**Chapter 16: Monetary Policy**

Instruments, Goals, Targets, and the Fed’s Performance

**Topic: Policy Instruments**  
**Skill: Recognition**  
1) Which of the following is one of the Fed’s policy instruments?  
A) help the President win reelection  
B) discount rate  
C) monetary base  
D) price level stability.  
**Answer: B**

**Topic: Policy Goals**  
**Skill: Recognition**  
2) Which of the following is one of the Fed’s policy goals?  
A) help the President win reelection  
B) discount rate  
C) monetary base  
D) price level stability.  
**Answer: D**

**Topic: Intermediate Targets**  
**Skill: Recognition**  
3) Which of the following is one of the Fed’s intermediate targets?  
A) help the President win reelection  
B) discount rate  
C) monetary base  
D) price level stability.  
**Answer: C**

**Topic: Policy**  
**Skill: Conceptual**  
4) Monetary policy affects macroeconomic performance by  
A) changing aggregate supply.  
B) creating budget surpluses.  
C) changing aggregate demand.  
D) creating budget deficits.  
**Answer: C**

**Topic: Monetary Policy Since 1971**  
**Skill: Conceptual**  
5) Measures of Fed policy activity include  
I. The budget deficit or surplus.  
II. The federal funds rate.  
III. The growth rate of M2.  
A) I and II.  
B) I and III.  
C) II and III.  
D) I, II, and III.  
**Answer: C**

**Topic: Monetary Policy Since 1971**  
**Skill: Recognition**  
6) In general, the monetary policy record since 1971 has shown  
A) an increase in government spending.  
B) a decrease in the discount rate.  
C) increases in M2 as presidential elections approach.  
D) overall declines in interest rate.  
**Answer: C**

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* This is Chapter 32 in *Economics.*
Achieving Price Level Stability

Topic: Policies
Skill: Recognition
7) Monetary policy could be enacted on which of the following bases?
   I. variable-rule policy.
   II. fixed-rule policy.
   III. discretionary policy.
   A) I.
   B) I and II.
   C) II and III.
   D) I, II, and III.
Answer: C

Topic: Fixed-Rule Policies
Skill: Recognition
8) A policy that specifies an action to be pursued independently of the state of the economy is called a
   A) feedback rule.
   B) fixed rule.
   C) crowding-out rule.
   D) standard rule.
Answer: B

Topic: Fixed-Rule Policies
Skill: Recognition
9) The views of fixed-rule advocates closely resemble the views of
   A) Keynesians.
   B) feedback-rule advocates.
   C) monetarists.
   D) most non-economists.
Answer: C

Topic: Fixed-Rule Policies
Skill: Conceptual
10) An example of a fixed rule is to set the rate of growth of the quantity of money equal to
    A) the unemployment rate.
    B) the rate of growth of real GDP.
    C) the real interest rate.
    D) a constant.
Answer: D

Topic: Fixed-Rule Policies
Skill: Recognition
11) A policy that requires the quantity of money to grow at a constant rate is a
    A) feedback rule.
    B) fixed rule.
    C) Keynesian rule.
    D) Phillips rule.
Answer: B

Topic: Fixed-Rule Policies
Skill: Recognition
12) An example of a monetarist fixed-rule policy would be
    A) "every time GDP decreases, decrease the growth rate of the quantity of money."
    B) "every time GDP decreases, increase the growth rate of the quantity of money."
    C) "do not change the growth rate of the quantity of money."
    D) "use all information available to determine the growth rate of the quantity of money each time GDP changes."
Answer: C

Topic: Fixed-Rule Policies
Skill: Recognition*
13) Monetarists believe that the best monetary policy is
    A) a discretionary policy.
    B) no policy.
    C) a fixed-rule policy.
    D) a feedback-rule policy.
Answer: C

Topic: Fixed-Rule Policies
Skill: Conceptual
14) Economists who advocate fixed rules might suggest that
    A) the Fed should automatically adjust growth in the quantity of money to offset changes in the business cycle.
    B) the economy is inherently unstable.
    C) the quantity of money should expand at a constant rate.
    D) Congress should delegate its money-creation powers to the president.
Answer: C
15) Under a fixed-rule policy, if the economy goes into an expansion, the Fed would
   A) decrease purchases of government bonds.
   B) lower tax rates to keep revenue constant.
   C) increase the quantity of money.
   D) None of the above answers are correct.
   Answer: D

16) A policy that responds to current economic conditions is known as a
   A) business cycle rule.
   B) fixed rule.
   C) feedback rule.
   D) monetarist policy.
   Answer: C

17) Suppose the economy is in a recession and then the economy is pulled out of the recession by policy action. Based on this, you can determine that the government has adopted
   A) a fixed-rule policy.
   B) a feedback-rule policy.
   C) nondiscretionary policy.
   D) None of the above answers are correct.
   Answer: B

18) If the Fed follows a feedback-rule monetary policy and aggregate demand decreases, the Fed
   A) increases the growth rate of the quantity of money.
   B) does not change the quantity of money.
   C) decreases the growth rate of the quantity of money.
   D) None of the above answers is correct.
   Answer: A

19) Under a feedback-rule that targets real GDP, if the economy goes into a recession, the Fed would
   A) increase the quantity of money.
   B) reduce tax rates.
   C) increase government purchases.
   D) None of the above answers are correct.
   Answer: A

20) The economy is at full employment when aggregate demand temporarily decreases. A feedback-rule response to this decrease in aggregate demand would be to
   A) wait until the money wage rate increased.
   B) wait until the money wage rate decreased.
   C) perform expansionary policy.
   D) perform contractionary policy.
   Answer: C
22) Suppose that a booming stock market permanently increases aggregate demand by $0.4 trillion. A fixed-rule policy response to this change means that the Fed will ____.
   A) not attempt any change in aggregate demand
   B) attempt to decrease aggregate demand by $0.4 trillion
   C) attempt to increase aggregate demand by $0.4 trillion
   D) attempt to increase aggregate supply by $0.4 trillion
   Answer: A

23) In the above figure, the economy experiences an unanticipated decrease in aggregate demand so that the aggregate demand curve shifts from \( AD_0 \) to \( AD_1 \). If the Fed is following a feedback rule, it would ____.
   A) purchase bonds on the open market
   B) sell bonds on the open market
   C) lower taxes
   D) increase government purchases
   Answer: A
27) In the above figure, suppose the economy is initially at point A. Long-run aggregate supply decreases so that the long-run aggregate supply curve shifts from \( LAS_0 \) to \( LAS_1 \). If a fixed-rule policy is in place, what happens?

A) the economy never departs from point A.
B) the economy moves to point B.
C) the economy moves to point C.
D) the economy moves to point D.

Answer: B

28) In the above figure, suppose the economy is initially at point A. Long-run aggregate supply decreases so that the long-run aggregate supply curve shifts from \( LAS_0 \) to \( LAS_1 \). If a feedback rule that targets real GDP is in place, what happens?

A) the economy never departs from point A.
B) the economy moves to point B.
C) the economy moves to point C.
D) the economy moves to point D.

Answer: D

29) In the above figure, suppose the economy is initially at point A. Long-run aggregate supply decreases so that the long-run aggregate supply curve shifts from \( LAS_0 \) to \( LAS_1 \). In comparing outcomes of the fixed-rule policy versus a feedback-rule that targets real GDP, what happens?

A) real GDP is higher under the fixed-rule policy.
B) real GDP is higher under the feedback-rule policy.
C) the feedback-rule policy causes the price level to be higher than under the fixed-rule policy.
D) the fixed-rule policy causes the price level to be higher than under the feedback-rule policy.

Answer: C

30) In the above figure, suppose the economy is initially at point A. Long-run aggregate supply decreases so that the long-run aggregate supply curve shifts from \( LAS_0 \) to \( LAS_1 \). In comparing outcomes of the fixed-rule policy versus a feedback-rule that targets real GDP, what happens?

A) real GDP is higher under the fixed-rule policy.
B) real GDP is higher under the feedback-rule policy.
C) the feedback-rule policy causes the price level to be higher than under the fixed-rule policy.
D) the fixed-rule policy causes the price level to be higher than under the feedback-rule policy.

Answer: C
32) If the Fed is following a fixed-rule policy when there is a leftward shift of the SAS curve, real GDP will ____ in the short run and then ____ in the long run.
A) not change; the AD curve will shift rightward
B) increase; the SAS curve will shift leftward
C) decrease; the LAS curve will shift leftward
D) decrease; the SAS curve will shift leftward
Answer: D

33) If the price of oil rises and the Fed follows a fixed-rule policy the price level
A) rises and the Fed’s policy shifts the AD curve leftward.
B) falls and the Fed’s policy shifts the AD curve rightward.
C) rises and the Fed allows the economy to adjust on its own.
D) falls and the Fed allows the economy to adjust on its own.
Answer: C

34) Suppose that the economy is operating at full employment and the short-run aggregate supply curve shifts leftward as a result of a jump in the price of oil. If the quantity of money does not increase,
A) prices will rise and stay at the higher level with no further increase in the price level.
B) in the short run real GDP will be less than potential GDP and the short-run aggregate supply curve will eventually shift rightward.
C) aggregate demand will increase and cause further inflation.
D) aggregate demand will decrease.
Answer: B

35) If the economy is at natural GDP when hit by a shock that shifts the short-run aggregate supply curve leftward, the
A) AD curve will shift rightward if the Fed is following a fixed-rule policy.
B) SAS curve will shift back rightward if the Fed is following a feedback-rule policy that targets the price level.
C) AD curve will shift leftward if the Fed is following a feedback-rule policy that targets real GDP.
D) SAS will shift back rightward in the long run if the Fed is following a fixed-rule policy.
Answer: D

36) If the price of oil rises and the Fed uses a feedback rule that targets real GDP, the result will be
A) a higher price level and a decrease in aggregate demand when the Fed’s actions take effect.
B) no change in the price level but a decrease in real GDP when the Fed’s actions take effect.
C) a higher price level as real GDP returns to its original level when the Fed’s actions take effect.
D) a higher price level and a leftward shift in the AD curve when the Fed’s actions take effect.
Answer: C

37) Shocks that decrease the short-run aggregate supply are more likely to result in on-going inflation if
A) fixed rules are used.
B) the quantity of money is constant.
C) the quantity of money rises in response to the cost shock.
D) an unanticipated reduction in the quantity of money occurs.
Answer: C
Topic: Cost-Push Pressure  
Skill: Conceptual  
38) Shocks that decrease the short-run aggregate supply are more likely to result in on-going inflation if  
A) fixed rules are used.  
B) the quantity of money is constant.  
C) a feedback rule that targets real GDP is used.  
D) a feedback rule that targets the price level is used.  
Answer: C

Topic: Cost-Push Pressure  
Skill: Analytical  
39) In the above figure, suppose that the economy is at point A and oil prices rise while the Fed is using a feedback rule that targets real GDP. As a result of the oil price hike and Fed policy, the economy will  
A) move to point D and then return to point A.  
B) move to point B.  
C) move to point C.  
D) move to point D.  
Answer: C

Topic: Cost-Push Pressure  
Skill: Analytical  
40) In the above figure, suppose the economy is at point A and oil prices rise while the Fed follows a fixed policy rule. As a result of the oil price hike and Fed policy, in the short run the economy will  
A) move to point D and then return to point A.  
B) move to point B.  
C) move to point C.  
D) move to point D.  
Answer: D

■ Policy Credibility

Topic: Phillips Curve  
Skill: Conceptual  
41) According to the Phillips curve, a recession can result from an  
A) anticipated slowdown in the rate of growth of the quantity of money.  
B) unanticipated slowdown in the rate of growth of the quantity of money.  
C) anticipated drop in the long-term interest rate.  
D) unanticipated drop in the long-term interest rate.  
Answer: B

Topic: Credible Announcement  
Skill: Conceptual  
42) Eliminating inflation requires enduring a recession if  
A) feedback rules are used.  
B) no technology shocks occur in the economy.  
C) Congress is unwilling to expand the quantity of money.  
D) the Fed lacks credibility.  
Answer: D

Topic: Credible Announcement  
Skill: Analytical  
43) If the Fed has full credibility, then when it announces its intention to slow the rate of growth of the quantity of money, the short-run Phillips curve will  
A) quickly shift downward.  
B) quickly shift upward.  
C) not shift.  
D) become horizontal.  
Answer: A
44) If the Fed announces its intention to reduce the rate of growth of the quantity of money, but it lacks credibility, the short-run Phillips curve will
A) quickly shift downward.
B) quickly shift upward.
C) not shift.
D) be vertical.
Answer: C

45) If the Fed announces its intention to reduce the rate of growth of the quantity of money, but it lacks credibility, the long-run Phillips curve will
A) quickly shift downward.
B) quickly shift upward.
C) not shift.
D) become horizontal.
Answer: C

46) A reduction in the expected inflation rate shifts the
A) short-run Phillips curve downward.
B) short-run Phillips curve upward.
C) long-run Phillips curve downward.
D) long-run Phillips curve upward.
Answer: A

47) Which of the following shifts the short-run Phillips curve downward?
A) An expected rise in the inflation rate.
B) An expected fall in the inflation rate.
C) An unexpected rise in the inflation rate.
D) An unexpected fall in the inflation rate.
Answer: B

48) If the Fed credibly announces that it will slow growth in aggregate demand, the short-run Phillips curve _____ and the long-run Phillips curve _____.
A) shifts downward; shifts downward
B) shifts downward; does not shift
C) does not shift; shifts downward
D) does not shift; does not shift
Answer: B

49) Under which of the following scenarios will the Fed most likely be able to slow inflation without also pushing the economy into a recession?
A) An unanticipated reduction in the growth rate of the quantity of money.
B) An announced reduction in the growth rate of the quantity of money that is not believed by the public.
C) An announced reduction in the growth rate of the quantity of money that is believed by the public.
D) None of the above because all of the policies definitely result in a recession.
Answer: C
**Topic: Slowing Inflation**

**Skill: Analytical**

50) In the above figure, suppose that the economy is at point $A$ with a fully anticipated inflation rate of 6 percent. If the Fed increases the quantity of money so that aggregate demand increases and if this change is unanticipated by the public, the result will be

A) the economy stays at point $A$.
B) the economy moves to point $B$.
C) the economy moves to point $C$.
D) the economy moves to point $D$.

**Answer:** B

**Topic: Credible Announcement**

**Skill: Analytical**

51) In the above figure, suppose that the economy is at point $E$ with a fully anticipated inflation rate of 4 percent. If the Fed increases the money growth rate so that aggregate demand increases and if this policy change is anticipated by the public, the result will be

A) the economy moves to point $A$.
B) the economy moves to point $B$.
C) the economy moves to point $C$.
D) the economy moves to point $D$.

**Answer:** A

**Topic: Slowing Inflation in Reality**

**Skill: Conceptual**

54) To achieve a permanent reduction in the inflation rate, in reality it is likely that central bank policymakers must be willing to accept

A) a temporary increase in the unemployment rate.
B) a permanent increase in the unemployment rate.
C) the use of a feed-back rule policy.
D) the fact that it must permanently surprise the public.

**Answer:** A

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**New Monetarist and New Keynesian Feedback Rules**

**Topic: The McCallum Rule**

**Skill: Recognition**

55) The monetary policy rule that adjusts the growth rate of the monetary base to target the inflation rate is the

A) McCallum Rule.
B) Barro Rule.
C) Taylor Rule.
D) Keynes Rule.

**Answer:** A
56) The McCallum monetary policy rule puts more emphasis on ___ and the Taylor monetary policy rule puts more emphasis on ____.
A) price level stability; price level stability
B) price level stability; real GDP
C) real GDP; price level stability
D) real GDP; real GDP
Answer: A

57) The Taylor Rule is an example of
A) a feedback-rule policy.
B) discretionary monetary policy.
C) a fixed rule.
D) an activist rule.
Answer: A

58) Of the following, the monetary policy rule that responds most powerfully to the current level of real GDP is the
A) McCallum Rule.
B) Barro Rule.
C) Taylor Rule.
D) McCallum/Taylor Rule.
Answer: C

59) Which of the following is NOT a macroeconomic instrument?
A) open market operations
B) federal funds rate
C) discount rate
D) required reserve ratio
Answer: B

60) Which of the following is one of the Fed’s intermediate targets?
A) price level stability
B) open market operations
C) discount rate
D) M2
Answer: D

61) Price level stability
A) has no relationship to growth in potential GDP.
B) is thought by most economists to be reached with a measured inflation rate of between 0 and 3 percent a year.
C) is the most important tool of the Federal Reserve.
D) was attained by the Fed for the period between 1973 and 1984.
Answer: B

62) The data show that in the United States, in the year before an election, monetary policy generally is ___, and in the year after an election, monetary policy generally is ____.
A) expansionary; expansionary
B) expansionary; contractionary
C) contractionary; expansionary
D) contractionary; contractionary
Answer: D

63) The Federal Reserve came closest to its goals of price level stability and real GDP equal to potential GDP during
A) 1973 to 1983.
B) 1984 to 1993.
C) 1994 to 2003.
D) 1973 to 1978.
Answer: C
**Topic: Study Guide Question, Fixed-Rule Policies**

**Skill: Conceptual**

64) Which of the following is an example of a fixed-rule policy?

A) Wear your boots if it snows.
B) Leave your boots home if it does not snow.
C) Wear your boots every day.
D) Listen to the weather forecast and then decide whether to wear your boots.

**Answer: C**

**Topic: Study Guide Question, Discretionary Policies**

**Skill: Conceptual**

65) A policy that responds to the state of economy in a possibly unique way and uses all available information is

A) an anti-inflation policy.
B) a fixed-rule policy.
C) a feedback-rule policy.
D) a discretionary policy.

**Answer: D**

**Topic: Study Guide Question, Fixed-Rule Policies**

**Skill: Conceptual**

66) Monetarists generally

A) support the use of feedback rules.
B) support the use of fixed rules.
C) support the Taylor rule.
D) are divided as to whether a feedback-rule policy or a fixed-rule policy is superior.

**Answer: B**

**Topic: Study Guide Question, Feedback-Rule Policies**

**Skill: Conceptual**

67) The rule, “Do not change the quantity of money regardless of the state of the economy,” is an example of a

A) Keynesian fixed-rule policy.
B) Keynesian feedback-rule policy.
C) monetarist fixed-rule policy.
D) monetarist feedback-rule policy.

**Answer: C**

**Topic: Study Guide Question, Stabilizing Aggregate Demand**

**Skill: Conceptual**

68) Businesses become convinced that future profits from investment will be less than initially believed. This conviction leads to a change in aggregate _____ and a _____ policy might be able to keep real GDP from falling below potential GDP.

A) demand; fixed-rule
B) demand; feedback-rule
C) supply; feedback-rule
D) supply; fixed-rule

**Answer: B**

**Topic: Study Guide Question, Stabilizing Aggregate Demand**

**Skill: Conceptual**

69) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in aggregate demand occurs. The fixed rule being followed is: Do nothing. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; equals
B) is greater than; is less than
C) is greater than; equals
D) is greater than; is greater than

**Answer: D**

**Topic: Study Guide Question, Stabilizing Aggregate Demand**

**Skill: Conceptual**

70) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in aggregate demand occurs. The feedback rule being followed targets real GDP: Decrease the quantity of money whenever there is a increase in real GDP. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; equals
B) is less than; is greater than
C) is greater than; equals
D) is greater than; is greater than

**Answer: A**
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Topic: Study Guide Question, Stabilizing Aggregate Demand
Skill: Conceptual

71) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in aggregate demand occurs. The feedback rule being followed targets the price level: Decrease the quantity of money whenever there is a rise in the price level. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; equals
B) is less than; is greater than
C) is greater than; equals
D) is greater than; is greater than

Answer: A

Topic: Study Guide Question, Stabilizing Productivity Shocks
Skill: Conceptual

72) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in potential GDP occurs. The fixed rule being followed is: Do nothing. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; equals
B) is greater than; is less than
C) is less than; equals
D) is greater than; is greater than

Answer: A

Topic: Study Guide Question, Cost-Push Pressure
Skill: Conceptual

73) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in short-run aggregate supply occurs. The feedback rule being followed targets real GDP: Decrease the quantity of money whenever there is an increase in real GDP. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; is greater than*
B) is less than; is less than
C) is less than; equals
D) is less than; is greater than

Answer: C

Topic: Study Guide Question, Cost-Push Pressure
Skill: Conceptual

74) Suppose that initially real GDP equals potential GDP at $11 trillion and that the initial price level is 120. Then an increase in short-run aggregate supply occurs. The feedback rule being followed targets the price level: Increase the quantity of money whenever there is a decrease in the price level. As a result, real GDP ____ $11 trillion and the price level ____ 120.

A) equals; equals
B) is less than; is less than
C) is greater than; equals
D) is less than; is greater than

Answer: C

Topic: Study Guide Question, Slowing Inflation
Skill: Analytical

75) If the Fed unexpectedly increases the growth rate of the quantity of money, the short-run Phillips curve

A) shifts leftward.
B) shifts rightward.
C) does not shift.
D) becomes vertical.

Answer: C

Topic: Study Guide Question, Slowing Inflation
Skill: Analytical

76) If the Fed unexpectedly reduces the growth rate of the quantity of money, the long-run Phillips curve

A) shifts leftward.
B) shifts rightward.
C) does not shift.
D) becomes horizontal.

Answer: C

Topic: Study Guide Question, Inflation Reduction in Practice
Skill: Conceptual

77) The usual result when inflation is reduced is

A) an immediate strong expansion.
B) a recession.
C) more rapid growth in aggregate demand.
D) not known.

Answer: B
Topic: Study Guide Question, Slowing Inflation
Skill: Conceptual
78) When might inflation be reduced without increasing unemployment?
   A) When the Fed unexpectedly reduces inflation.
   B) When the Fed announces that it will reduce inflation and people do not believe the Fed’s announcement.
   C) When the Fed announces that it will reduce inflation and people believe the announcement.
   D) Never.
Answer: C

Topic: Study Guide Question, McCallum Rule
Skill: Recognition
79) The McCallum rule
   A) is in the spirit of a new Keynesian feedback rule.
   B) puts more weight on price level stability than on responding to fluctuations in real GDP.
   C) is the rule actually followed by the Fed.
   D) says that Fed should target the federal funds rate.
Answer: B

Topic: Study Guide Question, Taylor Rule
Skill: Recognition
80) The Taylor rule
   A) focuses on only fluctuations in real GDP.
   B) ignores price level stability to focus on responding to fluctuations in real GDP.
   C) is the rule actually followed by the Fed.
   D) is in the spirit of a new Keynesian feedback rule.
Answer: D

MyEconLab Questions

Topic: Policy Goals
Level 1: Definitions and Concepts
81) A goal of monetary policy is ____.
   A) using the discount rate
   B) achieving price level stability
   C) measuring M1
   D) influencing the federal funds rate
Answer: B

Topic: Monetary Policy
Level 1: Definitions and Concepts
82) Monetary policy is the adjustment of the ____ to achieve macroeconomic objectives.
   A) money market mutual funds
   B) quantity of money in circulation and interest rates by the Federal Reserve
   C) Treasury bill rate
   D) stock market
Answer: B

Topic: Fixed-Rule Policies
Level 1: Definitions and Concepts
83) A fixed-rule policy specifies ____.
   A) how policy should respond to high unemployment rates
   B) which action occurs because of the economic state
   C) only the growth rate of money
   D) which action is to occur independently of the economic state
Answer: D

Topic: Feedback-Rule Policies
Level 1: Definitions and Concepts
84) A feedback-rule policy ____.
   A) can be automatic
   B) is independent of the economic state
   C) is only used when there is a demand shock to the economy
   D) increases aggregate demand
Answer: A

Topic: Discretionary Policies
Level 1: Definitions and Concepts
85) Policy that uses all available information, including perceived lessons from past “mistakes” is called ____.
   A) feedback
   B) discretionary
   C) expected
   D) rational
Answer: B
CHAPTER 16

Topic: Fixed-Rule Policies
Level 2: Using Definitions and Concepts
86) Under a fixed-rule policy, when an economy initially at potential GDP suffers a permanent decrease in demand, real GDP will return to potential ____.
A) when the government decreases the tax rate
B) when the central bank increases the rate of money creation
C) as the money wage rate falls
D) due to expansionary monetary policies
Answer: C

Topic: Stabilizing Aggregate Demand Shocks
Level 2: Using Definitions and Concepts
87) An economy experiences a permanent decrease in aggregate demand. In the long run, with a fixed-rule policy, unemployment ____ with a feedback-rule policy.
A) will be less and the price level will be the same as
B) will be the same and the price level will be less than
C) and the price level will be less than
D) and price level will be greater than
Answer: C

Topic: Cost-Push Pressure
Level 2: Using Definitions and Concepts
88) There is less of a chance of a cost-push inflation with ____.
A) an increase in the price of oil
B) a fixed-rule policy
C) an increase in the money wage rate
D) a feedback-rule policy
Answer: B

Topic: Slowing Inflation
Level 2: Using Definitions and Concepts
89) A surprise inflation reduction results in lower inflation ____.
A) due to a shift of the short-run Phillips curve
B) and lower unemployment
C) at the expense of higher unemployment
D) and no change in unemployment
Answer: C

Topic: Credible Announcement
Level 2: Using Definitions and Concepts
90) A credible announced inflation reduction results in lower inflation ____.
A) and no change in unemployment
B) at the expense of higher unemployment
C) and a movement along the short-run Phillips curve
D) and lower unemployment
Answer: A

Topic: Feedback Rules are Better?
Level 2: Using Definitions and Concepts
91) A problem with using feedback-rule policy is that it ____.
A) is too slow
B) works only with supply-side shocks
C) decreases potential GDP
D) operates with time lags that extend beyond the forecast horizon
Answer: D
Topic: Fixed-Rule Policies
Level 3: Calculations and Predictions
92) The economy of Tomorrowland is in long-run equilibrium at point \( B \) in the above figure, where real GDP is $10 trillion and the price level is 130. The central bank of Tomorrowland follows the fixed rule, “Hold the quantity of money constant.” If there is a temporary decrease in aggregate demand so that aggregate demand curve shifts to \( AD_1 \), the economy will ____.
A) initially move to point \( D \)
B) remain at point \( A \)
C) initially move to point \( C \)
D) initially move to point \( B \)
Answer: A

93) The economy of Tomorrowland is in long-run equilibrium at point \( A \) in the above figure, where real GDP is $10 trillion and the price level is 130. The central bank of Tomorrowland follows the fixed rule, “Hold the quantity of money constant.” If there is a permanent decrease in aggregate demand so that the aggregate demand curve shifts to \( AD_1 \), after all adjustments have been made, the economy will ____.
A) move to point \( D \)
B) remain at point \( A \)
C) move to point \( C \)
D) move to point \( B \)
Answer: B

Topic: Feedback-Rule Policies
Level 3: Calculations and Predictions
94) The economy of Tomorrowland is in long-run equilibrium at point \( A \) in the above figure, where real GDP is $10 trillion and the price level is 130. The central bank of Tomorrowland follows the feedback rule: “Increase the quantity of money when aggregate demand decreases, and decrease the quantity of money when aggregate demand increases.” Aggregate demand permanently decreases. If there are no lags in the effect of monetary policy, to what point will the economy move?
A) move to point \( D \)
B) remain at point \( A \)
C) move to point \( C \)
D) move to point \( B \)
Answer: B

Topic: Cost-Push Pressure
Level 3: Calculations and Predictions
95) If the central bank responds to a continuing rise in the price of oil by continually increasing the quantity of money, ____.
A) persistent stagflation occurs
B) cost-push inflation occurs
C) unemployment increases
D) the economy remains at a business-cycle peak
Answer: B
CHAPTER 16

Topic: Slowing Inflation
Level 3: Calculations and Predictions

96) An economy is currently at point C in the following figure. If the central bank unexpectedly slows inflation, the economy will ____.
A) move to point A and unemployment will remain at the natural rate
B) move to point D and real GDP will increase
C) remain at point C because expectations have not changed
D) move to point B and real GDP will decrease
Answer: D

Topic: Credible Announcement
Level 3: Calculations and Predictions

97) An economy is currently at point C in the following figure. If the central bank announces that it will lower inflation, and the central bank has a reputation for doing what it says, then the economy will ____.
A) move to point B and real GDP will decrease
B) move to point B and real GDP will remain constant
C) move to point A and real GDP will remain constant
D) move to point A and real GDP will increase due to lower inflation
Answer: C