the aggregate supply curve?
- (a) No monetary policy can affect the aggregate supply curve.
  - (b) Increase in interest rate.
  - (c) Decrease in reserve supply.
  - (d) Increase in reserve supply.

**Short-answer and problem-solving questions:** Provide written answers to each question in the space provided.

26. (5 points) Describe the three functions of money.

27. (5 points) Define liquidity. Which is more liquid, stock in Microsoft or partial ownership of Creative Layers Hair and Nails (a highly rated business in Richland Center, WI)? Explain.

28. (5 points) Suppose the Fed engaged in an action that led to an increase in the interest rate. Describe the expected impact on consumer spending. Explain your answer.

29. (5 points) Describe what happens to the opportunity cost of holding reserves when the Fed increases the interest rate on reserve balances.

30. (5 points) Describe three ways in which the Federal Reserve System is structured so that decisions can be made independently of short-run political concerns.
31. (5 points) Suppose consumers decide to hold smaller fractions of their money in currency. Explain how this affects the cycle of money creation and the effect on the money multiplier.

32. (5 points) Suppose the required reserve ratio is 5%, banks hold an extra 15% of deposits in excess reserves, and consumers hold currency balances that are about 5% of what they hold in deposits in banks. Suppose the Fed makes an open market sale of \$80 billion of government bonds. Compute the change in money supply. Is this an increase or decrease in money supply?

33. (5 points) Suppose there is an increase in consumer confidence, where consumers expect rising incomes in the future. Describe and illustrate the short-run equilibrium outcomes for real GDP, price level, and employment.

34. (5 points) Suppose the economy is initially in a short-run equilibrium where GDP is above potential GDP and the economy is experiencing a high level of inflation (i.e. an expansionary gap or inflationary gap). Illustrate this situation in an aggregate demand/aggregate supply model and a labor market model. Suggest a monetary policy to bring down inflation, and describe and illustrate the short-run effects on the equilibrium real GDP, price level, and level of employment.

35. (5 points) Suppose there is an increase in taxes charged to businesses for using imported raw materials for the production of final goods in services. Describe and illustrate the short-run impact on real GDP, price level, and level of employment.