

ECO 301: Money and Banking

Practice Final Exam, Spring 2026

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Name: _____

Multiple choice: Choose the best response to each prompt.

1. What measure of money supply includes currency and demand deposits including deposits in checking and savings accounts?
 - (a) M3 reserve supply
 - (b) M4 reserve supply
 - (c) M2 money supply
 - (d) M1 money supply

2. How are the Federal Reserve Board of Governors chosen?
 - (a) They are approved by a board of directors at each Federal Reserve District Bank.
 - (b) They are appointed by the governor of each U.S. state.
 - (c) They are elected by the general public in each of their own districts.
 - (d) They are appointed by the U.S. President and approved by the Senate.

3. What is a responsibility of the Federal Open Market Committee?
 - (a) Make decisions on how to influence the federal funds rate.
 - (b) Oversee and regulate member bank behaviors and actions.
 - (c) Appoint members of the Federal Board of Governors.
 - (d) Appoint members of the Financial Stability Oversight Council.

4. Which of the following is true of the monetary base?
 - (a) The monetary base is equal to currency plus reserves
 - (b) The monetary base is equal to the reserve supply
 - (c) The monetary base is equal to M1 + M2 money supplies
 - (d) The monetary base is equal to currency plus deposits

5. Which of the following leads to an increase in the monetary base?
 - (a) Federal Reserve open market sale of bonds
 - (b) Federal reserve increases the required reserve ratio
 - (c) Federal Reserve open market purchase of bonds
 - (d) Federal reserve increases the interest rate

6. Which of the following leads to a larger money multiplier?
- (a) An increase in the currency ratio to total banking system deposits.
 - (b) An increase in the number of deposits in the banking system.
 - (c) A decrease in the excess reserve ratio to total banking system deposits.
 - (d) An increase in the required reserve ratio.
7. Which of the following leads to a reallocation of wealth away from lenders toward borrowers?
- (a) Unexpected inflation
 - (b) Increases in real GDP
 - (c) Unexpected deflation
 - (d) Decrease in bond prices
8. Which monetary policy tool increases reserve supply?
- (a) Increase in the federal funds rate
 - (b) Decrease in the discount rate
 - (c) Quantitative easing
 - (d) Open market sale of bonds
9. Which of the following results in an increase in the equilibrium federal funds rate?
- (a) Increase in the discount rate
 - (b) Decrease in the interest rate on reserves
 - (c) Increase in the interest rate on reserves
 - (d) Decrease in the discount rate
10. What is a debt instrument that makes fixed regular payments of interest and principal until a specified maturity date?
- (a) Fixed-payment loan
 - (b) Discount bond
 - (c) Coupon bond
 - (d) Securitized bond

11. Suppose you have a fixed-payment loan with monthly payments. What is the impact of choosing a new fixed-payment loan of the same amount, at the same interest rate, but with a shorter term until maturity?
- (a) Decrease the amount paid in principal
 - (b) Increase the amount paid in principal
 - (c) Decrease in the total interest paid on the loan
 - (d) Increase in the total interest paid on the loan
12. Which of the following causes a decrease in demand for a financial asset?
- (a) Less risk of loss associated with a financial asset.
 - (b) Greater amount of time and costs to get accurate information on the likely return and risks associated with the financial asset.
 - (c) Greater liquidity for a financial asset.
 - (d) Decrease in the supply of an asset.
13. Suppose businesses have a positive outlook for future sales and profitability. What will be the impact on the market for bonds?
- (a) No change in the market for bonds.
 - (b) Increase in the supply of bonds leading to a decrease in the price of bonds and an increase in interest rates.
 - (c) Increase in the demand of bonds leading to an increase in the price of bonds and a decrease in interest rates.
 - (d) Decrease in the supply of bonds leading to an increase in the price of bonds and a decrease in interest rates.
14. If households become more patient and prefer future consumption over current consumption, what happens to the supply of loanable funds?
- (a) The change in supply of loanable funds is indeterminate
 - (b) It stays the same
 - (c) It decreases
 - (d) It increases
15. If a bond rating agency lowered its rating on a bond, what is the likely impact on the bond market?
- (a) There will be an increase in demand for the bond and a decrease in the interest rate for the bond.
 - (b) There will be a decrease in demand for the bond and an increase in the interest rate for the bond.
 - (c) There will be a decrease in demand for the bond and a decrease in the interest rate for the bond.
 - (d) There will be an increase in demand for the bond and an increase in the interest rate for the bond.

16. What is the term for the behavior of interest rates for bonds that have different maturity dates, but are otherwise similar?
- (a) Maturity structure of bonds
 - (b) Interest structure of bonds
 - (c) Risk structure of interest rates
 - (d) Term structure of interest rates
17. Suppose the Fed conducts a quantitative easing measure in which it makes open market purchases of primarily long-term federal government bonds. What is the impact on the yield curve?
- (a) The yield curve will get shorter.
 - (b) The yield curve will be U-shaped
 - (c) The yield curve will become upward sloping or become steeper.
 - (d) The yield curve will get flatter or become downward sloping.
18. Which of the following is an example of adverse selection?
- (a) When risky borrowers are unable to get access to loanable funds.
 - (b) When risky borrowers default on loans, leading to lower payoffs for lenders.
 - (c) When disproportionately risky borrowers come to the market for loanable funds in the situation when lenders have less information on the credit worthiness of borrowers.
 - (d) When only borrowers without risk of default come to the market for loanable funds.
19. Which of the following is a strategy to reduce moral hazard problems?
- (a) Raising interest rates for borrowed funds
 - (b) Decreasing information costs paid by lenders.
 - (c) Lender takes an ownership stake in a firm and places its own employees as managers or board of director members.
 - (d) Increasing financial regulation compliance and enforcement.
20. Which of the following is a bank asset?
- (a) Commercial loan made to a business
 - (b) All of these are assets for a bank.
 - (c) Time deposits
 - (d) Checkable deposits

21. If bank assets have fixed interest rates and bank liabilities have variable interest rates, what impact does an increase in interest rates have?
- (a) Increases costs paid on liabilities and makes no change in revenue from assets, leading to higher profits.
 - (b) Increases revenue from assets and makes no change in costs paid on liabilities, leading to lower profits.
 - (c) Increases revenue from assets and makes no change in costs paid on liabilities, leading to higher profits.
 - (d) Increases costs paid on liabilities and makes no change in revenue from assets, leading to lower profits.
22. What is the situation when the present value of a bank's assets are greater than its liabilities, but it lacks sufficient liquid assets to meet its liabilities?
- (a) Bank is liquid but faces a solvency crisis.
 - (b) Bank is solvent but faces a liquidity crisis.
 - (c) Bank has a negative net worth.
 - (d) Bank is both illiquid and insolvent.
23. What problem does a lender of last resort help reduce?
- (a) Bank insolvency
 - (b) Bank illiquidity
 - (c) Negative net worth
 - (d) Recessions
24. Suppose there is an increase in the interest rate. What is the impact on the market for final goods and services?
- (a) There is no effect on the market for final goods and services
 - (b) Consumption demand and investment demand both increase, causing the AD curve to shift to the right.
 - (c) Consumption demand and investment demand both decrease, causing the aggregate demand curve to shift to the left.
 - (d) Consumption demand and investment demand both decrease, causing the aggregate supply curve to shift to the left.
25. Which of the following monetary policies lead to a leftward shift in the aggregate supply curve?
- (a) Decrease in reserve supply.
 - (b) Increase in reserve supply.
 - (c) Increase in interest rate.
 - (d) No monetary policy can affect the aggregate supply curve.

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

26. (5 points) Describe how the Federal Reserve is a public/private partnership.
27. (5 points) Suppose the required reserve ratio is 10%, banks hold an extra 5% of deposits in excess reserves, and consumers hold currency balances that are about 10% of what they hold in deposits in banks. Suppose the Fed makes an open market sale of \$50 billion of government bonds. Compute the change in money supply. Is this an increase or decrease in money supply?
28. (5 points) Suppose the Federal Reserve increases the interest rate that it pays banks for reserves they hold. Describe and illustrate the impact on reserves and the federal funds rate, using the supply and demand model for reserves.

29. (5 points) Suppose banks decide to hold a smaller portion of their deposits on reserve as a precautionary measure. What defensive open market operation should the Fed conduct to assure that the equilibrium federal funds rate does not change. Use the model for supply and demand for reserves to describe and illustrate the impact of both the change in behavior by banks and the impact of the defensive open market operation.
30. (5 points) Suppose a coupon bond on the secondary market has a face value of \$1,000, makes one payment per year, has an annual coupon rate of 5%, and has 6 years until maturity. Suppose the average market interest rate expected over the next four years is 6%. Use this interest rate to compute the present value of this bond. Show the computations to receive credit for this question.
31. (5 points) Suppose new machine learning technology allows for more reliable rating of bonds, allowing financial investors to buy and sell bonds with more confidence. Describe and illustrate the impact on the market for bonds. What is the equilibrium impact on the price of bonds, interest rate on bonds, and quantity of borrowing?

32. (5 points) Suppose the economy is at full employment when the Federal Reserve conducts an open market sale of bonds. Describe and illustrate the short-run effects on the equilibrium interest rate, quantity of reserves, real GDP, price level, employment, and wage. Hint: You need three graphs to fully illustrate your answer.
33. (5 points) Suppose the economy is initially in a short-run equilibrium where GDP is below potential GDP (i.e. a recessionary gap). Illustrate this situation in an aggregate demand/aggregate supply model and a labor market model. Suggest a monetary policy to fix the problem, and describe and illustrate the effects on the equilibrium interest rate, quantity of reserves, real GDP, price level, employment, and wage. Hint: You need three graphs to fully illustrate your answer.
34. (5 points) Do banks typically have a positive or negative variable-rate gap (usually defined simply as gap)? Explain why and explain the risk this creates for a bank.

35. (5 points) Suppose people expect the Fed will enact policies to fight high inflation for the next 12 months, at which point they expect the Fed may decrease interest rates to encourage continued spending. Draw and describe a yield curve that illustrates this situation. Identify the one-year maturity in your illustration.