NAME ____________________ DATE ____________ CLASS ________

Guided Reading Activity

Monetary Policy

Lesson 2 *Monetary Policy*

Review Questions

Directions: Read each main idea and complete the statements below. Refer to your textbook as you write the answers.

A. Fractional Reserves and Deposit Expansion

Main Idea: Banks must keep a portion of their deposits on reserve in their vaults, plus a deposit at the Fed.

1. Under a ____________ reserve system, banks must keep a portion of their ____________ in their vault.

2. The reserve ____________ is the percentage of every deposit that must be set aside as ____________ reserves.

3. A ____________ bank reserve is the deposit kept by member banks at the ____________ to satisfy reserve requirements.

4. The ____________ reserves are the amount of cash, currency, and reserves a bank has that are not needed for ____________ requirements.

B. Conducting Monetary Policy

Main Idea: Monetary policy changes the amount of money in circulation, or the money supply. Changing the money supply raises or lowers interest rates.

1. An ____________ rate is the price of credit to a borrower.

2. An ____________ money policy expands the money supply, which leads to ____________ interest rates.

3. A tight money policy____________ the money supply, which ____________ interest rates.

4. If banks'____________ requirement is low, then banks have ____________ money to lend, and this boosts economic activity. If the reserve requirement is raised, then banks have less money to ____________, and the economy tends to shrink.

Guided Reading Activity *cont.*

Monetary Policy

5. Monetary policy that takes the form of the purchase and sale of government securities is called open ________ ________, and is one of the Fed's most ________ tools.

6. When the Fed buys securities, it ________ the economy by increasing banks' ________ reserves. When the Fed sells these securities, people take money out of the bank to buy them, so banks have less money to ________, and the economy shrinks.

7. The ________ rate is the interest the Fed charges to banks that ________ money from it.

8. A high discount rate makes it more ________ for banks to borrow, thus ________ their excess reserves.

9. If the Fed ________ the discount rate, banks are more eager to borrow and then use that extra money to make ________ to their customers.

10. The ________ rate is the lowest ________ rate commercial banks charge their best customers. The federal ________ rate is the interest rate banks charge each other for ________-________ loans (usually overnight).

C. Monetary Policy Dilemmas

Main Idea: Timing is important in Fed policy and its effects on the economy. Some advocate monetarism, or a stable money supply. Those who advocate manipulating the money supply recognize that the money supply can have unwanted effects on prices.

1. One problem the Fed faces is timing, because it cannot know when to ________ an action and when to ________ it for the best economic results.

2. ________ states that changes in the money supply are ________ for the economy, so the money supply should be kept stable.

Guided Reading Activity *cont.*

Monetary Policy

3. The _______________ theory of money is a hypothesis that the supply of money directly affects the price level over the long run. When the _______________ supply grows, prices tend to increase, which can lead to _______________.

4. Wage-_______________ controls are measures taken to freeze wages and prices in an attempt to control _______________; they make it illegal for firms to give raises or raise prices without _______________ from the government.

Summary and Reflection

Directions: Summarize the main ideas of this lesson by answering the following question.

Suppose you want to buy a house or a new car. You need to borrow money for a mortgage or a car loan. What type of Fed monetary policy would be most advantageous for you when you want to borrow money? Explain.

____

____

____

____

____

____