# Monetary Policy Cause and Effect

1. If the FED wants to increase the money supply, determine the use of the three FED tools and explain how the money supply increase would happen.

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| **Increase the money supply…** | **Reserve Requirement** | **Discount Rate** | **Open Market operations** |
| **Action by FED?** |  |  |  |
| **How is money supply change made?** |  |  |  |

1. If the FED wants to decrease the money supply, determine the use of the three FED tools and explain how the money supply decrease would happen.

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| **Decrease the**  **money supply…** | **Reserve Requirement** | **Discount Rate** | **Open Market operations** |
| **Action by FED?** |  |  |  |
| **How is money supply change made?** |  |  |  |

# Monetary Policy Cause and Effect Answer Key

1. If the FED wants to increase the money supply, determine the use of the three FED tools and explain how the money supply increase would happen.

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| **Increase the money supply…** | **Reserve Requirement** | **Discount Rate** | **Open Market operations** |
| **Action by FED?** | *Lower the requirement percentage* | *Lower the discount rate* | *Buy government securities* |
| **How is money supply change made?** | *When the requirement percentage is lower, banks have more excess reserves to make loans and money supply is increased.* | *When the discount rate is lower, banks can borrow funds at lower cost. They can make more loans and money supply is increased.* | *When the FED buys bonds, a deposit demand is created. Banks can make more loans after they set aside the required reserves and the money supply is increased.* |

1. If the FED wants to decrease the money supply, determine the use of the three FED tools and explain how the money supply decrease would happen.

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| **Decrease the money supply…** | **Reserve Requirement** | **Discount Rate** | **Open Market operations** |
| **Action**  **by FED?** | *Raise the requirement*  *percentage* | *Raise the discount*  *rate* | *Sell government*  *securities* |
| **How is money supply change made?** | *When the requirement percentage is higher, banks have fewer excess reserves to make loans and money supply is decreased.* | *When the discount rate is higher, banks can borrow less at the higher cost.*  *They make fewer loans and money supply is decreased.* | *When the FED sells bonds, buyers use their funds from a deposit demand. Banks have fewer excess reserves and the money supply is decreased.* |