Tools of Monetary Policy
ECON 4673
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Problems

1. During the holiday season, the public typically increases its currency holdings. How do you think the open market operations manager responds to this change? Briefly explain.

2. Why is it important for the Federal Reserve to be able to pay interest on reserves when managing a crisis?

3. Briefly explain the difference between borrowed and nonborrowed reserves. Which type is controlled by the Federal Reserve and which type is controlled by banks?

4. Name and briefly describe the three distinct types of discount window lending. Which type of discount window lending usually has the highest interest rate?

5. Briefly describe two reasons why conventional monetary policy might not work.

6. What is the main advantage and the main disadvantage of unconditional forward guidance?

7. Using the supply and demand analysis of the market for reserves, indicate what happens to the federal funds rate, borrowed reserves, and nonborrowed reserves, holding everything else constant, under the following situations.

   a. The economy is surprisingly strong, leading to an increase in the amount of checkable deposits.

   b. Banks expect an unusually large increase in withdrawals from checking deposit accounts in the future.

   c. The Federal Reserve raises its federal funds rate target.

   d. The Federal Reserve raises the interest rate on reserves above the current equilibrium federal funds rate.

   e. Banks reduce the reserves-to-deposits ratio.

   f. Banks reduce the reserves-to-deposits and then the Federal Reserve offsets this action by conducting an open-market sale of securities to keep the federal funds rate unchanged.