ECON 212, PRINCIPLES OF MACROECONOMICS Midterm B Fall 2014

Name\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_ Student number \_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question. (23 Marks)**

1. The objective of the Bank of Canada's monetary policy is

A) 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.

B) to control the quantity of money and interest rates to avoid inflation and when possible prevent excessive swings in real GDP growth and unemployment.

C) 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.

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.

Answer: B

1. The overnight loans rate is the interest rate
2. banks charge their best loan customers.
3. banks pay on term deposits.
4. the Bank of Canada pays on reserves held by banks.
5. the Bank of Canada charges when it lends reserves to banks.
6. on overnight loans that banks make to each other.

Answer: E

1. How does the Bank of Canada set the bank rate?
   1. The Bank of Canada does not determine the bank rate.
   2. The bank rate is set at a quarter percentage point above the prime lending rate.
   3. The bank rate is set at a quarter percentage point above the overnight loans rate.
   4. The bank rate is set at a quarter percentage point below the overnight loans rate.
   5. The bank rate is set at 25 basis points above the operating band.

Answer: C

1. The bank rate is the interest rate
   1. banks charge their very best loan customers.
   2. banks pay on term deposits.
   3. the Bank of Canada pays on reserves held by banks.
   4. the Bank of Canada charges when it lends reserves to banks.
   5. received for holding Government of Canada Treasury Bills.

Answer: D

1. If the Bank of Canada aims to lower the overnight rate, it will
   1. lower the bank rate and settlement balances rate, as well as buy government securities.
   2. lower the bank rate, increase the settlement balances rate, as well as buy government securities.
   3. lower the bank rate and settlement balances rate, as well as sell government securities.
   4. raise the bank rate and settlement balances rate, as well as buy government securities.
   5. raise the bank rate and settlement balances rate, as well as sell government securities.

Answer: A

1. Which of the following quotations correctly describes the impact of monetary policy on the economy?
   1. "House sales are down lots, due to the higher money growth."
   2. "The extra money pumped into the economy by the central bank is creating less exports."
   3. "The tightening of money growth is helping sell goods abroad."
   4. "Businesses are investing more, now that monetary policy has become less expansionary."
   5. "The extra money pumped into the economy by the central bank is creating more jobs."

Answer: E

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

Answer: C

1. Which statement below best expresses the relationship between the 3-month Treasury bill rate and the overnight loans rate? The rates are
   1. not similar because banks can not readily substitute between them.
   2. similar because they are both required to remain with the Bank of Canada's operating band.
   3. similar because banks can readily substitute between them.
   4. 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.
   5. 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.

Answer: C

1. 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 borrow from the Bank of Canada at 2.25 percent, no bank would borrow on the overnight loan market at 3 percent.

C) 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.

D) 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.

E) There is a legal requirement that the overnight rate must be within the Bank of Canada's operating band.

Answer: A

1. The quantity of money that the banking system can create is limited by

A) bank managers' decisions.

B) the monetary base, desired reserves, and desired currency holdings.

C) the number of consumers who apply for loans.

D) the credit ratings of the consumers who are applying for loans.

E) the quantity of bank notes released by the Bank of Canada.

Answer: B

1. Which one of the following is *not* a function of money?
   1. medium of exchange
   2. means of payment
   3. store of value
   4. measure of liquidity
   5. unit of account

D

1. Money can take the form of any one of the following *except*
2. a credit card.
3. a chequing deposit.
4. a saving deposit.
5. Bank of Canada notes.
6. coins.

A

1. The Bank of Canada is the lender of last resort. This means banks may borrow money from the Bank of Canada
2. whenever they are short of reserves.
3. overnight.
4. if they have sufficient securities to support the loan.
5. if the banking system as a whole is short of reserves.
6. to finance a sudden and dramatic increase in overseas reserves.

D

1. A bank can create money by
2. selling some of its securities.
3. increasing its reserves.
4. lending its excess reserves.
5. printing more cheques.
6. converting reserves into securities.

C

1. Suppose that a country has $50 billion in bank reserves, $100 billion in currency held by the public, and $500 billion in bank deposits. The currency drain ratio is
2. 18%.
3. 50%.
4. 30%.
5. 10%.
6. 20%.

E

1. The reserves of a bank include

A) the cash in its vault plus the value of its chequable deposits.

B) the cash in its vault plus any deposits held on account at the Bank of Canada.

C) the cash in its vault plus any gold held for the bank at the Bank of Canada.

D) all of its common stock holdings, the cash in its vault, and all deposits held on account with the Bank of Canada.

E) the cash in its vault plus any deposits held on account with the Bank of Canada plus the value of any government bonds that it holds.

B

**Table 25.1.1**

|  |  |  |
| --- | --- | --- |
| Currency | 2009 Exchange Rate | 2010 Exchange Rate |
| EU euro  Japanese yen | 2 euros/dollar  120 yen/dollar | 3 euros/dollar  90 yen/dollar |

1. Refer to Table 25.1.1. Between 2009 and 2010, the Canadian dollar \_\_\_\_\_\_\_\_ versus the euro and \_\_\_\_\_\_\_\_ versus the yen.
2. appreciated; depreciated
3. appreciated; appreciated
4. depreciated; depreciated
5. depreciated; appreciated
6. not changed; not changed

A

1. If the current account is in surplus and the capital account is also in surplus, then the official settlements account balance is
2. negative.
3. positive.
4. probably close to zero, but could be either negative or positive.
5. zero.
6. equal to the sum of the current account and the capital account.

A

1. Which of the following exchange rate policies uses a target exchange rate, but allows the target to change?
2. crawling peg
3. flexible exchange rate
4. fixed exchange rate
5. moving target
6. none of the above

A

1. Suppose the Bank of Canada follows a fixed exchange rate of $1 U.S. per Canadian dollar. If the demand for Canadian dollars temporarily increases, to maintain the target exchange rate, the Bank can
2. sell Canadian dollars and buy US dollars.
3. buy Canadian dollars and sell US dollars.
4. Sell Canadian dollars and buy government bonds.
5. Buy US dollars and sell government bonds.
6. Do nothing.

A

1. Which one of the following transactions would be recorded as a positive entry in the Canadian balance of payment accounts?

A) A Canadian tourist spends $3,000 while visiting France.

B) A Canadian tourist spends $3,000 while visiting Banff (a Canadian National Park).

C) A Canadian citizen purchases a U.K. government bond.

D) A Canadian corporation sends interest payments on outstanding bonds to U.S. citizens.

E) A French tourist spends $3,000 while visiting Banff.

E

1. If a bank's net worth is negative, then the bank is

A) liquid.

B) insolvent.

C) illiquid.

D) solvent.

E) none of the above.

Answer: B

1. The market in which the currency of one country is exchanged for the currency of another country is the

A) money market.

B) capital market.

C) foreign exchange market.

D) forward exchange market.

E) international trading market.

Answer: C