Quiz 6 – Answers

Question 1
How does fiat money differ from commodities like gold and silver that were used as money?

A. Fiat money is easier to carry around than gold or silver coins.
B. **Fiat money is intrinsically worthless, whereas gold and silver have intrinsic value.**
C. It is more resistant to hyperinflationary forces than commodity money.
D. The unit of account measures can be tuned better to the prices in the economy.

Question 2
Over the last 50 years, credit cards have become an increasingly popular way for people to purchase goods and services.
Do credit cards satisfy all functions of money?

A. No, because not everyone accepts credit cards.
B. No, because credit cards are not assets.
C. Yes, because they are a medium of exchange.
D. Yes, because you are spending your money since you have to pay the credit card company back.

Question aimed at discussing three values of money

Question 3
According to the quantity theory of money, what must the growth rate of the money supply be, given the following information?
The growth rate of real GDP is 2.3 %.
The growth rate of nominal GDP is 3.7 %.
The nominal interest rate is 1.8 %.
The real interest rate is 0.4 %.
The money supply (M2) is $8,591 (in billions)

A. 0.4%
B. 1.4%
C. 1.8%
D. 2.3%
E. 3.7%

Discuss quantity theory of money by which the ratio of money supply to nominal GDP is exactly constant.

Question 4

What is the significance of the real wage as it relates to inflation?

A. Since an increase in inflation increases the real wage that firms must pay, firms are less willing to hire workers, thus depressing economic activity.
B. **Since an increase in inflation reduces the real wage that firms must pay, firms are more willing to hire workers, thus stimulating economic activity.**
C. The real wage drives inflation, and so a decrease in the real wage will decrease inflation and the overall price level in the economy.
D. The real wage is linked to the real interest rate, and so a change in the real wage will impact business investment.

Question 5

The federal funds rate is the

A. interest rate at the discount window where banks obtain overnight loans of reserves from one another.
B. interest rate at the discount window where banks obtain overnight loans of reserves from the Federal Reserve.
C. interest rate in the federal funds market where banks obtain overnight loans of reserves from one another.
D. interest rate in the federal funds market where banks obtain overnight loans of reserves from the Federal Reserve.

Question 6

An economic recession will imply

A. **An inward shift in the demand curve for reserves at the central bank**
B. An inward shift in the supply curve for reserves at the central bank
C. An outward shift in the demand curve for reserves at the central bank
D. An outward shift in the supply curve for reserves at the central bank

Question aimed at discussing demand and supply of reserves at the central bank; discuss possible factors of shifts in demand (recessions, liquidity needs, deposit requirements).

Question 7

How does the Federal Reserve usually work to affect the federal funds rate?

A. It shifts demand through changes in reserve requirements.
B. It shifts demand through open market operations.
C. It shifts supply through changes in reserve requirements.
D. It shifts supply through open market operations.

The question aims at discussing the working of the Federal Reserve in the fed funds market. See handout 12.

Question 8

Who bears the risk that a bank faces when stockholders' equity is greater than zero?

A. Depositors with accounts greater than $250,000.
B. Taxpayers.
C. The bank's stockholders.
D. The FDIC.

Explanation: Stockholder equity is the difference between a bank's total assets and total liabilities. When it’s positive, stockholders face the risk of variation in the price of assets. When it becomes negative, the risk must fall upon the depositors or, ultimately, taxpayers.