

Macroeconomics, 10e, Global Edition (Parkin)
Chapter 25 Money, the Price Level, and Inflation

1 What is Money?

1) The functions of money are

- A) medium of exchange and the ability to buy goods and services.
- B) medium of exchange, unit of account, and means of payment.
- C) pricing, contracts, and means of payment.
- D) medium of exchange, unit of account, and store of value.

Answer: D

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) Which of the following does NOT describe a function of money?

- A) a unit of account
- B) a hedge against inflation
- C) a medium of exchange
- D) a store of value

Answer: B

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) Which of the following is a primary function of money?

- A) to serve as a unit of account
- B) to serve as an encouragement to work
- C) to reduce the burden of excessive imports
- D) to raise funds for the government

Answer: A

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) The functions of money are

- A) interest rates, prices and output.
- B) M1, M2 or currency.
- C) currency, deposits, and traveler's checks.
- D) medium of exchange, unit of account, and store of value.

Answer: D

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

5) Which of the following is NOT considered a function of money?

- A) It facilitates exchange.
- B) It acts as a means of payment.
- C) It can be held and exchanged for future goods and services.
- D) It allows banks to lend out funds.

Answer: D

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

6) Which of the following does NOT describe a function of money?

- A) a unit of account
- B) barter
- C) a medium of exchange
- D) a store of value

Answer: B

Topic: What Is Money?

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

7) Barter is

- A) another type of money.
- B) printing too much money.
- C) the exchange of goods and services directly for other goods and services.
- D) the exchange of goods and services for any type of money.

Answer: C

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) The most direct way in which money replaces barter is through its use as a

- A) medium of exchange.
- B) recording device.
- C) store of value.
- D) unit of account.

Answer: A

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) The most direct way in which money eliminates the need for a double coincidence of wants is through its use as a

- A) medium of exchange.
- B) standard of deferred payment.
- C) store of value.
- D) unit of account.

Answer: A

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

10) Which function of money refers to the use of money to solve the problem of a need for a double coincidence of wants?

- A) medium of exchange
- B) unit of account
- C) store of value
- D) none of the above

Answer: A

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) A medium of exchange is

- A) an object that sellers will accept as payment.
- B) a measure by which prices are expressed.
- C) an asset that is used to settle future debts.
- D) the thing traded when barter takes place.

Answer: A

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

12) The "double coincidence of wants" problem is

- A) resolved under a system of barter.
- B) always present in all economic systems.
- C) resolved by the use of money.
- D) created by the use of money.

Answer: C

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) The direct exchange of goods and services for other goods and services is known as

- A) primitive trade.
- B) nonmarket trade.
- C) barter.
- D) purchasing power trading.

Answer: C

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

14) Barter occurs when you exchange

- A) money for goods.
- B) goods for money.
- C) goods for other goods.
- D) one money, such as U.S. dollars, for another money, such as Japanese yen.

Answer: C

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) The fact that using money avoids the double coincidence of wants necessary in a barter economy illustrates which function of money?

- A) medium of exchange
- B) unit of account
- C) store of value
- D) source of liquidity

Answer: A

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

16) Money _____.

- A) is always composed of coins and paper
- B) loses its value as it becomes older
- C) requires a double coincidence of wants
- D) is any commodity that is generally acceptable as a means of payment

Answer: D

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

17) If an economy has no money, then all transactions must be conducted through the use of _____.

- A) credit cards
- B) barter
- C) debit cards
- D) tobacco or wampum

Answer: B

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

18) In a barter system, we would see

- A) many different units of money.
- B) money and goods exchanged for each other.
- C) wide-spread depository institutions.
- D) goods traded directly for other goods and services.

Answer: D

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

19) When you buy a hamburger for lunch, you are using money as a

- A) store of value.
- B) standard of deferred payment.
- C) medium of exchange.
- D) unit of accounting.

Answer: C

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

20) When money is accepted as payment in a market transaction, it is functioning as a

- A) store of value.
- B) unit of accounting.
- C) medium of exchange.
- D) unit of investment.

Answer: C

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) Money's function as a medium of exchange means that

- A) money is a common denominator for expressing the prices of goods and services.
- B) money can be used to store wealth.
- C) money serves as an acceptable means of payment.
- D) money requires a double coincidence of wants.

Answer: C

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

22) Matthew purchases a candy bar with his allowance. This purchase represents using money as

- A) a medium of exchange.
- B) a store of value.
- C) an unit of account.
- D) none of the above

Answer: A

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

23) When you bought your textbook for this course, you were using money as a

- A) store of value.
- B) price mechanism.
- C) medium of exchange.
- D) unit of account.

Answer: C

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

24) Money as a medium of exchange

- I. facilitates the exchange of goods.
- II. reduces or eliminates the need for barter.

- A) I only
- B) II only
- C) both I and II
- D) neither I nor II

Answer: C

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

25) Suppose prices are quoted in dollars and transactions are conducted in pesos. The peso serves as a

- A) medium of exchange.
- B) store of value.
- C) unit of account.
- D) all of the above

Answer: A

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

26) Barter is an inefficient means of exchange because

- A) barter transactions require a double coincidence of wants.
- B) barter only occurs in relatively primitive economies.
- C) demand will not necessarily equal supply.
- D) in a barter transaction only one party needs to want what the other party has to sell.

Answer: A

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

27) The unit of account

- A) is a type of accounting of how many currency units there are in an economy.
- B) is an accounting of the total units of goods and services produced in an economy.
- C) is an agreed measure for stating the prices of goods and services in an economy.
- D) is a type of value stored within all assets.

Answer: C

Topic: Unit of Account

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

28) Which function of money refers to the use of money to state the prices of goods and services?

- A) medium of exchange
- B) unit of account
- C) store of value
- D) means of payment

Answer: B

Topic: Unit of Account

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) Which of the following applies to the use of money as a unit of account?

- I. A unit of account is an agreed measure for stating the prices of goods and services.
- II. Using money as a unit of account creates a simplified pricing system.
- III. Economies choose many goods as units of account.

- A) I only
- B) II only
- C) I and III
- D) I and II

Answer: D

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

30) A \$25,000 price tag on a new car is an example of money as

- A) medium of exchange.
- B) a unit of account.
- C) a store of value.
- D) a time deposit.

Answer: B

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

31) After you finish your degree, suppose your salary is \$52,000 per year. This is an example of using the function of money known as

- A) medium of exchange.
- B) a unit of account.
- C) a store of value.
- D) M1.

Answer: B

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

32) Suppose prices are quoted in dollars and transactions are conducted in pesos. The dollar serves as a

- A) medium of exchange.
- B) store of value.
- C) unit of account.
- D) all of the above

Answer: C

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

33) Suppose that I find out from an L.L. Bean catalogue that a sweater costs \$30.00. In this case, money is serving as a

- A) medium of exchange.
- B) unit of account.
- C) store of value.
- D) double coincidence of want.

Answer: B

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

34) As a unit of account, money is used to

- A) state prices of all goods and services.
- B) pay off future debts.
- C) hold purchasing power over time.
- D) exchange for goods and services.

Answer: A

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

35) Cigarettes served as money in some POW camps during World War II. Given this fact, we would expect to observe

- A) no one ever smoking a cigarette.
- B) people usually resorting to barter rather than using cigarettes as money.
- C) prices of other goods expressed in terms of cigarettes.
- D) only government-issued cigarettes being accepted as money.

Answer: C

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

36) Catherine compares the prices of candy bars in order to get the "best buy." This comparison represents using money as a

- A) medium of exchange.
- B) store of value.
- C) unit of account.
- D) none of the above

Answer: C

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

37) Frank spends Saturday afternoon at the Dodge dealership looking at new trucks. The model he is interested in has a sticker price of \$29,000. The fact the price is quoted in dollars is an example of money as a

- A) medium of exchange.
- B) unit of account
- C) store of value.
- D) All of the above answers are correct.

Answer: B

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

38) In a world with no money, costs are expressed in terms of other goods. If one video game costs two hamburgers, and a hamburger costs three sodas, how many sodas would it take to buy a video game?

- A) 6
- B) 5
- C) 3
- D) 3/2

Answer: A

Topic: Unit of Account

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

39) Which of the following is an example of using money as a store of value?

- A) paying for a new dress with a credit card
- B) paying cash for a new automobile
- C) paying rent with a check on a demand deposit
- D) keeping \$200 on hand for an emergency

Answer: D

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

40) When you toss your spare quarters into a jar so you can use them later at the laundromat, you are using money in its function as a

- A) medium of exchange.
- B) unit of account.
- C) store of value.
- D) record keeping device.

Answer: C

Topic: Store of Value

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

41) During periods of inflation, which function of money is most severely affected?

- A) medium of exchange
- B) unit of account
- C) means of payment
- D) store of value

Answer: D

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

42) Which of the following applies to an object serving as a store of value?

I. If an object can be held and exchanged later for a good or service, it serves as a store of value.

II. The less stable an object's value, the better it serves as a store of value.

III. A work of art can serve as a store of value.

A) I only

B) I and II

C) I and III

D) I, II and III

Answer: C

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

43) If an economy tried to use bananas as money, which function would bananas likely have the most difficult time fulfilling?

A) a store of value

B) a unit of account

C) a medium of exchange

D) a means of payment

Answer: A

Topic: Store of Value

Skill: Conceptual

Question history: New 10th edition

AACSB: Analytical Skills

44) Which of the following applies to money when it serves as a store of value?

I. Money is a store of value because it is an agreed measure for stating goods' prices.

II. The more stable money's value, the better it serves as a store of value.

III. When money serves as a store of value, it requires a double coincidence of wants.

A) I only

B) II only

C) I and II

D) II and III

Answer: B

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

45) Nicholas is saving money collected from his paper route in order to purchase a new bicycle.

His saving represents using money as

- A) a medium of exchange.
- B) a store of value.
- C) an unit of account.
- D) none of the above

Answer: B

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

46) U.S. currency _____.

- A) is less efficient than barter
- B) includes tobacco
- C) is the sum of M1 and M2
- D) is composed of the bills and coins that we use today

Answer: D

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

47) In the United States today, money consists of

- A) currency only.
- B) deposits at banks only.
- C) coins only.
- D) currency and deposits at banks.

Answer: D

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

48) Checking deposits are

- A) not part of money.
- B) part of money.
- C) small in volume relative to currency in circulation.
- D) quite different from checking accounts.

Answer: B

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

49) Which of the following is money?

- A) checking deposits
- B) checks in the checkbook
- C) credit cards
- D) All of the above are money.

Answer: A

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

50) Which of the following counts as part of money?

- A) \$10,000 of gold bars
- B) \$10,000 of government bonds
- C) \$10,000 in a checking account
- D) \$10,000 of corporate bonds

Answer: C

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

51) Which of the following correctly completes this statement? Money in the United States includes

- A) the sum of all money incomes.
- B) the cash in banks plus the sum of all checks written.
- C) the currency and bank deposits outside of banks.
- D) the sum of currency, deposits, and bonds held by the public and by the banking industry.

Answer: C

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

52) Checking deposits at banks are

- A) money.
- B) not money because they are an intangible.
- C) money only because they are insured by the FDIC.
- D) not money until they are converted into currency.

Answer: A

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

53) M1 includes

- A) currency, checking deposits and traveler's checks.
- B) money, stocks and bonds.
- C) money, checking deposits and traveler's checks.
- D) money market mutual funds, stocks and bonds.

Answer: A

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

54) The money aggregate M1 consists of

- A) currency and savings accounts.
- B) currency and demand deposits, including traveler's checks.
- C) only demand deposits and time deposits.
- D) checking accounts, savings accounts and Treasury bills.

Answer: B

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

55) M1 is a measure of

- A) money and includes both currency and checking deposits.
- B) liquidity and in which the most liquid asset is money.
- C) money and includes both savings deposits and currency.
- D) money and includes both savings deposits and money market mutual funds.

Answer: A

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

56) Which of the following is NOT included in the M1 definition of money?

- A) currency held outside banks
- B) time deposits
- C) traveler's checks
- D) checking deposits at savings and loans

Answer: B

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

57) M1 includes all the following items except _____.

- A) checking deposits owned by individuals and businesses
- B) traveler's checks
- C) deposits in money market mutual funds
- D) currency owned by individuals and businesses

Answer: C

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

58) Which of the following is NOT included in M1?

- A) currency
- B) checking deposits owned by individuals
- C) saving deposits
- D) traveler's checks

Answer: C

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

59) Which of the following is NOT included in the M1 measure of money?

- A) currency held outside banks
- B) currency held in bank vaults
- C) checking deposits at commercial banks
- D) checking deposits at credit unions

Answer: B

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

60) Which of the following is NOT included in the M1 measure of money?

- A) checking deposits
- B) currency
- C) traveler's checks
- D) savings deposits

Answer: D

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

61) Which of the following measures is NOT included in the M1 definition of money?

- A) currency held by the public
- B) time deposits
- C) checking deposits
- D) travelers checks

Answer: B

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

62) Which of the following is included in M1?

- A) the \$200 you charged on your credit card to purchase your textbooks
- B) the \$200 check you wrote to purchase your textbooks
- C) the \$200 in cash you used to purchase your textbooks
- D) the \$200 loan you arranged to purchase your textbooks

Answer: C

Topic: Money in the United States Today, M1

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

63) In an economy, there is \$200 million in currency held outside banks, \$100 million in traveler's checks, \$250 million in currency held inside the banks, \$300 million in checking deposits, and \$600 million in savings deposits. The value of M1 is _____.

- A) \$750 million
- B) \$1,200 million
- C) \$1,150 million
- D) \$600 million

Answer: D

Topic: Money in the United States Today, M1

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

64) M2 _____.

- A) does not include currency
- B) does not include traveler's checks
- C) is a broader measure of money than M1
- D) does not include checking deposits held at credit unions

Answer: C

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

65) The definition of M2 includes

- A) M1.
- B) savings deposits.
- C) time deposits.
- D) all of the above

Answer: D

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

66) The definition of M2 includes

- I. M1.
 - II. money market mutual funds.
 - III. currency held outside of banks.
- A) I and II only
 - B) I and III only
 - C) II and III only
 - D) I, II, and III

Answer: D

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

67) Which of the following is NOT included in the M2 definition of money?

- A) currency held by banks
- B) money market mutual fund balances
- C) savings deposits
- D) checkable deposits

Answer: A

Topic: Money in the United States Today, M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

68) Which of the following is NOT included in the M2 measure of money?

- A) checking deposits
- B) traveler's checks
- C) time deposits
- D) shares of the stocks of large companies

Answer: D

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

69) The largest component of M2 is

- A) savings deposits
- B) currency
- C) money market mutual funds
- D) travelers checks

Answer: A

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

70) Which of the following is part of M2?

- A) checks
- B) credit cards
- C) currency held inside a bank
- D) none of these are part of M1 or M2

Answer: D

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

71) M2 is

- A) smaller than M1.
- B) larger than M1.
- C) equal to M1, given full employment.
- D) equal to M1, but only when all three functions of money apply.

Answer: B

Topic: Money in the United States Today, M1 and M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

72) Checking deposits are included in

- A) M1 only.
- B) M2 only.
- C) M1 and M2.
- D) neither M1 nor M2.

Answer: C

Topic: Money in the United States Today, M1 and M2

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

73) Currency held outside the banking system is included

- A) in M1 but not M2.
- B) in M2 but not M1.
- C) in both M1 and M2.
- D) in neither M1 nor M2.

Answer: C

Topic: Money in the United States Today, M1 and M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

74) Comparing M1 and M2 we know that

- A) M1 is larger because it contains currency.
- B) M2 is approximately equal to M1.
- C) M2 is larger because it contains M1 and other assets.
- D) M2 is larger because it contains more liquid assets than does M1.

Answer: C

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

75) Suppose you cash in a Certificate of Deposit (a small time deposit) to acquire the traveler's checks you'll need for your vacation. What happens to M1 and M2?

- A) M1 and M2 both increase.
- B) M1 stays the same and M2 increases.
- C) M1 increases and M2 decreases.
- D) M1 increases and M2 stays the same.

Answer: D

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

76) If you use \$500 of currency to make a deposit in a saving deposit,

- A) M1 decreases, but M2 is unchanged
- B) M1 decreases and M2 increases
- C) M1 is unchanged, but M2 increases
- D) M1 and M2 both increase

Answer: A

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

77) Sam has \$500 in traveler's checks. He cashes a \$100 traveler check, deposits \$150 into his checking account at a Savings and Loan Association, and deposits the remaining \$250 into a savings account at a credit union. Immediately, _____.

- A) M1 decreases by \$250 and M2 does not change
- B) M1 decreases by \$400 and M2 increases by \$250
- C) M1 does not change and M2 increases by \$250
- D) M1 and M2 do not change

Answer: A

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

78) A new financial innovation results in people switching their funds from checking deposits to savings accounts. The quantity of M1 _____ and the quantity of M2 _____.

- A) decreases; decreases
- B) increases; decreases
- C) decreases; does not change
- D) decreases; increases

Answer: C

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

Component	Amount (billions of dollars)
Money market mutual fund deposits	4,400
Time deposits	1,237
Savings deposits	1,589
Checking deposits	752
Currency	609

79) Based on the data in the table above, what is the value of M1?

- A) \$2,950 billion
- B) \$1,361 billion
- C) \$752 billion
- D) \$609 billion

Answer: B

Topic: Money in the United States Today, M1

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

80) Based on the data in the table above, what is the value of M2?

- A) \$2,950 billion
- B) \$4,187 billion
- C) \$4,400 billion
- D) \$8,587 billion

Answer: D

Topic: Money in the United States Today, M2

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Component	Amount (billions of dollars)
Currency	235
Checking deposits	570
Savings deposits	416
Traveler's checks	8
Time deposits	1,144
Money market mutual funds	930
Available credit on credit cards	675

81) According to the table above, the value of M1 is _____ and the value of M2 is _____.

- A) \$813 billion; \$2490 billion
- B) \$805 billion; \$2490 billion
- C) \$813 billion; \$3303 billion
- D) \$1,488 billion; \$3978 billion

Answer: C

Topic: Money in the United States Today, M1 and M2

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Component	Amount (billions of dollars)
Currency	300
Checking deposits	600
Savings deposits	450
Traveler's checks	10
Time deposits	1,200
Money market mutual funds	1,100
Available credit on credit cards	900

82) According to the table above, the value of M1 is _____ and the value of M2 is _____.

- A) \$860 billion; \$2,750 billion
- B) \$910 billion; \$1,960 billion
- C) \$860 billion; \$4,560 billion
- D) \$910 billion; \$3,660 billion

Answer: D

Topic: Money in the United States Today, M1 and M2

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

83) Liquidity is the

- A) speed with which the price of an asset changes as its intrinsic value changes.
- B) inverse of the velocity of money.
- C) same as the velocity of money.
- D) ease with which an asset can be converted into money.

Answer: D

Topic: Liquidity

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

84) Liquidity is the

- A) degree to which an asset acts as money without a loss of value.
- B) ease with which an asset can be converted into a means of payment with little loss of value.
- C) degree to which money can be converted into an asset with little loss of value.
- D) ease with which credit cards are accepted as a means of payment.

Answer: B

Topic: Liquidity

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

85) Liquidity is the same as

- A) easy conversion of money to an asset, allowing for loss of value.
- B) diversification of an investor's store of value.
- C) easy conversion of an asset to a means of payment, allowing for loss of value.
- D) easy conversion of an asset to a means of payment, with little or no loss of value.

Answer: D

Topic: Liquidity

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

86) A highly liquid asset

- A) has high transaction costs associated with its sale.
- B) is highly leveraged.
- C) generally has a very limited market for its resale.
- D) can be converted into a means of payment easily without loss of value.

Answer: D

Topic: Liquidity

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

87) Liquidity _____.

- A) increases when a country owns gold
- B) increases when a consumer has more credit cards
- C) is how quickly an asset loses its worth
- D) is the property of being instantly convertible into money

Answer: D

Topic: Liquidity

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

88) In the list of assets below, which is the most liquid?

- A) \$500 worth of Ford Motors common stock
- B) \$500 worth of Ford Motors bonds
- C) a \$500 traveler's check
- D) a one-ounce gold coin

Answer: C

Topic: Liquidity

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

89) An individual wanting the most liquid asset possible will hold

- A) currency.
- B) a savings account.
- C) gold.
- D) U.S. government bonds.

Answer: A

Topic: Liquidity

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

90) Which of the following is the most liquid?

- A) the U.S. dollars in your pocket.
- B) the funds in your checking account.
- C) your house.
- D) your friend's house.

Answer: A

Topic: Liquidity

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

91) Which of the following is the most liquid?

- A) the U.S. dollars that your professor used this morning to buy breakfast.
- B) your credit card.
- C) gold.
- D) the pencil or pen in your hand right now.

Answer: A

Topic: Liquidity

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

92) Which of the following is the most liquid asset?

- A) money
- B) land
- C) a government bond
- D) a share of stock

Answer: A

Topic: Liquidity

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

93) Checks _____ money and credit cards _____ money.

- A) are; are
- B) are not; are
- C) are; are not
- D) are not; are not

Answer: D

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

94) Which of the following is NOT money?

- A) currency
- B) checking deposits
- C) checks in the checkbook
- D) All of the above are money.

Answer: C

Topic: Checks Are Not Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

95) Checks are

- A) the largest component of the money supply.
- B) not money.
- C) only part of M2 but not part of M1.
- D) part of M1 but not part of M2.

Answer: B

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

96) Which of the following is true?

- I. Checks are considered money because they can be used as a medium of exchange.
 - II. Checks represent a transfer of money.
- A) I only
 - B) II only
 - C) both I and II
 - D) neither I nor II

Answer: B

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

97) Checks _____ money and checking deposits _____ money.

- A) are; are
- B) are; are not
- C) are not; are
- D) are not; are not

Answer: C

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

98) Checks are NOT money because they

- A) are issued by banks, not by the government.
- B) are merely instructions to transfer money.
- C) have value in exchange but little intrinsic value.
- D) are not backed by either gold or silver.

Answer: B

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

99) Credit cards are

- A) money but are not a large part of the money supply.
- B) not money.
- C) money and are the largest part of the money supply.
- D) not money because they are not made of paper.

Answer: B

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

100) Credit cards are

- A) not a part of money because they are not a means of payment.
- B) a part of M1 but not of M2.
- C) a part of money because they are used to purchase goods and services.
- D) a part of M2 but not a part of M1.

Answer: A

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

101) Credit cards are

- A) a part of money because they are used in so many transactions.
- B) a part of money when the transaction approach is used but not when the liquidity approach is used.
- C) not part of money because they represent a loan of money to the user.
- D) not part of money because the government has no control over the amount of credit outstanding.

Answer: C

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

102) Using a credit card can best be likened to

- A) taking out a loan.
- B) a barter exchange.
- C) using any other form of money because you immediately get to take the goods home.
- D) writing a check on your demand deposit account.

Answer: A

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

103) Credit cards are NOT money because they

- A) have a value in exchange but little intrinsic value.
- B) are not issued by the government.
- C) do not serve as a unit of account.
- D) are ID cards that make borrowing easier.

Answer: D

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

104) Checks and credit cards are NOT considered money because they

- A) are issued by banks, not the Federal Reserve.
- B) are not the means of payment.
- C) typically require an identification check, such as your driver's license.
- D) are not backed by all commercial banks.

Answer: B

Topic: Checks and Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

105) Which of the following is NOT a function of money?

- A) medium of exchange
- B) barter
- C) unit of account
- D) store of value

Answer: B

Topic: Study Guide Question, Barter

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

106) The fact that money can be exchanged for goods reflects money's role as a

- A) cause of inflation.
- B) medium of exchange.
- C) unit of account.
- D) store of value.

Answer: B

Topic: Study Guide Question, Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2 Depository Institutions

1) Which of the following is considered a depository institution?

- I. the U.S. Treasury
 - II. a commercial bank like Citibank
 - III. a credit union for federal government employees
- A) I only
 - B) I and II
 - C) II and III
 - D) I, II and III

Answer: C

Topic: Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) Which of the following institutions is NOT a depository institution?

- A) the U.S. Treasury
- B) a commercial bank
- C) a money market mutual fund
- D) a thrift institution, such as a savings and loan association

Answer: A

Topic: Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) A depository institution is a firm that takes deposits from _____ and makes loans to _____.

- A) households and firms; other households and firms
- B) firms; households
- C) households; firms
- D) firms; other firms

Answer: A

Topic: Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 4) A depository institution is
A) the lender of last resort.
B) an insurance agency, such as the FDIC.
C) the most powerful body within the Federal Reserve.
D) as a financial that accepts deposits from households and firms.

Answer: D

Topic: Depository Institutions

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 5) Depository institutions
A) make profit from the spread between the interest rate they pay on deposits and the interest rate they receive on loans.
B) make a profit according to how much the Federal Reserve pays them.
C) make their profit by charging the government for their services.
D) make zero profit but receive compensation by the government because their services are so valuable.

Answer: A

Topic: Depository Institutions

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 6) The major role of a commercial bank is to
A) make mortgage loans.
B) sell shares and use the proceeds to buy stocks.
C) receive deposits and make loans.
D) restrain the growth of the quantity of money.

Answer: C

Topic: Commercial Banks

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 7) Commercial banks do not
A) buy U.S. government Treasury bills.
B) accept deposits from their customers.
C) make loans to creditworthy individuals and businesses.
D) determine what assets are money.

Answer: D

Topic: Commercial Banks

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) Modern U.S. commercial banks perform all of the following functions EXCEPT

- A) accept checking deposits.
- B) issue paper currency.
- C) make loans to households and business firms.
- D) accept savings deposits.

Answer: B

Topic: Commercial Banks

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) A savings bank is a depository institution that _____.

- A) sells shares which it uses to purchase shares in U.S. Treasury bills
- B) makes mostly home-purchase loans
- C) is owned by a social or economic group
- D) makes mostly consumer loans

Answer: B

Topic: Savings Banks

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

10) Examples of thrift institutions include

- A) savings deposits and checking deposits.
- B) commercial banks, savings and loan associations, and insurance companies.
- C) savings and loan associations, savings banks, and credit unions.
- D) money market mutual funds, commercial banks, and credit unions.

Answer: C

Topic: Thrift Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) A credit union is

- A) a combination of credit card corporations.
- B) an depository institution owned by members of a particular group.
- C) a thrift institution that issues credit cards.
- D) a commercial bank owned by its depositors.

Answer: B

Topic: Credit Union

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

12) Money market mutual funds invest in

- A) residential mortgages.
- B) commercial real estate.
- C) long-term government securities.
- D) highly liquid assets.

Answer: D

Topic: Money Market Mutual Funds

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) Sarah buys shares from a financial institution that uses her funds together with other funds to purchase U.S. treasury bills. Sarah has deposited her money into a _____.

- A) savings bank
- B) credit union
- C) money market mutual fund
- D) savings and loan association

Answer: C

Topic: Money Market Mutual Funds

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

14) Money market mutual funds

- A) are provided by the Federal Reserve as liquidity for private banks.
- B) have no restrictions on shareholder withdrawals.
- C) do not provide any checking services to their owners.
- D) allow shareholders to write check on their funds.

Answer: D

Topic: Money Market Mutual Funds

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) Which of the following is true regarding money market mutual funds?

- I. Money market mutual funds buy highly liquid assets like Treasury bills.
- II. Shareholders can obtain loans from money market mutual funds.

- A) I only
- B) II only
- C) both I and II
- D) neither I nor II

Answer: A

Topic: Money Market Mutual Funds

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 16) A money market mutual fund is
- A) essentially the same as a demand deposit account.
 - B) a time deposit of \$100,000 or less.
 - C) a time deposit of more than \$100,000.
 - D) a depository institution that sells shares and buys securities such as U.S. Treasury bills.

Answer: D

Topic: Money Market Mutual Funds

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 17) For a commercial bank, the term "reserves" refers to
- A) a banker's concern ("reservation") in making loans to an individual without a job.
 - B) the profit that the bank retains at the end of the year.
 - C) the cash in its vaults and its deposits at the Federal Reserve.
 - D) the net interest that it earns on loans.

Answer: C

Topic: Banks' Reserves

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 18) Which of the following are part of a commercial bank's reserves?

- I. cash in the bank's vaults
 - II. loans
 - III. cash in checking accounts
- A) I only
 - B) I and II
 - C) I and III
 - D) I, II and III

Answer: A

Topic: Banks' Reserves

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 19) Reserves are _____.

- A) gold in a bank's vault plus its gold at Federal Reserve banks
- B) cash in a bank's vault plus its deposits at Federal Reserve banks
- C) cash in a bank's vault plus its gold at Federal Reserve banks
- D) cash in a bank's vault plus the cash carried by its customers

Answer: B

Topic: Banks' Reserves

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

20) A bank's reserves include

- A) the cash in its vault plus the value of its depositors' accounts.
- B) the cash in its vault plus its deposits held at a Federal Reserve bank.
- C) the cash in its vault plus any gold held for the bank at Fort Knox.
- D) its common stock holdings, the cash in its vault, and any deposits at a Federal Reserve bank.

Answer: B

Topic: Banks' Reserves

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) Bank reserves include

- I. the cash in the bank's vault
- II. the bank's deposits at the Federal Reserve

- A) only I
- B) only II
- C) both I and II
- D) neither I nor II

Answer: C

Topic: Banks' Reserves

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

22) Of the following, the riskiest assets held by commercial banks are

- A) reserves.
- B) U.S. government bonds.
- C) U.S. government Treasury bills.
- D) loans.

Answer: D

Topic: Commercial Banks

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

23) An asset category that carries the highest interest rate is

- A) checkable deposit accounts.
- B) loans.
- C) cash in the bank vault.
- D) savings deposits.

Answer: B

Topic: Commercial Banks

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 24) Which of the following functions are performed by depository institutions?
- I. They make long-term loans using short-term deposits, thereby creating liquidity.
 - II. They efficiently gather funds from a large base of depositors.
 - III. They concentrate risk.
- A) I only
 - B) II only
 - C) III only
 - D) I and II

Answer: D

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 25) Which of the following is a service of depository institutions?
- A) decreasing the liquidity drain of funds in the banking system
 - B) monitoring the Federal Reserve
 - C) pooling risk
 - D) loaning funds to other depository institutions at the discount rate

Answer: C

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 26) Which of the following is a service of depository institutions?
- A) monitoring the Federal Reserve
 - B) decreasing the liquidity drain in the banking system
 - C) loaning funds to other depository institutions at the discount rate
 - D) creating liquidity

Answer: D

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 27) Depository institutions are good at minimizing
- A) the costs of monitoring borrowers.
 - B) risky borrowers.
 - C) liquidity.
 - D) all of the above

Answer: A

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

28) If a savings and loan "pools risk," which of the following must it do?

- A) take funds in from a large number of lenders
- B) have a large spread between the interest rate it charges borrowers and the interest rate it pays lenders
- C) lend money to a large number of firms
- D) Both answers A and C are correct.

Answer: D

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) Depository institutions undertake all the following activities except they do not _____.

- A) print money
- B) minimize the cost of monitoring borrowers
- C) pool risk
- D) create liquidity

Answer: A

Topic: Economic Functions of Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

30) Depository institutions do all of the following EXCEPT

- A) set the required reserve ratio
- B) create liquidity
- C) pool risks
- D) minimize the cost of obtaining funds

Answer: A

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

31) Liquidity can

- A) not be created.
- B) be created by borrowing short and lending long.
- C) only be created by the government.
- D) be created by borrowing long and lending short.

Answer: B

Topic: The Economic Functions of Depository institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

32) The practice of borrowing short and lending long

- A) pools risk.
- B) minimizes the cost of monitoring borrowers.
- C) creates liquidity.
- D) All of the above answers are correct.

Answer: C

Topic: The Economic Functions of Depository institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

33) Which of the following is NOT an economic benefit of depository institutions?

- A) They borrow long and lend short
- B) They create liquidity
- C) They pool risk
- D) They reduce the cost of monitoring borrowers

Answer: A

Topic: The Economic Functions of Depository institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

34) Depository institution create liquidity when they

- A) buy assets that are liquid.
- B) borrow short and lend long.
- C) have liabilities that are illiquid.
- D) borrow long and lend short.

Answer: B

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

35) Which of the following allow banks to minimize the cost to a business of borrowing?

- I. Borrowing long and lending short.
 - II. Raising funds from a large number of depositors.
 - III. Creating money by lending all their reserves.
- A) I only
 - B) II only
 - C) I and III
 - D) II and III

Answer: B

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

36) When banks use specialized resources to monitor borrowers, they are

- A) pooling risk.
- B) lowering the cost of creating liquidity.
- C) minimizing the cost of assessing borrowers' creditworthiness.
- D) lending to only high-risk borrowers.

Answer: C

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

37) The risk of making a loan is

- A) earning profits that are too high and cause higher taxes.
- B) the risk that lender does not pay.
- C) the risk that the borrower does not pay.
- D) called "default risk" when taxes are not paid.

Answer: C

Topic: Economic Functions of Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

38) Pooling of risk occurs when depository institutions

- A) make assets more liquid.
- B) specialize in loaning only to good borrowers.
- C) bring lenders together.
- D) lend to a variety of different borrowers.

Answer: D

Topic: Economic Functions of Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

39) When a depository institution pools risk, it

- A) buys short and lends long.
- B) borrows reserves from the Federal Reserve.
- C) spreads loan losses across many depositors so that no one depositor faces a high degree of risk.
- D) makes loans to just one firm.

Answer: C

Topic: Economic Functions of Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

40) Financial innovation is

- A) the process of turning assets into a more liquid form.
- B) the development of new financial products and services.
- C) responsible for credit cards being included as part of money.
- D) causing a decrease in bank profits.

Answer: B

Topic: Financial Innovation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

41) Depository institutions do all the following EXCEPT

- A) minimize the cost of obtaining funds.
- B) create liquidity.
- C) pool risks.
- D) create required reserve ratios.

Answer: D

Topic: Study Guide Question, Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3 The Federal Reserve System

1) The Federal Reserve System is the

- A) insurance agency the insures deposits.
- B) central bank of the United States.
- C) law enforcement agency that tracks counterfeit money.
- D) federal government agency that undertakes deregulation for depository institutions.

Answer: B

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) In the United States, the central bank is the _____.

- A) Bank of America
- B) Federal Reserve System
- C) Federal Reserve Bank of New York
- D) Federal Reserve Bank of Washington D.C.

Answer: B

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) Which of the following is the central bank of the United States?

- A) Comptroller of the Currency
- B) Treasury Department
- C) Federal Reserve System
- D) Office of the Budget

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) The Federal Reserve System

- A) regulates the nation's financial institutions.
- B) conducts the nation's monetary policy.
- C) Both answers A and B are correct.
- D) Neither answer A nor B is correct.

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

5) All the following statements about the Federal Reserve are true EXCEPT it _____.

- A) is a public authority
- B) regulates a nation's depository institutions
- C) accepts checking deposits from the nation's residents
- D) controls the quantity of money

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

6) The Bank of Japan is Japan's central bank. As part of its duties, the Bank of Japan would

- A) provide banking services to Japan's citizens and firms.
- B) provide banking services to foreigners.
- C) control the quantity of money in circulation in Japan.
- D) change tax rates.

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

7) As a "central bank," which of the following is true regarding the Fed?

- I. The Fed is a public authority that regulates the nation's banks.
- II. The Fed is not allowed to provide services to commercial banks like Citibank.
- III. The Fed is required to provide banking services to private citizens.

- A) I
- B) II
- C) I and II
- D) I and III

Answer: A

Topic: The Federal Reserve System

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) The Federal Reserve System

- A) has officers that are elected, like members of Congress.
- B) controls the amount of currency in circulation.
- C) is headquartered in San Francisco.
- D) was recently declared unconstitutional by the Supreme Court.

Answer: B

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) Control of the nation's quantity of money is handled by

- A) Congress.
- B) the Federal Reserve System.
- C) the President of the United States.
- D) Congress, the Federal Reserve System, and all commercial banks.

Answer: B

Topic: Monetary Policy

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

10) Monetary policy is conducted

- A) only by the Federal Reserve.
- B) by the Federal Reserve and the President of the United States.
- C) by the Federal Reserve, the President of the United States, and Congress.
- D) by the Federal Reserve with veto power residing with the President of the United States.

Answer: A

Topic: Monetary Policy

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) When the Fed is _____ it is _____.

- A) adjusting the amount of money in circulation; issuing government bonds
- B) issuing government bonds; conducting monetary policy
- C) adjusting the amount of money in circulation; conducting monetary policy
- D) regulating the nation's financial institutions; conducting monetary policy

Answer: C

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

12) Controlling the quantity of money and interest rates to influence aggregate economic activity is called

- A) foreign policy.
- B) monetary policy.
- C) fiscal policy.
- D) bank antitrust policy.

Answer: B

Topic: Monetary Policy

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) The interest rate banks charge other banks for overnight loans is

- A) the federal funds rate.
- B) targeted by the FDIC
- C) higher than interest rates for securities and loans.
- D) lower than interest rates for loans, but higher than interest rates for securities.

Answer: A

Topic: Monetary Policy

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

14) The nation is divided into _____ Federal Reserve districts, each having a Federal Reserve Bank.

- A) 10
- B) 52
- C) 12
- D) 7

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) There are _____ regional Federal Reserve banks.

- A) 10
- B) 12
- C) 15
- D) over 10,000

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

16) The Federal Reserve has _____ regional Federal Reserve banks and _____ members of the Board of Governors.

- A) 12; 12
- B) 12; 7
- C) 7; 12
- D) 7; 7

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

17) Regional Federal Reserve banks

- A) are located in each of the 50 states.
- B) are run by the governors of the states in which they are located.
- C) provide general banking services to the public.
- D) None of the above answers is correct.

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

18) Which of the following institutions is NOT part of the structure of the Federal Reserve system?

- A) The Federal Open Market Committee
- B) The Federal Reserve Banks
- C) The Board of Governors
- D) The Federal Government

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

19) Members of the Federal Reserve System's Board of Governors

- A) are elected for life.
- B) hold 14-year staggered terms.
- C) are a special subcommittee of the Senate.
- D) are elected at large by district banks.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

20) The Board of Governors of the Federal Reserve System consists of

- A) 7 members appointed by Congress and 7 appointed by the President.
- B) the presidents of each regional Federal Reserve bank.
- C) 12 members appointed by Congress.
- D) 7 members appointed by the President of the United States.

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) The Board of Governors is the

- A) Presidents of the 12 regional banks of the Federal Reserve.
- B) 7-member group that oversees the Federal Reserve.
- C) 12-member monetary policy committee of the Federal Reserve.
- D) 50-member organization of state banking regulators of the Federal Reserve.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

22) The Board of Governors of the Federal Reserve System is

- A) appointed by the Congress.
- B) elected by the public.
- C) appointed by the President of the United States and confirmed by the U.S. Senate.
- D) elected by members of the American Banking Association.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

23) This group consists of seven members appointed by the President of the United States for 14-year terms:

- A) the presidents of the Federal Reserve Banks.
- B) the members of the Federal Open Market Committee.
- C) the members of the Board of Governors.
- D) None of the above answers are correct.

Answer: C

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

24) The Board of Governors of the Federal Reserve System does NOT

- A) consist of seven members with fourteen-year terms.
- B) include the presidents of the twelve Federal Reserve Banks.
- C) utilize a system of rotations so that a position comes open every two years.
- D) consist of members whose appointments have been approved by the Senate.

Answer: B

Topic: The Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

25) The Federal Open Market Committee

- A) consists of the Fed chairman and the 12 regional bank presidents.
- B) is the main policy-making organ of the Federal Reserve.
- C) is headed by the president of the New York Federal Reserve Bank.
- D) meets every week to review the state of the economy.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

26) The Federal Open Market Committee (FOMC)

- A) consists of the 12 districts of the Federal Reserve.
- B) is the 7-member group that oversees the Federal Reserve.
- C) is the 12-member monetary policy committee of the Federal Reserve.
- D) is the 50-member organization of state banking regulators of the Federal Reserve.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

27) The Federal Open Market Committee (FOMC) is composed of
A) representatives from the governors of all 50 states.
B) Presidents of 5 Federal Reserve regional banks and the Board of Governors.
C) the 12 Presidents of the Federal Reserve regional banks.
D) the Board of Governors, the Vice-President of the United States, and the Secretary of Treasury for the United States.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

28) The Federal Open Market Committee (FOMC)
A) determines the government's tax policy.
B) determines the Fed's monetary policy.
C) oversees all transactions on the stock market.
D) lends to the least credit-worthy customers who otherwise can't get loans.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) The Federal Open Market Committee consists of the
A) Federal Reserve chairman and the other six members of the Board of Governors.
B) Federal Reserve branch bank presidents.
C) Federal Reserve chairman and the Federal Reserve branch bank presidents.
D) Federal Reserve chairman, the other six members of the Board of Governors, and the Federal Reserve branch bank presidents.

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

30) The main policy-making organ of the Federal Reserve System is
A) the Board of Governors.
B) the Federal Reserve branch banks.
C) the Federal Reserve chairman and the Federal Reserve branch bank presidents.
D) the Federal Open Market Committee.

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

31) Which part of the Federal Reserve System meets every 6 weeks to determine the nation's monetary policy?

- A) Federal Open Market Committee
- B) Board of Governors
- C) the Federal Reserve Banks
- D) depository institutions such as commercial banks

Answer: A

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

32) Which of the following is TRUE regarding the Federal Open Market Committee (FOMC)?

- A) It is the main policy-making group of the Congress.
- B) Representatives from each state control its operation.
- C) It meets about every six weeks to decide on monetary policy.
- D) Both answers A and C are correct.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

33) The monetary policy-making body of the Federal Reserve is the

- A) the Federal Open Market Committee
- B) the New York Federal Reserve Bank
- C) regional Federal Reserve Banks
- D) Board of Governors

Answer: A

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

34) Which Federal Reserve Bank president is always on the Federal Open Market Committee?

- A) New York
- B) Chicago
- C) St. Louis
- D) Boston

Answer: A

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 35) The Federal Open Market Committee of the Federal Reserve System is responsible for
- A) maintaining competition among the nation's commercial banks.
 - B) determining monetary policy actions.
 - C) establishing the official price of gold.
 - D) defining the foreign exchange value of the dollar.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 36) The Federal Open Market Committee
- A) meets weekly to set Fed policy.
 - B) has 7 voting members.
 - C) always includes the president of the Federal Reserve Bank of New York as a member.
 - D) does not include any members of the Board of Governors.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 37) The main policy-making organ of the Federal Reserve System is the
- A) Board of Governors.
 - B) Federal Reserve bank presidents.
 - C) Federal Open Market Committee.
 - D) Joint Congressional Committee on Monetary Policy.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 38) The main policy-making body of the Federal Reserve System is the
- A) Board of Governors.
 - B) Federal Open Market Committee.
 - C) Federal Reserve Banks.
 - D) member commercial banks.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

39) The main policy-making organization of the Federal Reserve System is the _____.

- A) U.S. Mint
- B) U.S. Treasury
- C) monetary commission
- D) Federal Open Market Committee

Answer: D

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

40) The main policy designer of the Federal Reserve system is the

- A) 12 district banks.
- B) President and Congress.
- C) Federal Open Market Committee.
- D) Council of Economic Advisors.

Answer: C

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

41) The main policy making group that makes decisions about the nation's monetary policy is the

- A) Federal Reserve Banks.
- B) Federal Open Market Committee.
- C) Board of Governors.
- D) federal government.

Answer: B

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

42) The Chairman of the Fed is appointed by _____.

- A) the Board of Governors of the Federal Reserve System
- B) the President of the United States
- C) Congress
- D) the U.S. Senate

Answer: B

Topic: The Fed's Power Center

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

43) The current chairman of the Federal Reserve System is

- A) Milton Friedman.
- B) Alan Greenspan.
- C) President Obama.
- D) Ben Bernanke.

Answer: D

Topic: The Fed's Power Center

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

44) The chairman of the Federal Reserve's Board of Governors

- A) controls the agenda of the Federal Open Market Committee meetings.
- B) is the main point of contact between the Fed and the President of the U.S.
- C) receives frequent background briefings on monetary policy issues from a large staff of economists and technical experts.
- D) All of the above answers are correct.

Answer: D

Topic: The Fed's Power Center

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

45) Most of the day-to-day power in monetary policy decisions lies with

- A) the President of the United States
- B) the Senate Banking Committee
- C) the chairman of the Board of Governors
- D) large commercial banks

Answer: C

Topic: The Fed's Power Center

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

46) On the Fed's balance sheet, assets include

- A) depository institutions deposits at the Federal Reserve and loans to depository institutions.
- B) U.S. government securities and loans to depository institutions.
- C) Federal Reserve notes and depository institutions' deposits at the Federal Reserve.
- D) Federal Reserve notes and loans to depository institutions.

Answer: B

Topic: Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

47) Which of the following is an asset of the Fed?

- A) loans to depository institutions
- B) Federal Reserve notes
- C) banks' deposits
- D) Both answers B and C are correct.

Answer: A

Topic: Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

48) Which of the following is an asset of the Federal Reserve?

- A) loans to depository institutions
- B) Federal Reserve notes
- C) commercial bank deposits
- D) the monetary base

Answer: A

Topic: The Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

49) Which of the following is NOT an asset of the Federal Reserve?

- A) Federal Reserve notes
- B) government securities
- C) loans to depository institutions
- D) None of the above are correct because they are all assets of the Federal Reserve

Answer: A

Topic: The Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

50) Which of the following is NOT an asset of the Federal Reserve System?

- A) loans to depository institutions
- B) reserves of depository institutions
- C) U.S. government securities
- D) None of the above are correct because they are all assets of the Federal Reserve

Answer: B

Topic: The Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

51) Which of the following is a liability of the Federal Reserve?

- A) Federal Reserve notes
- B) loans to depository institutions
- C) U.S. government securities
- D) U.S. coins

Answer: A

Topic: The Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

52) Which of the following is a liability on the balance sheet of the Federal Reserve System?

- A) Federal Reserve notes
- B) U.S. government securities
- C) Loans to depository institutions
- D) None of the above are correct because they are all liabilities of the Federal Reserve

Answer: A

Topic: The Fed's Balance Sheet

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

53) The monetary base is the sum of

- A) U.S. Treasury notes and other government securities.
- B) Federal Reserve notes, coins, and deposits of depository institutions.
- C) foreign and domestic deposits at the Fed.
- D) coins, currency, and checkable deposits.

Answer: B

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

54) The monetary base is the sum of

- A) Federal Reserve notes, coins, and deposits of depository institutions
- B) currency, travelers' checks, and checking deposits
- C) currency
- D) M1 and M2

Answer: A

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

55) The monetary base consists of

- A) the quantity of money.
- B) the sum of Federal Reserve notes, coins, and depository institutions' deposits at the Fed.
- C) demand deposits and vault cash.
- D) government securities held by the Fed.

Answer: B

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

56) The monetary base is

- A) the sum of Federal Reserve notes, coins, and depository institutions' deposits at the Federal Reserve.
- B) Federal Reserve notes minus depository institutions' deposits at the Federal Reserve.
- C) depository institutions' deposits at the Federal Reserve minus Federal Reserve notes.
- D) the money borrowed by banks from other banks.

Answer: A

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

57) The monetary base does NOT include

- A) Federal Reserve notes.
- B) reserves of depository institutions.
- C) checking accounts at commercial banks.
- D) commercial banks' reserves.

Answer: C

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

58) Which of the following is NOT part of the monetary base?

- A) Federal Reserve notes
- B) reserves of depository institutions at the Fed
- C) the public's checking deposits at commercial banks
- D) coins

Answer: C

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

59) The sum of Federal Reserve notes, coins, and depository institutions' reserves is the _____.

- A) reserves of the Fed
- B) assets of the Fed
- C) monetary base
- D) liabilities of the Fed

Answer: C

Topic: Monetary Base

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

60) Which of the following is NOT a part of the monetary base?

- A) Chemical Bank's deposits of reserves at the Fed
- B) First Bank's required reserves held at the Federal Reserve
- C) Federal Reserve notes
- D) U.S. government securities owned by the Fed

Answer: D

Topic: Monetary Base

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

61) Which of the following is a tool that is used by the Fed to control the quantity of money?

- A) open market operations
- B) excess reserves
- C) government expenditure multiplier
- D) real interest rate

Answer: A

Topic: The Fed's Policy Tools

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

62) Which of the following is NOT a monetary policy tool of the Federal Reserve?

- A) changes in required reserves
- B) last resort loans
- C) deposit insurance
- D) open market operations

Answer: C

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

63) Which of the following is NOT one of the Fed's monetary policy tools?

- A) last resort loans
- B) the required reserve ratio
- C) the income tax rate
- D) buying and selling U.S. government securities

Answer: C

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

64) Which of the following tools is NOT a policy tool of the Fed?

- A) last resort loans
- B) the tax rate on interest income
- C) the reserve ratio
- D) open market operations

Answer: B

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

65) Which of the following is NOT a monetary policy tool?

- A) last resort loans
- B) open market operations
- C) required reserve ratio
- D) federal funds rate

Answer: D

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

66) Which of the following is NOT a policy tool of the Federal Reserve System?

- A) open market operations
- B) the tax rate imposed on interest income
- C) the interest rate charged by the Fed for loans to member banks
- D) the amount of required reserves held by member banks

Answer: B

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

67) The tools at the disposal of the Fed for changing the quantity of money do NOT include

- A) open market operations.
- B) changing the required reserve ratio.
- C) changing discount rates.
- D) increasing the number of commercial banks.

Answer: D

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

68) Federal Reserve policy tools include all of the following EXCEPT

- A) excess reserve ratios.
- B) required reserve ratios.
- C) last resort loans.
- D) open market operations.

Answer: A

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

69) Federal Reserve policy tools include all of the following EXCEPT

- A) desired reserve ratios.
- B) required reserve ratios.
- C) the discount rate.
- D) open market operations.

Answer: A

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

70) The minimum percentage of deposits that a depository institution must hold and cannot use for lending is known as the

- A) minimum rate.
- B) required reserve ratio.
- C) money multiplier.
- D) discount rate.

Answer: B

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

71) Reserve requirements are the

- A) minimum percentages of deposits that banks must hold as reserves.
- B) minimum amount of an owner's financial resources that must be placed in a depository institution.
- C) rules covering the types of deposits that banks may offer.
- D) rules covering the types of assets that banks may purchase.

Answer: A

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

72) The fraction of deposits that banks must keep on hand or at the Federal Reserve is called the

- A) discount rate.
- B) required reserve ratio.
- C) deposit multiplier.
- D) money multiplier.

Answer: B

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

73) The required reserve ratio is the ratio of reserves to _____ required by banking regulations.

- A) deposits
- B) loans
- C) profits
- D) cash

Answer: A

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

74) The required reserve ratio

- A) is the amount of money that banks require borrowers to reserve in their accounts.
- B) is the fraction of a bank's total deposits that are required to be held in reserve.
- C) increases when withdrawals from a bank are made.
- D) is higher for banks that make riskier loans.

Answer: B

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

75) Which of the following is true regarding the required reserve ratio?

- A) The ratio determines the legally required amount of reserves a bank must hold.
- B) The ratio determines the amount of excess reserves a bank must hold.
- C) The ratio is only enforced against banks that are operating in a risky manner.
- D) None of the above answers is correct.

Answer: A

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

76) Required reserves for a commercial bank

- A) are the reserves a bank is legally required to hold to back its deposits.
- B) are only the reserves required to be held in the bank's vault.
- C) are only the money used by the bank tellers.
- D) consist only of deposits at the Fed.

Answer: A

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

77) The required reserve ratio ranges from

- A) 0 to 3 percent.
- B) 0 to 7 percent.
- C) 3 to 30 percent.
- D) 0 to 10 percent.

Answer: D

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

78) Changing which of the following is a Federal Reserve monetary policy tool?

- A) required reserve ratios.
- B) desired reserve ratios.
- C) excess reserve ratios.
- D) gold and foreign reserve ratios

Answer: A

Topic: The Fed's Policy Tools, Required Reserve Ratio

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

79) The discount rate is the interest rate
A) that banks charge their best customers.
B) that the Fed charges on its last resort loans.
C) on interbank lending.
D) that bank insurers pay on insured deposits.
Answer: B
Topic: The Fed's Policy Tools, Discount Rate
Skill: Recognition
Question history: Previous edition, Chapter 8
AACSB: Reflective Thinking

80) When the Federal Reserve lends reserves to depository institutions, it charges them interest. That interest rate is called the
A) federal funds rate.
B) loan rate.
C) prime rate.
D) discount rate.
Answer: D
Topic: The Fed's Policy Tools, Discount Rate
Skill: Recognition
Question history: Previous edition, Chapter 8
AACSB: Reflective Thinking

81) The interest rate that the Fed charges when it makes a last resort loan is the _____ rate.
A) discount
B) short-term
C) reserve
D) federal funds
Answer: A
Topic: The Fed's Policy Tools, Discount Rate
Skill: Recognition
Question history: Previous edition, Chapter 8
AACSB: Reflective Thinking

82) The discount rate is the interest rate that
A) the Federal Reserve charges when it loans reserves to depository institutions.
B) is the lowest rate that banks will charge when lending to their best customers.
C) the Federal Reserve charges when it loans to the U.S. Government.
D) banks charge when they lend to each other.
Answer: A
Topic: The Fed's Policy Tools, Discount Rate
Skill: Recognition
Question history: Previous edition, Chapter 8
AACSB: Reflective Thinking

83) The discount rate is the interest rate

- A) paid on time deposits.
- B) paid on funds banks borrow from other banks.
- C) paid on funds that depository institutions borrow from the Federal Reserve.
- D) that banks charge their "best" customers.

Answer: C

Topic: The Fed's Policy Tools, Discount Rate

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

84) The _____ rate is the interest rate at which the Fed lends _____ to depository institutions.

- A) discount rate; reserves
- B) discount rate; gold
- C) federal funds rate; deposits
- D) federal funds rate; reserves

Answer: A

Topic: The Fed's Policy Tools, Discount Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

85) When the Fed wants to undertake open market operations, it

- A) can require all commercial banks to buy from or sell to it.
- B) can require all member banks to buy from or sell to it.
- C) buys or sells securities.
- D) buys securities from or sells securities to the federal government.

Answer: C

Topic: The Fed's Policy Tools, Open Market Operations

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

86) An open market operation occurs when the _____ buys or sells securities _____.

- A) Federal Reserve System; from or to the federal government
- B) Federal Reserve System; in the open market
- C) a commercial bank; from or to the federal government
- D) a commercial bank; from or to the public

Answer: B

Topic: The Fed's Policy Tools, Open Market Operations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 87) An open market operation involves
- A) the Federal Reserve's purchase or sale of securities.
 - B) the Federal Reserve's issuance of new stock.
 - C) changing federal income tax rates.
 - D) raising the debt limit of the United States.

Answer: A

Topic: The Fed's Policy Tools, Open Market Operations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 88) When the Fed sells government securities to a bank, how are the Fed's *assets* affected?

- A) The amount of the Fed's government securities decreases.
- B) The amount of the Fed's government securities increases.
- C) The amount of reserves held at the Fed increases.
- D) The amount of reserves held at the Fed decreases.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 89) An open market purchase of securities by the Fed

- A) increases banks' reserves and decreases banks' securities.
- B) decreases banks' reserves and increases banks' securities.
- C) decreases banks' total assets.
- D) involves a bank purchasing government securities from the Fed.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: New 10th edition

AACSB: Analytical Skills

- 90) An open market sale of securities by the Fed

- A) decreases banks' reserves and increases banks' securities.
- B) increases banks' reserves and decreases banks' securities.
- C) increases banks' total assets.
- D) involves a bank selling government securities to the Fed.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: New 10th edition

AACSB: Analytical Skills

91) In an open market purchase, the Fed _____ government securities, which _____ bank reserves.

- A) buys, increases
- B) buys, decreases
- C) sells, increases
- D) sells, decreases

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

92) The Fed buys securities and gives the bank a check for the amount. After the check has cleared,

- A) reserves remain unchanged because the increase of reserves at the bank are offset by an increase in reserves at the Fed.
- B) reserves have decreased by the amount of the check because the Fed pays for the check by decreasing the bank's deposits at the Fed.
- C) reserves have increased by the amount of the check because the Fed pays for the check by increasing the amount of the bank's deposits with the Fed.
- D) reserves have increased by the amount of the reserves multiplied by the required reserve ratio, and the quantity of money increases by the difference between the amount of the check and the increase in the reserves.

Answer: C

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

93) If the Federal Reserve purchases government securities,

- A) banks' reserves will increase.
- B) the federal funds rate will rise.
- C) the discount rate will be forced higher.
- D) None of the above answers is correct because none of the effects occur.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 94) When the Fed buys U.S. government securities from a bank, the Fed
- A) loans the money needed to buy the securities to the bank.
 - B) increases the bank's reserves at the Fed.
 - C) obtains the money for the purchase from the U.S. Treasury.
 - D) decreases the monetary base and raises the federal funds rate.

Answer: B

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 95) If the Fed buys \$100 in securities from a commercial bank, the
- A) Fed's assets will decrease.
 - B) quantity of money will decrease.
 - C) quantity of reserves will increase.
 - D) amount of reserves will not change.

Answer: C

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 96) If the Fed sells government securities,
- A) commercial bank reserves will decrease.
 - B) the government's debt will be decreased.
 - C) commercial bank reserves will increase.
 - D) there will be no effect on the quantity of money.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 97) The initial impact of the Fed's open market sale of government securities to banks is
- A) an increase in the quantity of money by some multiple of the dollar volume of the sale.
 - B) an increase in bank deposits at the Fed.
 - C) a decrease in the quantity of money by some multiple of the dollar volume of the sale.
 - D) a decrease of the banking system's reserve deposits at the Fed.

Answer: D

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 98) A decrease in the quantity of reserves supplied to commercial banks could be the result of
- A) a decision by U.S. households to hold less currency.
 - B) the sale of government securities by the Federal Reserve.
 - C) a decrease in the government's budget deficit.
 - D) an increase in the exchange rate.

Answer: B

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 99) The Fed's purchase of government securities will
- A) increase loans made by banks.
 - B) be an effective anti-inflationary policy.
 - C) decrease the price level and have no effect on real GDP.
 - D) decrease bank reserves.

Answer: A

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

- 100) When the Fed buys one million dollars in government securities from a commercial bank,
- A) the Fed's total assets decrease by one million dollars.
 - B) the commercial bank's total assets increase by one million dollars.
 - C) there is a change in the composition of the commercial bank's assets: reserves increase and government securities decrease.
 - D) All of the above answers are correct.

Answer: C

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

- 101) If the Fed buys \$100,000 in U.S. government securities from a commercial bank, the bank now has an additional \$100,000 of
- A) total assets.
 - B) excess reserves.
 - C) actual reserves.
 - D) net worth.

Answer: C

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

102) When the Fed sells one million dollars in securities to a commercial bank,

- A) the Fed's total assets increase by one million dollars.
- B) the commercial bank's total assets decrease by one million dollars.
- C) there is no change in the total assets of the Fed or the commercial bank.
- D) None of the above answers is correct.

Answer: D

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

103) Which of the following will occur if the Fed buys \$10 million of securities from the University National Bank?

- A) The Fed will pay by increasing the University National Bank's deposit account with the Fed by \$10 million.
- B) The University National Bank has \$10 million more in securities.
- C) The Fed will pay by decreasing the University National Bank's deposit account with the Fed by \$10 million.
- D) The University National Bank has \$10 million less in excess reserves.

Answer: A

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

104) The Fed buys \$100 million of government securities from Bank A. What is the effect on the Federal Reserve's balance sheet?

- A) Securities increase by \$100 million and Federal Reserve notes (currency) decrease by \$100 million.
- B) Securities increase by \$100 million and reserves of Bank A increase by \$100 million.
- C) Securities increase by \$100 million and reserves of Bank A decrease by \$100 million.
- D) Securities decrease by \$100 million and reserves of Bank A increase by \$100 million.

Answer: B

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

105) The Fed buys \$100 million of government securities from Bank A. What is the effect on Bank A's balance sheet?

- A) Securities decrease by \$100 million and reserves increase by \$100 million.
- B) Securities decrease by \$100 million and deposits decrease by \$100 million.
- C) Securities increase by \$100 million and reserves decrease by \$100 million.
- D) Securities increase by \$100 million and reserves increase by \$100 million.

Answer: A

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

Banking System Balance Sheet	
Assets	Liabilities
Reserves	
Required	
\$200,000	
Excess	
\$0	
Total reserves	Deposits
\$200,000	\$2,000,000
Loans	
<u>1,800,000</u>	
Total assets	Total liabilities
2,000,000	\$2,000,000

106) Using the data in the above table, an open market operation in which the Fed purchased \$100,000 of government securities from a bank would

- A) create a reserve deficiency for the banking system.
- B) lead to a rise in the federal funds rate.
- C) increase the banking system's reserves by \$100,000.
- D) cause demand deposits to fall by \$100,000.

Answer: C

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

107) When the Fed lowers the federal funds rate, it leads to

- A) the Fed selling government securities.
- B) an increase in lending by banks.
- C) a decrease in demand deposits.
- D) a decrease in the quantity of money.

Answer: B

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

108) The sale of government securities by the Fed leads to

- A) a decrease in bank reserves.
- B) a contraction in bank lending.
- C) an increase in the federal funds rate.
- D) All of the above answers are correct.

Answer: D

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

109) The sale of \$1 billion of securities to a bank or some other business by the Fed is an example of

- A) a last resort loan.
- B) a multiple contraction of the quantity of money.
- C) an open market operation.
- D) a change in the required reserve ratio.

Answer: C

Topic: Study Guide Question, Open Market Operations

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

4 How Banks Create Money

1) Money is created by

- A) government taxation.
- B) banks taking in deposits.
- C) banks making loans.
- D) banks paying for depositor's insurance.

Answer: C

Topic: How Banks Create Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) The majority of money is created when

- A) banks make loans
- B) new coins are minted
- C) the federal government borrows from the public
- D) the Fed sells bonds

Answer: A

Topic: How Banks Create Money

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 3) A bank creates money by
A) lending its excess reserves
B) purchasing currency from the Federal Reserve
C) buying bonds from the Federal Reserve
D) printing more checks

Answer: A

Topic: How Banks Create Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 4) Banks create money whenever they
A) accept a deposit.
B) lend excess reserves to a borrower.
C) receive monthly payments on their loans.
D) receive interest on existing loans.

Answer: B

Topic: How Banks Create Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 5) Whenever a bank's actual reserves exceed its desired reserves, the bank
A) can lend out additional funds.
B) needs to call in loans.
C) will go out of business.
D) must increase the amount of its required reserves by obtaining more cash.

Answer: A

Topic: How Banks Create Money

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

- 6) Commercial banks are able to create money by
A) printing Federal Reserve Notes.
B) making loans.
C) making customers pay back their loans.
D) exchanging their reserves at the Fed for vault cash.

Answer: B

Topic: How Banks Create Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

7) The banking system in the United States creates money through the combination of excess reserves and

- A) banks loaning excess reserves.
- B) commodity money.
- C) banks' assets being more than their liabilities.
- D) stringent Federal Reserve regulations.

Answer: A

Topic: How Banks Create Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) If the desired reserve ratio is 3 percent and deposits totaled \$575 billion, banks would hold

- A) \$534.75 in reserves.
- B) \$17.25 billion in excess reserves.
- C) \$1,725 billion in currency.
- D) \$17.25 billion in reserves.

Answer: D

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

9) A bank with \$100 million in deposits has \$15 million of cash in the bank, \$10 million in deposits with the Fed, and \$15 million in government securities in its vault. Its total reserves equal

- A) \$10 million.
- B) \$15 million.
- C) \$25 million.
- D) \$40 million.

Answer: C

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

10) If required reserves are \$150 and deposits are \$1000, what is the required reserve ratio?

- A) 10 percent
- B) 15 percent
- C) 5 percent
- D) 85 percent

Answer: B

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

11) If a customer deposits \$10,000 in currency into a checking account, the bank's total reserves _____.

- A) increase
- B) do not change
- C) are greater than 100 percent
- D) decrease

Answer: A

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

12) A bank's required reserves are calculated by multiplying _____.

- A) its deposits by the required reserve ratio
- B) the sum of its deposits and cash in its vault by the reserve ratio
- C) cash in its vault by the required reserve ratio
- D) the gold in its vault by the reserve ratio

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) When bank deposits increase from \$1 million to \$2 million, banks' required reserves increase from \$100,000 to \$200,000. The required reserve ratio is _____.

- A) 10.0
- B) 0.10
- C) 1.00
- D) 0.25

Answer: B

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

14) Excess reserves are

- A) desired reserves minus actual reserves.
- B) required reserves minus actual reserves.
- C) liquidity funds minus actual reserves.
- D) actual reserves minus desired reserves.

Answer: D

Topic: Reserves: Actual and Required

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) The difference between actual reserves and required reserves is

- A) net worth.
- B) excess reserves.
- C) illegal reserves.
- D) borrowings from the Fed.

Answer: B

Topic: Reserves: Actual and Required

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

16) Excess reserves are equal to

- A) the sum of desired reserves plus any reserves that are more than are required.
- B) actual reserves minus desired reserves.
- C) actual reserves plus desired reserves.
- D) desired reserves minus actual reserves.

Answer: B

Topic: Reserves: Actual and Required

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

17) The commercial banks on Sunny Island have checking deposits of \$4 million, reserves of \$600,000, and loans of \$2.4 million. The desired reserve ratio is 10 percent. The banks have _____ of desired reserves and _____ of excess reserves.

- A) \$600,000; \$0
- B) \$400,000; \$200,000
- C) \$400,000; \$600,000
- D) \$600,000; \$200,000

Answer: B

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

18) Suppose a bank has \$1,500,000 in deposits and the desired reserve ratio is 12 percent. If the bank is currently holding \$200,000 in reserves, the excess reserves are equal to

- A) zero.
- B) \$40,000.
- C) \$120,000.
- D) \$20,000.

Answer: D

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

19) If Bank A holds \$200 in reserves, deposits are \$1000, and the desired reserve ratio is 15 percent, how much are excess reserves?

- A) zero, because banks never hold excess reserves
- B) \$200
- C) \$50
- D) \$150

Answer: C

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

20) A small commercial bank has \$10,000 in actual reserves, \$60,000 in deposits, and has a 10 percent desired reserve ratio. Its excess reserves are

- A) \$4,000.
- B) \$10,000.
- C) \$50,000.
- D) \$60,000.

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

21) Suppose that a bank begins with \$500 million in deposits and \$100 million in reserves and is just meeting its desired reserve ratio. Now suppose a decrease in the required reserve ratio lowers the desired reserve ratio to 10 percent. After the fall in the desired reserve ratio but before the bank makes any changes, the bank's excess reserves are

- A) 0.
- B) \$400 million.
- C) \$450 million.
- D) \$50 million.

Answer: D

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

22) Suppose a bank has a desired reserve requirement ratio of 12 percent. If someone deposits \$1,000 in the bank,

- A) immediately after the deposit, excess reserves increase by \$880.
- B) the bank can make loans of \$1,000.
- C) the bank's desired reserves rise by \$1,000.
- D) Both answers B and C are correct.

Answer: A

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

23) Suppose a bank is exactly meeting its desired reserve ratio of 10 percent and a new deposit of \$75,000 is made. Immediately after the deposit is made, the bank's excess reserves equal

- A) zero.
- B) \$7,500.
- C) \$67,500.
- D) It is impossible to determine without additional information.

Answer: C

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

24) A bank cannot create money unless its _____.

- A) required reserves are greater than actual reserves
- B) excess reserves are zero
- C) desired reserves are greater than actual reserves
- D) excess reserves equal deposits multiplied by the reserve ratio

Answer: C

Topic: Reserves and Loans

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

25) You deposit \$4,000 in currency in your checking account. The bank holds 20 percent of all deposits as desired reserves. As a direct result of your deposit, your bank will make loans and by so doing will create

- A) \$200 of new money.
- B) \$800 of new money.
- C) \$1,600 of new money.
- D) \$3,200 of new money.

Answer: D

Topic: Reserves and Loans

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

26) You withdraw \$2,000 from your account. Your bank has a desired reserve ratio of 20 percent. This transaction, by itself, will directly reduce

- A) the quantity of money by \$1,600.
- B) deposits by \$1,600.
- C) the quantity of money by \$2,000.
- D) deposits by \$2,000.

Answer: D

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

TBK Bank Balance Sheet	
Assets	Liabilities
Reserves	Deposits
\$120	\$600
Loans	Net worth
580	100
Total assets	Total liabilities
\$700	\$700

27) The above table presents the balance sheet of the TBK commercial bank. What is this bank's actual reserve ratio?

- A) \$120
- B) \$700
- C) 20 percent
- D) 17.14 percent

Answer: C

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

28) The above table presents the balance sheet of the TBK commercial bank. If the desired reserve ratio is 25 percent, what is this bank's desired reserves?

- A) \$120
- B) \$150
- C) \$175
- D) 20 percent

Answer: B

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Assets	Liabilities
Reserves \$100	Deposits \$400
Loans \$600	Net Worth \$300
Total \$700	Total \$700

29) The above table gives the initial balance sheet for Mini Bank. Mini Bank's actual reserve ratio equals _____.

- A) 25 percent
- B) 14.3 percent
- C) 33.3 percent
- D) 20 percent

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

30) The above table gives the initial balance sheet for Mini Bank. If the bank's desired reserve ratio is 10 percent, how much does this bank have in excess reserves?

- A) \$60
- B) \$100
- C) \$40
- D) \$10

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

31) The above table gives the initial balance sheet for Mini Bank. Mini Bank's balance sheet is such that it will make

- A) more loans.
- B) fewer loans.
- C) no change in its lending.
- D) you cannot predict what the bank will do from this balance sheet.

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Assets	Liabilities
Reserves \$30	Deposits
Loans \$970	\$1,000
Total \$1,000	Total \$1,000

32) The above table gives the initial balance sheet for Mega Bank. Mega Bank's desired reserves equal its required reserves. Based on the initial balance sheet, what is the required reserve ratio for Mega Bank?

- A) 3 percent
- B) 10 percent
- C) 30 percent
- D) 1.4 percent

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

33) The above table gives the initial balance sheet for Mega Bank. Barney comes into the bank and deposits \$50 of currency into his checking account. The desired reserve ratio is 3 percent. After Barney's deposit, but before any other actions occur, MegaBank will have excess reserves of

- A) \$15.00.
- B) \$33.00.
- C) \$48.50.
- D) \$50.00.

Answer: C

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

34) The above table gives the initial balance sheet for Mega Bank. Barney comes into the bank and deposits \$50 of currency into his checking account. The desired reserve ratio is 3 percent. After Barney's deposit, but before any other actions occur, what volume of loans will be made by MegaBank if the bank wants more profit and holds no excess reserves?

- A) \$15.00
- B) \$33.00
- C) \$48.50
- D) \$50.00

Answer: C

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8
AACSB: Analytical Skills

Assets	Liabilities
Reserves \$500	Deposits
Loans \$2,500	\$3,000
Total assets \$1,000	Total \$3,000

35) The table above shows the balance sheet for Ralph's Bank. If the desired reserve ratio is 15 percent, Ralph's Bank has desired reserves of _____.

- A) \$3,000
- B) \$2,500
- C) \$500
- D) \$450

Answer: D

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

36) The table above shows the balance sheet for Ralph's Bank. If the desired reserve ratio is 15 percent, Ralph's Bank has excess reserves of _____.

- A) \$50
- B) \$500
- C) \$3,000
- D) \$2,500

Answer: A

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

37) The table shows the balance sheet for Ralph's Bank. If the desired reserve ratio is 15 percent, the maximum additional amount that Ralph's Bank can loan is equal to _____.

- A) \$50
- B) \$500
- C) \$3,000
- D) \$2,500

Answer: A

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

38) When a bank has excess reserves

- A) it can create money.
- B) it can make loans.
- C) it has too many loans.
- D) Both answers A and B are correct.

Answer: D

Topic: Reserves and Loans

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

39) A bank can only make a loan if it has

- A) excess reserves.
- B) a creditworthy customer willing to pay a high interest rate.
- C) permission from the Federal Reserve.
- D) reserves equal to its deposits.

Answer: A

Topic: Reserves and Loans

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

40) Given a desired reserve ratio of 20 percent, a commercial bank that has received a new deposit of \$100 can make additional loans of

- A) \$0.
- B) \$20.
- C) \$80.
- D) \$400.

Answer: C

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

41) A bank has no excess reserves. Then it receives a new deposit for \$100,000. If it has a desired reserve ratio of 20 percent, by how much can it increase its loans?

- A) \$20,000
- B) \$80,000
- C) \$400,000
- D) \$500,000

Answer: B

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

42) Suppose Bank A holds \$200 of reserves, has deposits of \$1000, and the desired reserve ratio is 15 percent. How many loans can Bank A create *at* Bank A?

- A) zero, because Bank A has no excess reserves
- B) \$200
- C) \$50
- D) \$850

Answer: C

Topic: Reserves and Loans

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

43) Suppose Bank A holds \$200 of reserves, has deposits of \$1000, and the desired reserve ratio is 20 percent. How many deposits can Bank A create?

- A) zero, because Bank A has no excess reserves
- B) \$200
- C) \$850
- D) \$50

Answer: A

Topic: Reserves and Loans

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

University National Bank Balance Sheet

Assets	Liabilities
Reserves \$320	Deposits \$440
Loans <u>120</u>	
Total assets \$440	Total liabilities \$440

44) The above table has the balance of the University National Bank. All figures are in millions of dollars. The desired reserve ratio is 20 percent. What is the value of excess reserves held by the University National Bank?

- A) \$120 million
- B) \$232 million
- C) \$320 million
- D) \$760 million

Answer: B

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

45) The above table has the balance of the University National Bank. All figures are in millions of dollars. The desired reserve ratio is 20 percent. What would be the total increase in loans at this bank if all excess reserves were loaned out?

- A) \$1,160 million
- B) \$600 million
- C) \$232 million
- D) \$0

Answer: C

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

46) When part of the quantity of money is held in currency, then

- A) a currency drain occurs.
- B) there is a higher level of excess reserves.
- C) the money multiplier will increase in value.
- D) the Fed will find it beneficial to increase the discount rate.

Answer: A

Topic: Currency Drain

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

47) An increase in currency held outside the banks is _____.

- A) a currency drain
- B) income
- C) a currency surplus
- D) wealth

Answer: A

Topic: Currency Drain

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

48) Currency outside of banks increases from \$100 million to \$200 million. This change is considered

- A) a currency drain.
- B) a decrease in the monetary base.
- C) expansionary monetary policy.
- D) contractionary monetary policy.

Answer: A

Topic: Currency Drain

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

49) An increase in the currency drain

- A) leads to an increase in excess reserves.
- B) decreases the size of the money multiplier.
- C) results in an increase in deposits.
- D) results in an increase in required reserves.

Answer: B

Topic: Currency Drain

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

50) The larger the public's currency drain from the banking system, the

- A) smaller is the monetary base.
- B) smaller is the money multiplier.
- C) larger is the monetary base.
- D) larger is the money multiplier.

Answer: B

Topic: Currency Drain

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

51) When the Fed conducts an open market operation by purchasing securities from a bank, _____.

- A) public holdings of securities increase
- B) the bank's deposits increase but its reserves do not change
- C) the bank's deposits increase but its reserves decrease
- D) the bank's reserves increase

Answer: D

Topic: How an Open Market Operation Works

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

52) Which of the following best describes the chain of events in the money creation process?

A) The monetary base increases. Banks acquire excess reserves which they loan out, increasing deposits and also the quantity of money. The new deposits then create additional excess reserves.

B) Currency is drained from the quantity of money into the banking system, where it is lent out. The loans are spent, increasing the currency drain and also the quantity of money.

C) Desired reserves increase, encouraging banks to seek new deposits. When the new depositors come in, desired reserves decrease and the quantity of money increases.

D) Low interest rates discourage people from holding currency. When they deposit the currency, interest rates rise, increasing the quantity of money.

Answer: A

Topic: The Multiplier Effect of an Open Market Operation

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

53) The monetary expansion process from an open market operation continues until

A) required reserves are eliminated.

B) the Federal Reserve takes actions to stop the process.

C) the discount rate is lower than market interest rates.

D) excess bank reserves are eliminated.

Answer: D

Topic: The Multiplier Effect of an Open Market Operation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

54) The money multiplier determines how much

A) real GDP will be expanded given an increase in autonomous investment.

B) the monetary base will be expanded given a change in the quantity of money.

C) the quantity of money will be expanded given a change in the monetary base.

D) money demand will expand given a change in the quantity of money.

Answer: C

Topic: The Money Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

55) The money multiplier is

A) the amount by which a change in the quantity of money is multiplied to determine the change in the monetary base.

B) the amount by which a change in the monetary base is multiplied to determine the change in the quantity of money.

C) equal to bank reserves divided by the change in the monetary base.

D) equal to bank reserves divided by the change the quantity of money.

Answer: B

Topic: The Money Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

56) When the monetary base increases by \$2 billion, the quantity of money increases by \$10 billion. Thus, the money multiplier equals

A) 0.2

B) 5

C) 20.0

D) none of the above

Answer: B

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

57) When the monetary base increases by \$4 billion, the quantity of money increases by \$10 billion. Thus, the money multiplier equals

A) 0.4

B) 2.5

C) 40.0

D) none of the above

Answer: B

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

58) If an increase in the monetary base of \$8 billion increases the quantity of money by \$64 billion, then the money multiplier is equal to _____.

- A) \$64 billion
- B) 8
- C) \$8 billion
- D) 1/8

Answer: B

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

59) Suppose that the money multiplier is 3. If the monetary base increases by \$1 million, the quantity of money will

- A) increase by \$3 million.
- B) increase by \$300,000.
- C) decrease by \$3 million.
- D) decrease by \$300,000.

Answer: A

Topic: Using the Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

60) Suppose that the money multiplier is 4. If the monetary base decreases by \$2 million, the quantity of money will

- A) increase by \$8 million.
- B) increase by \$500,000.
- C) decrease by \$8 million.
- D) decrease by \$500,000.

Answer: C

Topic: Using the Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Assets	Liabilities
Reserves \$400	Deposits \$1,200
Loans \$800	
Total \$1,200	Total \$1,200

61) In the balance sheet above, the entries are in millions of dollars for the FBN Bank. If the desired reserve ratio on deposits is 10 percent, FBN Bank has desired reserves of

- A) \$700 million.
- B) \$120 million.
- C) \$100 million.
- D) \$0.

Answer: B

Topic: Study Guide Question, Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

62) In the balance sheet above, the entries are in millions of dollars for the FBN Bank. If the desired reserve ratio equals 10 percent, FBN Bank has excess reserves of

- A) \$280 million.
- B) \$200 million.
- C) \$100 million.
- D) \$0.

Answer: A

Topic: Study Guide Question, Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

63) In the balance sheet above, the entries are in millions of dollars for the FBN Bank. If the desired reserve ratio on deposits is 10 percent, FBN Bank can loan an additional

- A) \$280 million.
- B) \$200 million.
- C) \$100 million.
- D) \$0.

Answer: A

Topic: Study Guide Question, Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

64) In the balance sheet above, the entries are in millions of dollars for the FBN Bank. After FBN Bank loans the maximum amount it can, the loans have been spent, and the proceeds have been deposited in other banks, FBN Bank has excess reserves of

- A) \$300 million.
- B) \$200 million.
- C) \$100 million.
- D) \$0.

Answer: D

Topic: Study Guide Question, Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

65) If the money multiplier is 3.5, a \$10 billion increase in the monetary base

- A) increases the quantity of money by \$35 billion.
- B) increases the quantity of money by \$10 billion.
- C) increases the quantity of money by \$3.5 billion.
- D) increases the quantity of money but not by an amount given above.

Answer: A

Topic: Study Guide Question, Using the Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

5 The Money Market

1) The quantity of money that people choose to hold depends on which of the following?

- I. The price level.
- II. Financial innovation.
- III. The exchange rate.

- A) I
- B) I and II
- C) I and III
- D) I, II, and III

Answer: B

Topic: Influences on Money Holding

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) Which of the following affects the amount of money a person is willing to hold?

- A) The use of credit cards increases.
- B) The price level rises from 103 to 107.
- C) The interest rate that you earn on your savings account increases.
- D) All of the above are correct.

Answer: D

Topic: Influences on Money Holding

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) If the price level rises, the quantity of

- A) nominal money people demand increases.
- B) real money people demand increases.
- C) nominal money people demand decreases.
- D) real money people demand decreases.

Answer: A

Topic: Influences on Money Holding, The Price Level

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 4) The demand for nominal money
A) increases as the price level increases.
B) decreases as the price level increases.
C) depends on the quantity of money.
D) is the same as the demand for real money.

Answer: A

Topic: Influences on Money Holding, The Price Level

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 5) Which of the following decreases the demand for nominal money?

- A) a decrease in the nominal interest rate
B) an increase in real GDP
C) an increase in the quantity of money
D) a decrease in the price level

Answer: D

Topic: Influences on Money Holding, The Price Level

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 6) If the price level doubles, the
A) nominal demand for money increases.
B) nominal demand for money decreases.
C) real demand for money decreases.
D) real demand for money increases.

Answer: A

Topic: Influences on Money Holding, The Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 7) Suppose you hold \$50 to buy groceries weekly and then the price of groceries increases by 5 percent. To be able to buy the same amount of groceries, what must happen to your nominal money holdings?

- A) They must increase by \$5.
B) They can decrease by \$5.
C) They must increase by \$2.50.
D) They must increase, but the amount of the increase is different than the above answers.

Answer: C

Topic: Influences on Money Holding, The Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

8) The quantity of real money demanded is

- A) negatively related to the price level.
- B) positively related to the price level.
- C) independent of the price level.
- D) sometimes negatively and sometimes positively related to the price level.

Answer: C

Topic: Influences on Money Holding, The Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) The real quantity of money is

- A) inversely related to GDP.
- B) measured in current dollars.
- C) inversely related to the price level.
- D) measured in constant dollars.

Answer: D

Topic: Influences on Money Holding, The Price Level

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

10) When price levels rise, the quantity of nominal money demanded will _____ and the quantity of real money demanded will _____.

- A) increase; stay the same
- B) increase; increase
- C) increase; decrease
- D) decrease; increase

Answer: A

Topic: Influences on Money Holding, The Price Level

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) When the nominal interest rate rises, the

- A) quantity of money demanded decreases.
- B) demand for money decreases.
- C) demand for money increases.
- D) quantity of money demanded increases.

Answer: A

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

12) The opportunity cost of holding money balances rather than other assets is

- A) the nominal interest rate.
- B) the price level.
- C) forgone consumption.
- D) forgone liquidity.

Answer: A

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

13) The opportunity cost of holding money is the

- A) nominal interest rate on assets other than money.
- B) price of goods and services.
- C) level of wage and rental income.
- D) ease with which an asset can be converted into a means of payment.

Answer: A

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

14) The opportunity cost of holding money is

- A) the price level.
- B) real GDP.
- C) the inverse of the price level multiplied by the nominal interest rate.
- D) the nominal interest rate.

Answer: D

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

15) The demand for money is _____ related to the nominal interest rate.

- A) positively
- B) negatively
- C) not
- D) None of the above answers is correct because the relationship between the demand for money and the nominal interest rate changes with the inflation rate.

Answer: B

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

16) The opportunity cost of holding money increases when

- A) the purchasing power of money rises.
- B) the nominal interest rate rises.
- C) the price level falls.
- D) consumers' real incomes increase.

Answer: B

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

17) A decrease in the nominal interest rate _____ the opportunity cost of holding money.

- A) increases
- B) decreases
- C) can increase or decrease
- D) None of the above answers is correct because the nominal interest rate does not affect the opportunity cost of holding money.

Answer: B

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

18) The opportunity cost of holding money refers to

- A) the service fees charged to withdraw currency from an ATM.
- B) the price level.
- C) the interest that could have been earned if the money balances had been changed into an interest-bearing asset.
- D) the pleasure that would have been received if the money balances had been used to buy a good or service.

Answer: C

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

19) The demand for money is _____ related to the nominal interest rate.

- A) positively
- B) negatively
- C) not related
- D) None of the above answers is correct because the relationship between the demand for money and the interest rate varies with the inflation rate.

Answer: B

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

20) When the nominal interest rate rises, the opportunity cost of holding money

- A) rises and people hold more money.
- B) falls and people hold less money.
- C) falls and people hold more money.
- D) rises and people hold less money.

Answer: D

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) The higher the nominal interest rate, the

- A) greater the opportunity cost of holding money.
- B) lower the quantity of money demanded.
- C) more the demand for money curve shifts leftward.
- D) Both answers A and B are correct.

Answer: D

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

22) When the nominal interest rate rises, the quantity of money demanded decreases because

- A) people will buy fewer goods and hold less money.
- B) the price level also rises and people decrease their demand for money.
- C) people move funds from interest-bearing assets into money.
- D) people shift funds from money holdings to interest-bearing assets.

Answer: D

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

23) Which of the following is correct? The demand for money

- A) increases as real GDP increases.
- B) decreases as the price level increases.
- C) depends on the quantity of money.
- D) increases when the nominal interest rate rises.

Answer: A

Topic: Influences on Money Holding, Real GDP

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

24) When real GDP increases, the demand for money

- A) increases.
- B) decreases.
- C) stays the same.
- D) we cannot make a prediction without additional information.

Answer: A

Topic: Influences on Money Holding, Real GDP

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

25) The quantity of money that people choose to hold is

- A) positively related to the nominal interest rate.
- B) positively related to real GDP.
- C) negatively related to the price level.
- D) positively related to the availability of ATM machines.

Answer: B

Topic: Influences on Money Holding, Real GDP

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

26) The quantity of money people want to hold increases if

- A) the price level falls.
- B) the nominal interest rate rises.
- C) real GDP increases.
- D) All of the above answers are correct.

Answer: C

Topic: Influences on Money Holding, Real GDP

Skill: Analytical

Question history: Modified 10th edition

AACSB: Reflective Thinking

27) Which of the following decreases the demand for money?

- A) an increase in the price level
- B) an increase in the quantity of money
- C) a decrease in real GDP
- D) a decrease in the cost of printing money

Answer: C

Topic: Influences on Money Holding, Real GDP

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

28) When real GDP increases, people demand

- A) the same quantity of real money.
- B) less real money.
- C) more real money.
- D) more money in nominal terms but less in real terms.

Answer: C

Topic: Influences on Money Holding, Real GDP

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) _____ real GDP increases the demand for money and _____ the nominal interest rate decreases the quantity of money demanded.

- A) Increasing; increasing
- B) Increasing; decreasing
- C) Decreasing; increasing
- D) Decreasing; decreasing

Answer: A

Topic: Influences on Money Holding

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

30) Financial innovations can have the effect of

- A) only decreasing the demand for money.
- B) only increasing the demand for money.
- C) either increasing or decreasing the demand for money depending on what the innovation is.
- D) increasing the Fed's monetary policy.

Answer: C

Topic: Influences on Money Holding, Financial Innovation

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

31) The demand for money curve is the relationship between _____ and _____, other things remaining the same.

- A) the quantity of real money demanded; the quantity of real money supplied
- B) the quantity of money demanded; the real interest rate
- C) the money demanded; the money supplied
- D) the quantity of real money demanded; the nominal interest rate

Answer: D

Topic: The Demand for Money Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 32) The effect of an increase in the nominal interest rate on the demand for money curve is to
- A) create a movement downward along the demand for money curve.
 - B) create a movement upward along the demand for money curve.
 - C) shift the demand for money curve leftward.
 - D) shift the demand for money curve rightward.

Answer: B

Topic: The Demand for Money Curve

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 33) An increase in the nominal interest rate
- A) shifts the demand for money curve rightward.
 - B) shifts the demand for money curve leftward.
 - C) leads to an upward movement along the demand for money curve.
 - D) leads to a downward movement along the demand for money curve.

Answer: C

Topic: The Demand for Money Curve

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 34) There is a movement along the demand for money curve if
- A) the nominal interest rate rises.
 - B) there is an economic expansion so that real GDP increases.
 - C) banking customers use ATM machines more.
 - D) the price level increases.

Answer: A

Topic: The Demand for Money Curve

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 35) An increase in real GDP
- A) shifts the demand for money curve rightward.
 - B) shifts the demand for money curve leftward.
 - C) leads to an upward movement along the demand for money curve.
 - D) leads to a downward movement along the demand for money curve.

Answer: A

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

36) The demand for money curve shifts rightward if

- A) the price level increases.
- B) real GDP increases.
- C) the nominal interest rate increases.
- D) the real interest rate decreases.

Answer: B

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

37) The demand for money curve shifts rightward if

- A) the nominal interest rate falls.
- B) financial innovation creates new substitutes for cash.
- C) real GDP increases.
- D) the price level falls.

Answer: C

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Reflective Thinking

38) An increase in the nominal interest rate creates a _____ the money demand curve, and an increase in real GDP creates a _____ the money demand curve.

- A) movement down along; leftward shift of
- B) rightward shift of; movement up along
- C) movement up along; rightward shift of
- D) leftward shift of; rightward shift of

Answer: C

Topic: The Demand for Money Curve

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Analytical Skills

39) An increase in the opportunity cost of holding money creates a _____ the money demand curve and an increase in real GDP creates a _____ the money demand curve.

- A) leftward shift of; movement down along
- B) rightward shift of; movement down along
- C) movement up along; leftward shift of
- D) movement up along; rightward shift of

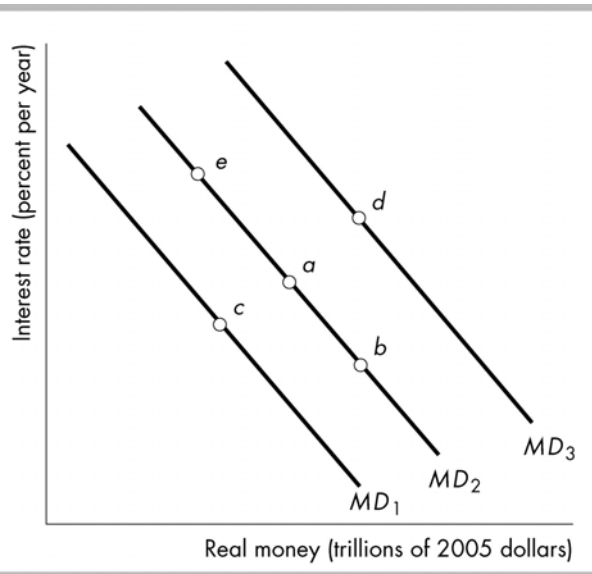
Answer: D

Topic: The Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



40) Use the figure above to answer this question. Suppose the economy is operating at point *a*. A move to _____ could be explained by _____.

- A) point *e*; a decrease in the nominal interest rate
- B) point *c*; an increase in the nominal interest rate
- C) point *d*; an increase in real GDP
- D) point *b*; an increase in real GDP

Answer: C

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

41) Use the figure above to answer this question. Suppose the economy is operating at point *a*. A move to _____ could be explained by _____.

- A) point *c*; an increase in the use of credit cards
- B) point *b*; an increase in real GDP
- C) point *b*; an increase in the nominal interest rate
- D) point *e*; an increase in U.S. exports

Answer: A

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

42) In the above figure, suppose the economy is initially at point *a*. If the nominal interest rate increases, there is a movement to point such as

- A) *b*.
- B) *c*.
- C) *d*.
- D) *e*.

Answer: D

Topic: The Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

43) In the above figure, suppose the economy is at point *a*. If there is an increase in real GDP, there is a movement to point such as

- A) *b*.
- B) *c*.
- C) *d*.
- D) *e*.

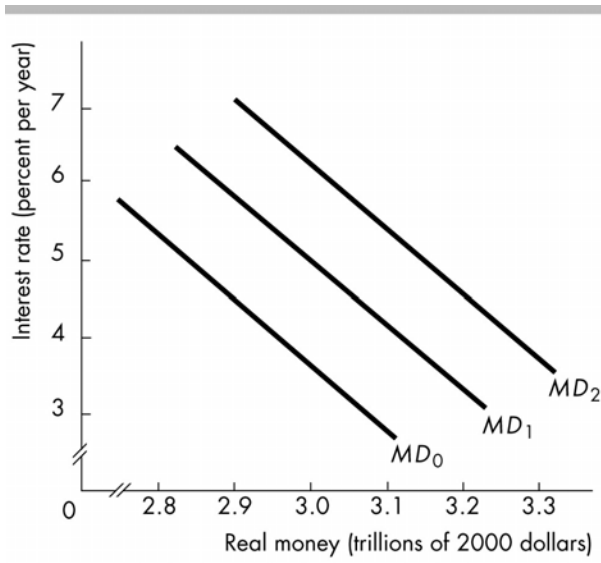
Answer: C

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



44) In the above figure, suppose the economy is initially on the demand for money curve MD_1 . What is the effect of a fall in the nominal interest rate?

- A) The demand for money curve would shift rightward to MD_2 .
- B) The demand for money curve would shift leftward to MD_0 .
- C) There would be a movement upward along the demand for money curve MD_1 .
- D) There would be a movement downward along the demand for money curve MD_1 .

Answer: D

Topic: The Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

45) In the above figure, suppose the economy is initially on the demand for money curve MD_1 . What is the effect of a rise in the nominal interest rate?

- A) The demand for money curve would shift rightward to MD_2 .
- B) The demand for money curve would shift leftward to MD_0 .
- C) There would be a movement upward along the demand for money curve MD_1 .
- D) There would be a movement downward along the demand for money curve MD_1 .

Answer: C

Topic: The Demand for Money Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

46) In the above figure, suppose the economy is initially on the demand for money curve MD_1 .

What is the effect of an increase in real GDP?

- A) The demand for money curve would shift rightward to MD_2 .
- B) The demand for money curve would shift leftward to MD_0 .
- C) There would be a movement upward along the demand for money curve MD_1 .
- D) There would be a movement downward along the demand for money curve MD_1 .

Answer: A

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

47) In the above figure, suppose the economy is initially on the demand for money curve MD_1 .

What is the effect of an increase in financial innovation such as the introduction of ATMs?

- A) The demand for money curve would shift rightward to MD_2 .
- B) The demand for money curve would shift leftward to MD_0 .
- C) There would be a movement upward along the demand for money curve MD_1 .
- D) There would be a movement downward along the demand for money curve MD_1 .

Answer: B

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

48) In the above figure, suppose the economy is initially on the demand for money curve MD_1 .

What is the effect of increased use of credit cards?

- A) The demand for money curve would shift rightward to MD_2 .
- B) The demand for money curve would shift leftward to MD_0 .
- C) There would be a movement upward along the demand for money curve MD_1 .
- D) There would be a movement downward along the demand for money curve MD_1 .

Answer: B

Topic: Shifts in the Demand for Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

49) On a given day the quantity of money is _____ and the supply of money curve is _____.

- A) fixed; horizontal
- B) fixed; vertical
- C) variable; horizontal
- D) variable; vertical

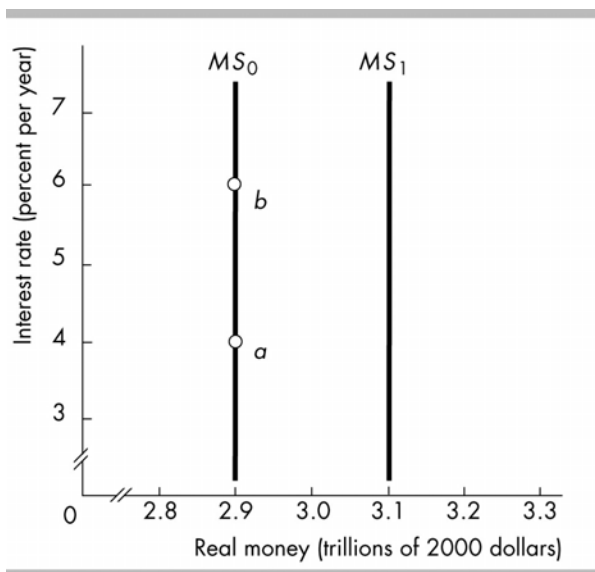
Answer: B

Topic: The Quantity of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking



50) In the figure above, an increase in the monetary base would create a change such as a

- A) movement from point *a* to point *b* along the supply of money curve MS_0 .
- B) movement from point *b* to point *a* along the supply of money curve MS_0 .
- C) shift from the supply of money curve MS_0 to the supply of money curve MS_1 .
- D) shift from the supply of money curve MS_1 to the supply of money curve MS_0 .

Answer: C

Topic: Supply of Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 51) In the figure above, a decrease in the monetary base would create a change such as a
- A) movement from point *a* to point *b* along the supply of money curve MS_0 .
 - B) movement from point *b* to point *a* along the supply of money curve MS_0 .
 - C) shift from the supply of money curve MS_0 to the supply of money curve MS_1 .
 - D) shift from the supply of money curve MS_1 to the supply of money curve MS_0 .

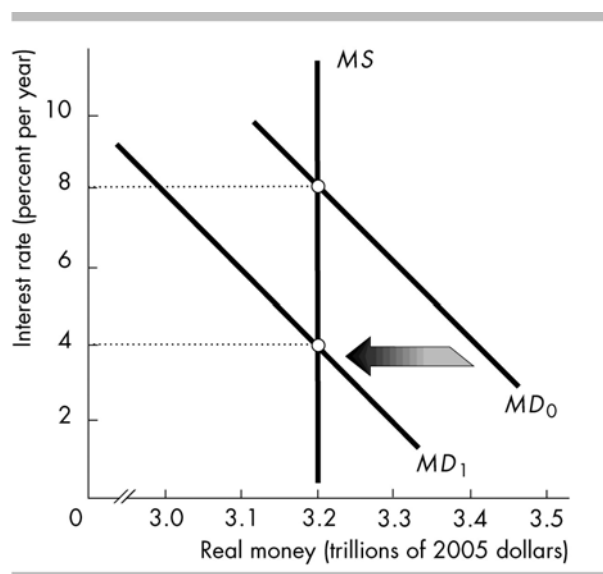
Answer: D

Topic: Supply of Money Curve

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



- 52) The figure above illustrates the effect of

- A) an increase in real GDP.
- B) a decrease in real GDP.
- C) an increase in the monetary base.
- D) a decrease in the monetary base.

Answer: B

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

53) When the interest rate falls in the money market, the quantity of money demanded _____ and the quantity of money supplied _____.

- A) increases; decreases
- B) decreases; increases
- C) stays the same; decreases
- D) increases; stays the same

Answer: D

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

54) When the quantity of money demanded is greater than the quantity of money supplied, people _____ bonds and the interest rate _____.

- A) sell; rises
- B) sell; falls
- C) buy; rises
- D) buy; falls

Answer: A

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

55) Suppose that the interest rate is greater than the equilibrium interest rate. Which of the following occurs?

- I. There is an excess quantity of money.
- II. The quantity of money automatically increases.
- III. The interest rate falls.

- A) I
- B) I and II
- C) I and III
- D) I, II and III

Answer: C

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

56) In the money market, if the interest rate exceeds the equilibrium interest, there is a surplus of money. How is the surplus eliminated?

- A) People buy bonds to rid themselves of the surplus money, bidding up their price and pushing interest rates down.
- B) Banks will lend out the surplus, lowering interest rates.
- C) The Federal Reserve will destroy currency, reducing the quantity of money.
- D) The high interest rate increases the demand for money, eliminating the surplus.

Answer: A

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

57) When the interest rate is above the equilibrium interest rate there is an

- A) excess quantity of money and people will sell bonds.
- B) excess demand for money and people will sell bonds.
- C) excess quantity of money and people will buy bonds.
- D) excess demand for money and people will buy bonds.

Answer: C

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

58) If the interest rate is above the equilibrium interest rate, then

- A) there is an excess demand for money.
- B) the quantity of money demanded exceeds the quantity supplied.
- C) people will sell bonds and the interest rate will fall.
- D) people will buy bonds and the interest rate will fall.

Answer: D

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

59) Suppose the equilibrium interest rate in the money market is 5 percent and the current interest rate is 7 percent. As a result,

- A) the interest rate rises.
- B) real GDP increases.
- C) the demand for money curve shifts rightward.
- D) people buy bonds and the interest rate falls.

Answer: D

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

60) Suppose the money market has an equilibrium interest rate of 10 percent. If the actual interest is 8 percent, which of the following occurs to bring the money market back to equilibrium?

- A) People buy bonds, the price of bonds rises and the interest rate rises.
- B) People buy bonds, the price of bonds falls and the interest rate rises.
- C) People sell bonds, the price of bonds rises and the interest rate rises.
- D) People sell bonds, the price of bonds falls and the interest rate rises.

Answer: D

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

Interest rate (percent)	Quantity of money (billions of dollars)	Money demand (billions of dollars)
2	500	575
3	500	550
4	500	525
5	500	500
6	500	475
7	500	450

61) The table above gives the quantity of money and money demand schedules. Suppose that the interest rate is equal to 6 percent. The effect of this interest rate in the money market is that

- A) the money market is in equilibrium.
- B) people buy bonds and the interest rate falls.
- C) people sell bonds and the interest rate falls.
- D) bond prices fall and so the interest rate falls.

Answer: B

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

62) The table above gives the quantity of money and money demand schedules. Suppose that the interest rate is equal to 3 percent. The effect of this interest rate in the money market is that

- A) the money market is in equilibrium.
- B) people buy bonds and the interest rate falls.
- C) people sell bonds and the interest rate rises.
- D) bond prices rise so that the interest rate rises.

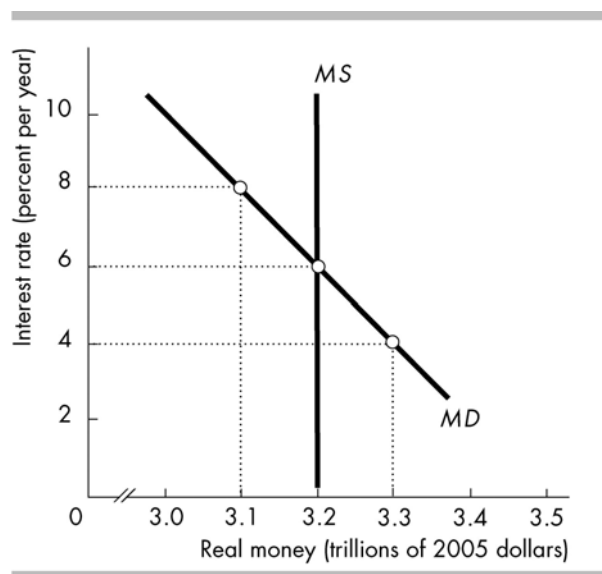
Answer: C

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



63) In the figure above, if the interest rate is 8 percent, people demand \$0.1 trillion

- A) less money than the quantity supplied and the interest rate will rise.
- B) less money than the quantity supplied and the interest rate will fall.
- C) more money than the quantity supplied and the interest rate will fall.
- D) more money than the quantity supplied and the interest rate will rise.

Answer: B

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 64) In the figure above, if the interest rate is 8 percent, people demand \$0.1 trillion
- A) less money than the quantity supplied and bond prices will rise.
 - B) less money than the quantity supplied and bond prices will fall.
 - C) more money than the quantity supplied and bond prices will fall.
 - D) more money than the quantity supplied and bond prices will rise.

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 65) In the figure above, if the interest rate is 4 percent, there is a \$0.1 trillion excess
- A) quantity of money and the interest rate will rise.
 - B) quantity of money and the interest rate will fall.
 - C) demand for money and the interest rate will fall.
 - D) demand for money and the interest rate will rise.

Answer: D

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 66) In the figure above, if the interest rate is 4 percent, there is a \$0.1 trillion excess
- A) quantity of money and bond prices will rise.
 - B) quantity of money and bond prices will fall.
 - C) demand for money and bond prices will fall.
 - D) demand for money and bond prices will rise.

Answer: C

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 67) In the figure above, if the interest rate is 6 percent,
- A) there is a \$0.1 trillion excess quantity of money and the interest rate will rise.
 - B) there is a \$0.1 trillion excess quantity of money and the interest rate will fall.
 - C) the money market is in equilibrium and the interest rate will remain constant.
 - D) there is a \$0.1 trillion excess demand for money and the interest rate will rise.

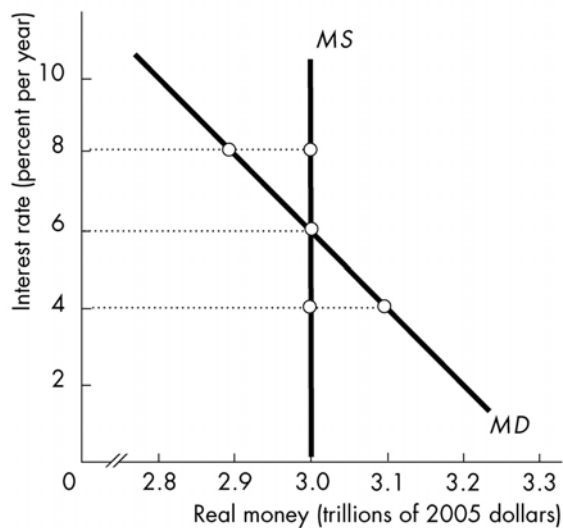
Answer: C

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



68) In the above figure, if the interest rate is 4 percent, people

- A) sell bonds so as to convert them into money.
- B) buy bonds so as to have a better store of value.
- C) petition the Fed to tighten the quantity of money.
- D) buy stocks, because stocks are more liquid than currency.

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

69) In the above figure, if the interest rate is 8 percent,

- A) people sell bonds so as to convert them into money.
- B) people buy bonds and the interest rate falls.
- C) the Fed increases the quantity of money.
- D) people buy stocks, because stocks are more liquid than currency.

Answer: B

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

70) In the short run, which of the following actions raise the interest rate?

- A) a decrease in the demand for money
- B) an increase in bond prices
- C) an increase in the quantity of money
- D) an increase in the demand for money

Answer: D

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

71) In the short run, which of the following actions lower the interest rate?

- A) a decrease in the demand for money
- B) an increase in the demand for money
- C) a decrease in the quantity of money
- D) a decrease in bond prices

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

72) In the short run, when the Fed increases the quantity of money

- A) bond prices rise and the interest rate falls.
- B) bond prices fall and the interest rate rises.
- C) the demand for money increases.
- D) the supply of money curve shifts leftward.

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

73) In the short run, when the Fed decreases the quantity of money

- A) bond prices fall and the interest rate rises.
- B) bond prices rise and the interest rate falls.
- C) the demand for money increases.
- D) the supply of money curve shifts rightward.

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

74) In the long run, when the Fed increases the quantity of money the

- A) nothing real changes.
- B) price level falls.
- C) real interest rate rises.
- D) nominal interest rate falls.

Answer: A

Topic: Money Market Equilibrium

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

75) An increase in _____ decreases the quantity of money people want to hold.

- A) the price level
- B) real GDP
- C) the interest rate
- D) the quantity of money

Answer: C

Topic: Study Guide Question, Influences on Money Holding, Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

76) A decrease in _____ decreases the demand for money.

- A) the discount rate
- B) real GDP
- C) the interest rate
- D) the quantity of money

Answer: B

Topic: Study Guide Question, Influences on Money Holding, Real GDP

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

77) If real GDP decreases, the demand for money curve will shift

- A) leftward and the interest rate will rise.
- B) leftward and the interest rate will fall.
- C) rightward and the interest rate will rise.
- D) rightward and the interest rate will fall.

Answer: B

Topic: Study Guide Question, Shifts in the Demand for Money Curve

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

6 The Quantity Theory of Money

1) The velocity of circulation is

- A) the rate of change of the GDP deflator.
- B) the average number of times a dollar of money is used in a year to buy goods and services in GDP.
- C) the changes in the purchasing power of money over a given time period.
- D) constant.

Answer: B

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) The velocity of circulation is

- A) the relationship between income and spending.
- B) the relationship between increases in income and investment.
- C) the ratio of currency to demand deposits.
- D) the average number of times per year a dollar is spent on goods and services in GDP.

Answer: D

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) The velocity of circulation is

- A) equal to the price level multiplied by real GDP.
- B) equal to the quantity of money multiplied by nominal GDP.
- C) the average number of times a dollar bill is used in a year to buy the goods and services in GDP.
- D) average quantity of money that exists during a year.

Answer: C

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) If an economy has a velocity of circulation of 3, then

- A) the quantity of money is 3 times real GDP.
- B) in a year the average dollar is exchanged 3 times to purchase goods and services in GDP.
- C) nominal GDP is $\frac{1}{3}$ the size of the quantity of money.
- D) the quantity of money is \$3 for every dollar of GDP.

Answer: B

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

5) In the quantity theory of money, the quantity of money is assumed to

A) not influence the velocity of circulation.

B) rise during recessions.

C) fall during recessions.

D) be constant.

Answer: A

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

6) When the velocity of circulation equals 4 in 2010, this fact means that

A) consumers held four dollars in wealth for each dollar they spent in 2010.

B) on average, each dollar of money in the economy purchased four dollars of goods and services in GDP in 2010.

C) for each additional dollar of money injected into the economy, the price level rose 4 percent in 2010.

D) real output of goods and services in GDP rose by four dollars for each additional dollar of money consumers saved.

Answer: B

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

7) If nominal GDP is \$12 trillion, the price level is 120, and the quantity of money is \$4 trillion, what is the velocity of circulation?

A) 3

B) 2.5

C) 30

D) 25

Answer: A

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

8) Suppose that $M = 300$, $P = 150$, and $Y = 6$. Then the velocity of circulation equals

A) 0.02.

B) 0.50.

C) 2.00.

D) 3.00.

Answer: D

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

9) If nominal GDP = \$15 trillion and the quantity of money is \$3 trillion, what is the velocity of circulation?

- A) 16
- B) 8
- C) 5
- D) 2

Answer: C

Topic: Quantity Theory of Money, Velocity of Circulation

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

10) Which of the following equations represents the equation of exchange?

- A) $PM = VY$
- B) $MY = PV$
- C) $MV = PY$
- D) $M = VP/Y$

Answer: C

Topic: Equation of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) The equation of exchange

- A) is $MV = PY$.
- B) becomes the quantity theory if velocity and the price level are constant.
- C) cannot be used in an economy with inflation.
- D) All of the above answers are correct.

Answer: A

Topic: Equation of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

12) The equation of exchange states that the price level is equal to

- A) the quantity of money.
- B) velocity of circulation multiplied by the quantity of money divided by real GDP.
- C) real GDP multiplied by the velocity of circulation divided by nominal GDP.
- D) the velocity of circulation.

Answer: B

Topic: Equation of Exchange

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 13) The equation of exchange states that the quantity of money
A) multiplied by the velocity of circulation equals nominal GDP.
B) divided by price level equals real GDP.
C) multiplied by nominal GDP equals the price level.
D) divided by nominal GDP equals real GDP.

Answer: A

Topic: Equation of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 14) If velocity is 6 and the quantity of money is \$2 trillion, what is nominal GDP?

- A) \$12 trillion
B) \$6 trillion
C) \$3 trillion
D) \$333 billion

Answer: A

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 15) The quantity of money in an economy is \$9 million, and the velocity of circulation is 3. Nominal GDP in this economy is _____.

- A) \$6 million
B) \$9 million
C) \$3 million
D) \$27 million

Answer: D

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 16) If real GDP is \$10 trillion and the velocity of circulation is 2, the quantity of money

- A) is \$2 trillion.
B) is \$5 trillion.
C) is \$20 trillion.
D) cannot be determined from the information given.

Answer: D

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

- 17) The quantity theory asserts that real GDP is
- A) not influenced by the quantity of money.
 - B) never different from potential GDP.
 - C) equal to nominal GDP multiplied by the quantity of money.
 - D) equal to nominal GDP divided by the quantity of money.

Answer: A

Topic: Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 18) The equation of exchange becomes the same as the quantity theory of money by assuming that the velocity of circulation _____ when the quantity of money changes and potential GDP _____ when the quantity of money changes.

- A) changes; changes
- B) changes; does not change
- C) does not change; changes
- D) does not change; does not change

Answer: D

Topic: Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 19) According to the quantity theory of money,
- A) V and M are constant.
 - B) V and Y are not affected by the quantity of money.
 - C) V and P are not affected by the quantity of money.
 - D) V and M are not affected by changes in the price level.

Answer: B

Topic: Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 20) If $V = 5$, $P = \$3$, and $Y = 50$, then the quantity of money equals
- A) \$10.
 - B) \$30.
 - C) \$150.
 - D) \$300.

Answer: B

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

21) If $M = \$100$, $Y = \$500$ and $P = \$2$, then V is equal to

- A) .10.
- B) 1.0.
- C) 10.
- D) 50.

Answer: C

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

22) If nominal GDP equals \$10 trillion and the velocity of circulation is 5, then

- A) real GDP is \$2 trillion.
- B) the quantity of money is \$50 trillion.
- C) the quantity of money is \$2 trillion.
- D) the real value of the quantity of money is \$10 trillion.

Answer: C

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

23) Suppose that the nominal quantity of money is \$200 billion and the value of nominal GDP is \$1 trillion. It must be the case that

- A) the economy is suffering from inflation.
- B) the average price paid for a "typical" good is \$5.
- C) there will be a shortage of money balances in the economy.
- D) the velocity of circulation is 5.

Answer: D

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

24) The quantity theory of money predicts how changes in

- A) the price level affect nominal GDP.
- B) the price level affect real GDP.
- C) the quantity of money affect the price level.
- D) real GDP affect the nominal GDP.

Answer: C

Topic: Predictions of the Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 25) The quantity theory of money addresses the
- A) long-run effect the quantity of money has on the price level.
 - B) determinants of potential GDP.
 - C) determinants of the equilibrium unemployment rate.
 - D) short-run effect the quantity of money has on the price level.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 26) The quantity theory of money asserts that inflation is the result of growth in
- A) the quantity of money.
 - B) potential GDP.
 - C) the natural rate of unemployment.
 - D) money wage rates.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 27) The quantity theory of money asserts that an increase in the quantity of money
- A) will decrease the price level by an offsetting amount.
 - B) by n percent will lead to an increase in the price level by $n + 1$ percent.
 - C) will lead to an equal percentage increase in real GDP.
 - D) will lead to an equal percentage increase in the price level.

Answer: D

Topic: Predictions of the Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 28) The quantity theory of money argues that, in the long run, the percentage change in money will create an equal percentage change in
- A) velocity.
 - B) real GDP.
 - C) potential GDP.
 - D) the price level.

Answer: D

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) The quantity theory of money predicts that in the _____, a 10 percent increase in the quantity of money leads to a 10 percent increase in _____.

- A) long run; real GDP
- B) short run; velocity
- C) long run; velocity
- D) long run; price level

Answer: D

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

30) The quantity theory of money states that in the long run

- A) the price level will not consistently rise, it will fluctuate.
- B) an increase in the quantity of money results in an equal percentage increase in the price level.
- C) a rise in the price level rises causes the quantity of money to increase.
- D) an increase in the quantity of money increases real GDP by a smaller percentage.

Answer: B

Topic: Predictions of the Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

31) According to the quantity theory of money, a 10 percent increase in the quantity of money ultimately leads to a 10 percent increase in

- A) real national income.
- B) real GDP.
- C) the price level.
- D) velocity.

Answer: C

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

32) According to the quantity theory of money, changes in the price level are the result of changes in the

- A) prime interest rate.
- B) real interest rate.
- C) quantity of money.
- D) velocity of circulation.

Answer: C

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

33) Other things constant, the quantity theory of money concludes that any increase in the quantity of money

- A) decreases the demand for money.
- B) decreases in the aggregate price level.
- C) decreases the aggregate level of nominal income.
- D) proportionally increases the price level.

Answer: D

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

34) The quantity theory of money states that

- A) inflation increases when the money growth rate increases.
- B) as the price level increases, the demand for money increases.
- C) as the interest rate rises, the demand for money decreases.
- D) changes in the quantity of money are determined by the commercial banks and not the Federal Reserve.

Answer: A

Topic: Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

35) According to the quantity theory of money, a 15 percent increase in the quantity of money creates a 15 percent rise in

- A) the price level.
- B) the velocity of circulation.
- C) real GDP.
- D) the unemployment rate.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

36) According to the quantity theory of money, money growth and inflation are

- A) positively correlated.
- B) negatively correlated.
- C) independent, that is, not correlated.
- D) positively if the inflation rate is positive and negatively correlated if the inflation rate is negative.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

37) According to the quantity theory of money, in the long run

A) an increase in the quantity of money creates an increase the price level but no increase in real GDP.

B) the quantity of money in the economy will always be just the right amount.

C) an increase in the quantity of money creates an increase in the price level and in real GDP.

D) None of the above answers are correct.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

38) According to the quantity theory of money, a 25 percent change in M , the quantity of money, leads to a 25 percent change in

A) V , the velocity of circulation.

B) P , the price level.

C) Y , real GDP.

D) R , the interest rate.

Answer: B

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

39) Suppose the money growth rate is 3 percent, velocity is constant, and real GDP is growing at 2 percent. What is the inflation rate?

A) 1 percent

B) 5 percent

C) 3 percent

D) 6 percent

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

40) Read the following statements and determine if they are true or false.

I. According to the quantity theory of money, an increase in the growth rate of the quantity of money increases inflation in the long run.

II. Historical and international data show that there is no correlation between inflation and money growth.

A) I and II are both true.

B) I and II are both false.

C) I is true and II is false.

D) I is false and II is true.

Answer: C

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

41) Which of the following is true regarding the quantity theory of money?

I. The theory predicts that in the long run the inflation rate equals the money growth rate minus the growth rate of real GDP.

II. The theory predicts that countries with high growth rates of money will have high inflation rates.

III. The theory predicts that increases in the growth rate of velocity lowers the inflation rate.

A) I and II

B) II and III

C) I and III

D) I, II and III

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

42) According to the quantity theory of money, in the long run, an increase in the quantity of money results in an equal percentage increase in _____.

A) the price level

B) the growth rate of real GDP

C) the inflation level

D) the growth rate of potential GDP

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

43) The data show that money growth and inflation are

- A) positively correlated.
- B) negatively correlated.
- C) not correlated.
- D) independent phenomena.

Answer: A

Topic: Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

44) The U.S. historical evidence

- A) generally supports the quantity theory of money in the long run.
- B) does not support the quantity theory of money.
- C) demonstrates that there is no correlation between the money growth rate and inflation.
- D) shows that a higher inflation rate causes an increase in the money growth rate.

Answer: A

Topic: Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

45) Looking at historical evidence from 1990 to 2005 for the United States and other countries, which of the following are true?

- I. There is a correlation between the growth rate of the quantity theory of money and the growth rate of real GDP.
 - II. There is a correlation between the growth rate of the quantity theory of money and the inflation rate.
- A) Only I is true.
 - B) Only II is true.
 - C) Both I and II are true.
 - D) Neither I or II is true.

Answer: B

Topic: International Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

46) According to the quantity theory, in the long run, an increase in the growth rate of _____ leads to an increase in the _____.

- A) real GDP; inflation rate
- B) the quantity of money; growth rate of real GDP
- C) the quantity of money; inflation rate
- D) real GDP; growth rate of velocity

Answer: C

Topic: Study Guide Question, Long-Run Effects of Change in Quantity of \$

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

47) The quantity theory of money is the idea that in the long run

- A) the quantity of money is determined by banks.
- B) the quantity of money serves as a good indicator of how well money functions as a store of value.
- C) the quantity of money determines real GDP.
- D) an increase in the growth rate of the quantity of money leads to an equal increase in the inflation rate.

Answer: D

Topic: Study Guide Question, Quantity Theory of Money

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

48) Nominal GDP, PY , is \$7.5 trillion. The quantity of money is \$3 trillion. The velocity of circulation is

- A) 22.5.
- B) 10.5.
- C) 2.5.
- D) 3.

Answer: C

Topic: Study Guide Question, The Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

7 News Based Questions

- 1) Which of the following is an example of money functioning as a medium of exchange?
- A) Walmart accepting your \$20 when buy a CD.
 - B) Apple pricing an iPhone at \$299.
 - C) Bank of America paying you 3 percent on your saving account.
 - D) You saving your spare change in a jar before depositing them in your savings account.

Answer: A

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 2) Which of the following is an example of money functioning as a unit of account?
- A) Bank of America charging 7 percent on an auto loan.
 - B) Pepsi charging \$1 for a can of soda.
 - C) eBay using PayPal as a method of payment.
 - D) Your writing a check at Target to pay for new clothes.

Answer: B

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 3) Which of the following is an example of money functioning as a store of value?
- A) Comcast charging \$99 for internet, phone and cable service.
 - B) McDonalds charging 99 cents for a burger.
 - C) Your saving your spare change in a jar in order to afford an end-of-term party.
 - D) Amazon.com charging \$9.95 for shipping.

Answer: C

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

- 4) In September 2008, Regions Bank has \$89 million in M1 deposits, \$3 million in reserves and \$81 million in loans. Regions Bank's desired reserve ratio is
- A) 3.4 percent
 - B) 3.7 percent
 - C) 91 percent
 - D) 29.67 percent

Answer: A

Topic: Reserves

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

5) In September 2007, Regions Bank held \$3 million in reserves against M1 deposits and made \$83 million in loans. Between September 2007 and September 2008, deposits decreased from \$114 million to \$95 million. If Regions Bank wants to maintain its desired reserve ratio in 2008, it will

- A) increase its reserves.
- B) definitely make more loans.
- C) cannot make more loans.
- D) decrease its reserves.

Answer: D

Topic: Reserves

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

6) In August 2007, Sun Trust Bank has \$83 million in loans and \$114 million in M1 deposits. If Sun Trust is holding \$4 million in reserves, the bank's reserve ratio is

- A) \$31 million.
- B) 4.8 percent
- C) 3.5 percent.
- D) 72.8 percent.

Answer: C

Topic: Reserves

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

7) The table below shows data (in millions) for Sun Trust Banks in September 2007 and September 2008.

	2007	2008
Loans	\$83	\$78
Reserves	\$4	\$5
Deposits	\$114	\$95

The data show that Sun Trust

- A) increased its reserve ratio to 5.3 percent over the 12 months.
- B) increased its reserve ratio to 6.4 percent over the 12 months.
- C) has fewer excess reserves in 2008.
- D) faced a higher currency drain ratio in 2008.

Answer: A

Topic: Reserves

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

8) The table below shows data (in millions) for Sun Trust Banks in September 2007 and September 2008. Suppose that the required reserve ratio is 3 percent.

	2007	2008
Loans	\$83	\$78
Reserves	\$4	\$5
Deposits	\$114	\$95

The data show that Sun Trust _____ make more loans in 2007 and _____ make more loans in 2008.

- A) can; can.
- B) can; cannot.
- C) cannot; cannot.
- D) cannot; can.

Answer: A

Topic: Reserves and Loans

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

9) The table below shows the data (in millions) for Wells Fargo Bank in September 2007 and September 2008. Suppose that the required reserve ratio is 3 percent.

	2007	2008
Loans	79	100
Reserves	11	11
Deposits	247	266

The data show that Wells Fargo

- A) the reserve ratio did not change.
- B) had fewer excess reserves in 2007.
- C) the reserve ratio increased as loans increased.
- D) had fewer excess reserves in 2008.

Answer: D

Topic: Reserves

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

10) The table below shows the data (in millions) for Wells Fargo Bank in September 2007 and September 2008. Suppose that the required reserve ratio is 3 percent.

	2007	2008
Loans	79	100
Reserves	11	11
Deposits	247	266

The data show that

- A) the currency drain ratio increased.
- B) the Federal Reserve must have increased the required reserve ratio.
- C) Wells Fargo had excess reserves and could create money in 2007.
- D) Wells Fargo was only able to make more loans in 2008 because it gained more deposits.

Answer: C

Topic: Reserves and Loans

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

11) Between 2008 and 2009, U.S. real GDP decreased from \$13.2 trillion to \$12.9 trillion. As a result, the real demand for money _____ and the demand for money curve _____.

- A) decreased; shifted leftward
- B) did not change; did not shift
- C) increased; shifted leftward
- D) decreased; shifted rightward.

Answer: A

Topic: The Demand for Money

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

12) In 2007, interest rates in Germany were 4.7 percent while the inflation rate was 1.7 percent. In 2008, interest rates increased to 5.3 percent and the inflation rate increased to 2.0. As a result, there is

- A) a leftward shift in Germany's demand for money curve.
- B) a downward movement along Germany's demand for money curve.
- C) a rightward shift in Germany's money supply curve.
- D) an upward movement along Germany's demand for money curve.

Answer: D

Topic: The Demand for Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

13) In 2006, real GDP in Belgium grew at a 3 percent rate and inflation was 1.8 percent while the population did not change. As a result, there was _____ demand for money curve in Belgium.

- A) a rightward shift of the
- B) a leftward shift of the
- C) a movement up along the
- D) no change in the

Answer: A

Topic: The Demand for Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

14) The table below shows data for Japan.

	2008	2009
M1 growth rate	0.7	0.9
Inflation rate	0.4	-0.3

Assuming the rate of velocity change is constant, real GDP

- A) grew by 0.3 percent in 2008.
- B) grew by -1.2 percent in 2009.
- C) grew by 1.1 percent in 2008.
- D) grew by 0.9 percent in 2009.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

15) The table below shows data for Brazil.

	2006	2007
Real GDP growth rate	3.8	5.4
Inflation rate	4.2	3.7

Assuming the rate of velocity change is constant,

- A) the growth rate of money increased between 2006 and 2007.
- B) the money growth rate was -0.4 percent in 2006.
- C) the growth rate of nominal GDP was 1.7 percent in 2006.
- D) the demand for money curve shifted leftward in 2006.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

16) The table below shows data for Indonesia.

	2009	2010
Real GDP growth rate	4.5	6.0
Inflation rate	4.8	5.7

Assuming the rate of velocity change is constant, the money growth rate in Indonesia was

- A) 0.3 percent in 2009.
- B) 11.7 percent in 2010.
- C) -0.3 percent in 2009.
- D) 5.7 percent in 2010.

Answer: B

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

17) The table below shows data for Indonesia between 2005 and 2006.

	2005	2006
Money growth rate	21.4	12.0
Real GDP growth rate	5.7	5.5

Assume the rate of velocity change is constant. According to the quantity theory of money, Indonesia's inflation rate

- A) is higher in 2005 than in 2006.
- B) was 17.5 percent in 2006.
- C) is 27.1 percent in 2005.
- D) will increase over the 12 months.

Answer: A

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

18) The inflation rate in Venezuela has increased between 2005 and 2010, rising from 14 percent per year to 31 percent per year. At the same time, the growth rate of real GDP fell from 10 percent per year to -2.6 percent per year. The quantity theory of money

A) states that the inflation rate over the period would average 4 percent.

B) predicts that the velocity of money will decrease over the period.

C) states that the growth rate of money must have increased over the period.

D) predicts that nominal GDP will decrease over the period.

Answer: C

Topic: Predictions of the Quantity Theory of Money

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

8 Essay Questions

1) Define money and list its functions.

Answer: Money is any commodity or token that is generally accepted as a means of payment. It has three main functions. It serves as a medium of exchange, a unit of account, and a store of value.

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) What are the three functions of money?

Answer: Money serves as a medium of exchange (so that money is accepted in exchange for goods and services), as a unit of account (so that prices are measured in units of money), and as a store of value (so that money is exchangeable at a later date).

Topic: What Is Money?

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) What is barter? What is a double coincidence of wants? How does the existence of money affect barter?

Answer: Barter is the direct exchange of one good or service for another. Barter is inefficient because it requires a "double coincidence of wants," that is, the good one person offers for exchange must be the good the trading partner wants and the trading partner's good must be what the first person wants. The existence of money means that we do not need to engage in barter. Instead, we can sell a good or service for money and then use the money to purchase another good or service we desire. There is no necessity for the "double coincidence of wants" because the seller is willing to accept money from any buyer.

Topic: Barter

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) Give an example of how money functions as a unit of account.

Answer: Money functions as a unit of account when it is used to in a price. For instance, a price of \$60 dollars for a purse shows how the price of the purse is being measured in units of money.

Topic: Unit of Account

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

5) Explain which of the following count as money.

a) a check in Ann's checkbook

b) currency in Ann's bank

c) currency in Ann's purse

d) Ann's checking deposit

Answer: Only parts (c), currency in Ann's purse, and (d), Ann's checking deposit, are money. Ann's check, given in part (a), is a method of transferring money from Ann to someone else. Thus the check (itself) is not money. Part (d), the currency in Ann's bank, is not money until someone withdraws it because currency inside a bank does not count as money.

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

6) "Even though we can convert them into money, deposits at banks are not money." Is the previous statement correct or not?

Answer: The statement is incorrect. Some deposits at banks, such as checking account deposits, are a means of payment and fulfill all the functions of money. These deposits are therefore money.

Topic: Money in the United States Today

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

7) Are checks money?

Answer: Checks are instructions to transfer funds from one person's checking account to another person's checking account. Checks are not money, but the checking account deposits that the check transfers are money.

Topic: Checks Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) "Credit cards are considered money because they serve to purchase goods and services." Is the previous statement true or false?

Answer: The statement is false. Credit cards are an ID card that, when presented, allow the owner to get an immediate loan. A loan is not money because a loan needs to be repaid with money. Thus a credit card is not money.

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) Are credit cards or debit cards money? Explain your answer.

Answer: Neither credit cards nor debit cards are money. Credit cards are a type of ID card that, when presented, allow the owner to get an immediate loan. The loan is not money; indeed, it must be repaid using money. A debit card allows the customer to pay immediately for his or her purchase by transferring money from the customer's checking account to the seller's account. Debit cards are similar to checks insofar as they are essentially instructions to move money from one person to another. The funds transferred are money, the debit card is not money.

Topic: Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

10) Are checks and credit cards money? Explain why or why not.

Answer: Checks are not money. Checks are instructions to your depository institution allowing for funds to be given to the entity listed on the check. Credit cards also are not money. Credit cards are ID cards that allow the user to access a previously-approved line of credit. The funds borrowed using a credit card must eventually be repaid using money.

Topic: Checks and Credit Cards Are Not Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) What makes up M1? Is M1 larger or smaller than real GDP?

Answer: M1 is the sum of currency outside of the banks plus checkable deposits owned by individuals and businesses plus traveler's checks. All the assets in M1 are accepted as means of payment and so all the assets are money. M1 is smaller than real GDP. Real GDP is about 9 times larger than M1.

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

12) What assets are included in M1? In M2? Is all of M1 and M2 money? If some assets of M1 or M2 are not money, why are they included in M1 or M2?

Answer: M1 is the sum of currency outside of the banks plus checkable deposits owned by individuals and businesses plus traveler's checks. All the assets in M1 are accepted as means of payment and so all the assets are money. M2 includes all of M1 plus savings deposits, small time deposits, and money market funds. Some components of M2, such as time deposits, are not money because they are not a means of payment. But they are easily convertible into money, which is why they are included in M2.

Topic: Money in the United States Today, M1 and M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) "By definition, all parts of M2 are money." Is the previous statement correct or not? Explain your answer.

Answer: The statement is incorrect. Many of the assets in M2 are money. But not all the assets are money. Some of the savings deposits, time deposits, and money market funds are not means of payment and hence are not money. But they are included in M2 because they are easily converted into money.

Topic: Money in the United States Today, M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

14) "Banks make a profit by paying depositors a high rate to attract funds and making loans at a low rate to encourage borrowing." Is the previous statement correct or not?

Answer: The statement is incorrect. Banks make a profit if the interest rate they collect on the loans they make exceeds the interest rate they must pay on the deposits they attract.

Topic: Commercial Banks

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) "Banks hold 100 percent of their customers' deposits as reserves." Is the previous statement correct or not?

Answer: The statement is incorrect. If banks kept all of their deposits as reserves, banks would earn no profit. So banks keep a fraction of their deposits as reserves.

Topic: Commercial Banks

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

16) What are the economic functions of depository institutions?

Answer: Depository institutions provide four economic services. First, they create liquidity, that is, bank deposits are highly liquid so that they are easily convertible into money. Second, they minimize cost of obtaining funds because borrowing from one bank is cheaper than borrowing from a variety of lenders. Third, they minimize cost of monitoring borrowers because depository institutions specialize in monitoring borrowers. Fourth, they pool risk by making loans to many borrowers.

Topic: Economic Functions of Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

17) List and discuss the four economic functions that depository institutions provide their customers.

Answer: Depository institutions create liquidity, lower costs of obtaining funds, lower costs of monitoring borrowers, and pool risk. They create liquidity because they create assets that can be easily converted into money. Indeed, some of their deposits are money itself! They lower the costs of lending and borrowing funds. If you have funds to loan, rather than searching for a borrower, you can simply deposit the funds in a financial firm. Similarly, if you want to borrow funds, rather than searching for someone with funds to loan, you can simply borrow from a financial firm. Depository institutions also lower the cost of monitoring borrowers because these firms specialize in this activity. Finally, depository institutions pool risk and thereby lower the average risk of loaning funds. In other words, by lending to a large number of firms and individuals, a bank lowers the average risk it faces because it knows that only a small fraction of the large number of loans won't be repaid.

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

18) How do banks create liquidity?

Answer: Banks create liquidity because they accept short-term deposits and make long-term loans. The short-term deposits can be quickly and easily changed into money indeed, some of the deposits are money itself! In exchange, the bank makes long-term loans that cannot be converted to money until their due date is reached.

Topic: Liquidity

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

19) Briefly describe the Federal Reserve System, how it is governed, and its roles in the economy.

Answer: The Federal Reserve, or Fed, is the U.S. central bank. The Fed consists of twelve regional Federal Reserve Banks scattered across the United States. These banks are overseen by the Board of Governors, a seven member board located in Washington D.C., whose members are appointed by the President of the United States and confirmed by the Senate. The Federal Open Market Committee, or FOMC, is the group within the Fed that sets the nation's monetary policy. The voting members of the FOMC consist of the chair and other six members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four presidents of the other regional Federal Reserve Banks, on a yearly rotating basis. The Fed's primary role in the economy is to set and conduct the nation's monetary policy. The Fed also provides banking services to banks and helps regulate the nation's financial institutions and markets.

Topic: The Federal Reserve System

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

20) Does the Federal Reserve conduct both the nation's monetary policy and its fiscal policy?

Answer: The Federal Reserve does not conduct both fiscal and monetary policy. The Federal Reserve is responsible for only the nation's monetary policy but it does not conduct the nation's fiscal policy.

Topic: The Federal Reserve System

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) Are the members of the Board of Governors of the Federal Reserve System elected officials?

Answer: No, the members are not elected. They are appointed by the president of the United States (for 14-year terms) and confirmed by the U.S. Senate.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

22) The president of which Federal Reserve bank is always a voting member of the FOMC?

Answer: The president of the New York Federal Reserve bank is always a voting member of the FOMC. The presidents of the other Federal Reserve banks rotate on and off as voting members. The president of the New York Federal Reserve bank is always a voting member because the New York Federal Reserve bank implements the Fed's policy decisions.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

23) What is the FOMC? Who are the members of the FOMC? What policy does the FOMC decide?

Answer: The FOMC is the Federal Open Market Committee. All seven members of the Board of Governors and the 12 Federal Reserve Bank presidents attend and discuss the economy at the FOMC meeting. The voting members of the FOMC, however, are only the seven members of the Board of Governors, the president of the Federal Reserve Bank of New York, and four presidents of the remaining Federal Reserve Banks who serve on an annual rotating basis. The FOMC meets approximately every six weeks to review the state of the economy and decide the monetary policy actions to be carried out by the Federal Reserve Bank of New York.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

24) "Because monetary policy must be approved by the president of the United States, the president is chair of the Federal Open Market Committee." Analyze the previous statement is it correct or incorrect?

Answer: The statement is incorrect on several dimensions. First, monetary policy does not need to be approved by the President of the United States. Second, the president of the United States is not chair of the Federal Open Market Committee, FOMC. Third, the president of the United States is not even a *member* of the FOMC! The chair of the FOMC is the chair of the Federal Reserve's Board of Governors.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

25) What is the interaction between the Federal Reserve districts and the Board of Governors of the Federal Reserve System?

Answer: The Federal Reserve System divides the nation into 12 regions, each with a Federal Reserve bank. Each Federal Reserve bank has a nine-member board of directors. Of the nine members, six are elected by the commercial banks within the Federal Reserve district and three are appointed by the Board of Governors. The directors of each Federal Reserve bank appoint the president of the bank, subject to approval from the Board of Governors.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

26) What is the structure of the Federal Reserve Bank System?

Answer: The key elements in the structure of the Fed are:

- a) The Board of Governors. The Board of Governors has seven members who are appointed by the President of the United States and confirmed by the Senate, each for a 14-year term.
- b) The Regional Federal Reserve Banks. There are 12 regional banks, one for each of the 12 Federal Reserve districts.
- c) The Federal Open Market Committee or FOMC. The FOMC is the Fed's main policy-making committee. It has 12 voting members. Seven of the members are on the Board of Governors. One of the members is the president of the Federal Reserve Bank in New York. The other four members are presidents of other Federal Reserve Banks. Which four presidents are members changes on an annual rotating basis.

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

27) List the Fed's main policy tools and briefly explain each one.

Answer: The Fed's main policy tools are: required reserve ratios, last resort loans, and open market operations. Banks and thrifts are required to hold a minimum percentage of deposits as reserves. This minimum percentage is determined by the Fed and is known as a required reserve ratio. The last resort loans reflects the fact that the Fed stands ready to make loans to financial institutions when other firms may be unwilling to do so. The interest rate charged on these loans is the discount rate. An open market operation is the buying and selling of government bonds by the Fed in the open market.

Topic: The Fed's Policy Tools

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Communication

28) What is the discount rate?

Answer: The discount rate is the interest rate that the Fed charges banks when the banks borrow reserves from the Fed.

Topic: How the Discount Rate Works

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) "When the Fed buys securities from a bank, the quantity of money eventually decreases by a fraction of the initial change in the monetary base." Is the previous statement correct or incorrect? Explain your answer.

Answer: The statement is wrong on two counts. First, if the Fed buys securities from a bank, the quantity of money increases rather than decreases. Second, the money multiplier points out that the change in the quantity of money is ultimately greater than, not less than, the initial change in the monetary base.

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

30) When the Fed buys securities from a bank, what happens to the monetary base and the quantity of money? Which changes by more or do both change by the same amount?

Answer: When the Fed buys securities from a bank, both the monetary base and the quantity of money increase. As reflected by the money multiplier, the increase in the quantity of money exceeds the increase in the monetary base.

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

31) If the Fed sells \$100 million of U.S. government securities, what happens to the quantity of money?

Answer: If the Fed sells \$100 million of U.S. government securities, the monetary base decreases and, along with it, the quantity of money decreases. The money multiplier shows that the quantity of money decreases by more than \$100 million.

Topic: How an Open Market Operation Works

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Reflective Thinking

32) Describe how actual reserves are calculated and explain the difference between desired reserves and excess reserves. How do reserves affect the amount of loans a bank can make?

Answer: Actual reserves are equal to the bank's reserves it keeps on deposit at the Federal Reserve plus the currency in the bank's vault. Desired reserves are the reserves that the bank wants to hold. The amount of desired reserves is equal to the desired reserve ratio multiplied by the bank's deposits. Excess reserves equal actual reserves minus desired reserves. A bank can make loans equal to the amount of its excess reserves.

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

33) "A bank can only use its excess reserves to make loans, while required reserves can only be used to buy U.S. government securities." Explain whether the previous statement is correct or incorrect.

Answer: The statement is incorrect on two dimensions. First, a bank can use excess reserves to buy government securities as well as make loans. Second, a bank is not allowed to use its required reserve to buy U.S. government securities. Required reserves must be kept in the form of reserves, which are either reserve deposits the bank has made at the Federal Reserve or cash in the bank's vault.

Topic: Reserves: Actual and Required

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

34) Explain the process by which the banking system creates money.

Answer: When a bank gains excess reserves, it uses the excess reserves to make a loan. The person or a business receiving the loan receives a deposit money! The borrower then generally spends the loan and it ends up as a deposit money in another company's account. That company's bank then gains some excess reserves, which it loans, and so more money is created. Thus the banking system creates money by making loans.

Topic: Reserves and Loans

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

35) What factors affect the demand for money?

Answer: Four factors influence the demand for money. First is the price level. An increase in the price level increases the *nominal* demand for money. Second is the interest rate. An increase in the interest rate raises the opportunity cost of holding money and decreases the quantity of money demanded. Third is real GDP. An increase in real GDP increases the demand for money. Fourth is financial innovation. Innovations that lower the cost of switching between money and other assets decrease the demand for money.

Topic: The Influences on Money Holding

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

36) How are the nominal and real demands for money related to changes in the price level?

Answer: When the price level rises the nominal demand for money increases by the same proportion. For example if the price level rises 5 percent, people demand 5 percent more nominal money so that they can continue to purchase the same quantity of goods and services. The nominal demand is measured in number of dollars. The real demand is the quantity of money measured in constant dollars. This amount does not change when the price level rises. The quantity of real money demanded is independent of the price level.

Topic: The Influences on Money Holding

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

37) What is the opportunity cost of holding money?

Answer: The opportunity cost of holding money is the nominal interest rate.

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

38) Why is the nominal interest rate the opportunity cost of holding money?

Answer: The nominal interest rate is the opportunity cost of holding money because the interest is the income forgone by holding money. For instance, an individual with \$1,000 can hold the funds either as money or as a financial asset with an interest rate of, say, 7 percent. If the funds are held as money, the interest paid is \$0; if they are held as a financial asset, the interest paid is \$70. Choosing to hold the funds as money therefore has an opportunity cost of the interest income forgone, which is \$70 or 7 percent per dollar. So, the opportunity cost of each dollar held as money is 7 percent.

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

39) What effect does an increase in the interest rate have on the opportunity cost of holding money and on the demand for money curve?

Answer: An increase in the interest rate increases the opportunity cost of holding money. There is a movement upward along the demand for money curve.

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

40) How does an increase in real GDP affect the demand for money curve?

Answer: An increase in real GDP increases the demand for money and shifts the demand curve rightward.

Topic: Shifts in the Demand for Money Curve

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

41) How would a widespread adoption of credit cards affect the demand for money and the demand for money curve?

Answer: The widespread adoption of credit cards decreases the demand for money and shifts the demand for money curve leftward.

Topic: Shifts in the Demand for Money Curve

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

42) Describe how financial innovation has affected the demand for money.

Answer: Financial innovation is the development by depository institutions of new financial products and changing technology within the banking industry. Examples include daily interest checking deposits, automatic transfers of money between deposits, ATM's and credit cards. In general these innovations have allowed the public to be more flexible in their choices between cash and less liquid assets as banks have delivered greater liquidity without forgoing interest earned. The result has been a large decrease in the demand for M1 and a smaller decrease in the demand for M2.

Topic: Shifts in the Demand for Money Curve

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

43) Explain how the money market determines the equilibrium interest rate.

Answer: The demand for money curve, MD , is downward sloping because as the interest rate decreases the quantity of money demanded increases. The supply of money curve, MS , is vertical at the quantity of real money. There exists only one interest rate for which the quantity of money demanded is equal to the quantity supplied. If the interest rate is above the equilibrium interest rate, so that there is an excess supply of money, people respond by buying bonds so that the interest rate falls. Likewise, if the interest rate is less than the equilibrium interest rate, so that there is an excess demand for money, people respond by selling bonds and the interest rate rises.

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Communication

44) Suppose the quantity of money is greater than the quantity of money demanded. In the short run, what occurs to set the quantity of money equal to the quantity of money demanded?

Answer: In the money market, the interaction between the supply of money and the demand for money determines the equilibrium interest rate. The quantity of money is greater than the quantity of the money demanded when the interest rate is above the equilibrium interest rate. When this occurs, in an effort to decrease the amount of money to be equal to the quantity they want to hold, people buy bonds with the excess money. As a result, the interest rate falls. The fall in the interest rate increases the quantity of money demanded. When the interest rate reaches its equilibrium, there is no longer an excess supply of money because at the equilibrium interest rate, the quantity of money supplied equals the quantity demanded.

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Communication

45) In the short run, how is the interest rate determined? If the interest rate is less than the equilibrium interest rate, what occurs?

Answer: The interest rate is determined in the money market by the interaction of the demand for money and the supply of money. If the interest rate is less than the equilibrium, there is an excess demand for money. In order to increase the quantity of money they hold, people sell bonds and other financial assets. As a result, the price of financial assets falls and the interest rate rises. People continue to sell assets and the interest rate continues to rise until it reaches its equilibrium.

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Communication

46) "The velocity of circulation is the average speed with which money is loaned to businesses and households." Is the previous statement correct or incorrect?

Answer: The statement is incorrect. The velocity of circulation is the average speed with which money is used to purchase goods and services.

Topic: Velocity of Circulation

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

47) According to the quantity theory of money, what is the effect of an increase in the quantity of money?

Answer: According to the quantity theory, in the long run an increase in the quantity of money brings an equal percentage increase in the price level.

Topic: Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

48) Discuss the quantity theory of money. Be sure to mention the velocity of circulation and the equation of exchange.

Answer: The quantity theory of money is the proposition that in the long run an increase in the money supply leads to an equal percentage increase in the price level. The velocity of circulation is defined as the average number of times a dollar is used annually in exchange for goods and services. Because GDP is the total of all goods and services purchased, we can derive a formula for the velocity of circulation from GDP. If we use Y for real GDP and P as the price level, the PY = nominal GDP. Because the money supply is used to purchase GDP, velocity, V , equals $(PY)/M$, where M is the quantity of money. This formula can be rearranged to become the equation of exchange, which states that $MV = PY$. Given the assumptions that neither velocity nor potential GDP are influenced by the quantity of money, we can then solve for the price level as $P = (MV/Y)$. Given the assumptions then, changes in the quantity of money lead to only changes in the price level. The quantity theory states that in the long run the percentage increase in the quantity of money equals the percentage increase in the price level.

Topic: Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Communication

49) Define the quantity theory of money and show how it is related to the equation of exchange.

Answer: The quantity theory of money is the proposition that in the long run, an increase in the quantity of money brings an equal percentage increase in the price level (other things remaining the same). The equation of exchange states that the quantity of money multiplied by velocity of circulation equals the price level times real GDP, or $M \times V = P \times Y$. Divide both sides of this formula by V to obtain $P = (M \times V) \div Y$. This formula shows that when M increases, as long as V and Y do not change, P increases by the same percentage, which is the conclusion of the quantity theory of money.

Topic: Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Communication

50) What is the equation of exchange? Suppose that real GDP and velocity are constant. In this case, what effect will an increase in the quantity of money have?

Answer: The equation of exchange is that $M \times V = P \times Y$, where M is the quantity of money, V is the velocity of circulation, P is the price level, and Y is real GDP. If real GDP and velocity are constant, then an increase in the quantity of money will increase the price level.

Topic: Equation of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

51) How has growth in M2 minus the growth in real GDP compared to the inflation rate in the United States?

Answer: Since 1960, M2 growth minus the growth in real GDP has been closely correlated with inflation rates. The period of rapid inflation, during the 1970s, occurred at the same time there was a high growth rate of M2 minus the growth rate of real GDP. This correlation is present throughout all the years.

Topic: Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

52) What is the relationship between money growth and inflation across countries? Does your answer support the quantity theory of money?

Answer: The international evidence shows that the money growth rate and inflation rate are positively related. While the correlation is not precise, it is generally high.

Topic: International Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

53) "If the currency drain increases, the monetary base decreases." Explain whether the previous statement is correct or incorrect.

Answer: The statement is false. If the currency drain increases, the money multiplier (and the quantity of money) decreases but the monetary base itself is unaffected.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

54) What is a "currency drain?" How and why does it affect the money multiplier?

Answer: An increase in currency held outside the banks is a currency drain. A currency drain decreases the size of the money multiplier. The money multiplier exists because when banks loan their excess reserves, the funds wind up in other banks as excess reserves, where they are loaned once again. As a result, an initial increase in reserves and the monetary base wind up increasing the quantity of money by a magnified amount. A currency drain means that when banks make loans, some of the funds are taken out as cash and not deposited back in another bank. Thus the other banks' excess reserves do not increase as much, so the amount that they can loan is decreased. The decrease in loans means that the ultimate increase in the quantity of money is less, so that the money multiplier is smaller.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

55) How does a currency drain affect the money multiplier?

Answer: If the currency drain is zero so that all money created is deposited in bank accounts, the money multiplier is equal to one divided by the desired reserve ratio. If the currency drain is positive, then some newly created money is held in cash and is not deposited in bank accounts. In this case, the money multiplier is smaller so that a change in the monetary base leads to a smaller change in the quantity of money.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

56) Explain how a currency drain affects the size of the money multiplier. In your explanation, suppose that a bank gains \$1 million in new deposits and reserves. Further suppose that the desired reserve ratio is 10 percent and the currency drain is 50 percent.

Answer: A currency drain decreases the size of the money multiplier. The money multiplier reflects the fact that the banking system has a magnified effect on any change in reserves because the reserves are loaned by many banks. A currency drain decreases the amount of reserves that stay within the banking system.

For example, take the bank that gains \$1 million in new deposits and reserves. With the desired reserve ratio equal to 10 percent, start by assuming there is no currency drain. In this case, the desired reserve ratio of 10 percent means that the bank will keep \$100,000 as reserves and so it will loan \$900,000. The *entire* \$900,000 will be deposited in a second bank. The entire \$900,000 deposit adds to the initial \$1 million deposit to create \$1.9 million of new money. That bank will then keep \$90,000 as reserves and loan \$810,000. In this stage, the *entire* \$810,000 will be deposited in a third bank and so the total new money (so far) created will become \$2.71 million. Now, suppose that there is a currency drain, say of 50 percent. In this case, of the \$900,000 first loan, only \$600,000 is deposited in the second bank because \$300,000 (50 percent of the \$600,000 of newly created deposit money) is kept outside the banks as currency. Hence the second bank, which must keep \$60,000 as reserves, can loan only \$540,000. And of this loan, 50 percent or \$180,000 is kept as currency and only \$360,000 is deposited in the third bank. Therefore the amount that each bank can loan is reduced and so the ultimate effect on the quantity of money is decreased.

Topic: Requires Mathematical Note

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

57) If the currency drain increases, how can the Fed adjust the monetary base to offset the effect on the quantity of money?

Answer: If the currency drain increases, the size of the money multiplier decreases, which decreases the quantity of money. To maintain the quantity of money at its initial amount by changing the monetary base, the Fed must increase the monetary base.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

58) What is the money multiplier and what affects its size?

Answer: The money multiplier is the amount by which a change in the monetary base is multiplied to determine the change in the quantity of money. The money multiplier is greater than 1.0. Its size is affected by the desired reserve ratio and the currency drain. The higher the desired reserve ratio and/or the larger the currency drain, the smaller the money multiplier.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

59) Suppose the Fed buys government securities from a commercial bank. Why is there a multiplier effect on the quantity of money?

Answer: When the Fed buys government securities from a bank, the payment to the bank is in the form of reserves. Hence the bank gains excess reserves. The bank can loan these excess reserves. When the loan is spent, the recipients deposit some or all of the funds in their banks. These banks gain deposits (which increase the quantity of money) as well as excess reserves. The "second round" banks then loan their excess reserves. And when these loans are spent, once again the recipients deposit some or all of the funds in their banks. These third-round banks thereby gain deposits (which further increases the quantity of money) as well as excess reserves. These reserves are loaned, spent, and then deposited in a fourth round of banks, which still further increases the quantity of money. Hence the process of loaning and depositing the proceeds increases the quantity of money by a multiple of the initial amount of the open market operation.

Topic: Requires Mathematical Note

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

9 Numeric and Graphing Questions

1) If you have assets that include \$50 in cash, a checking account with \$135, a savings account with \$500, and a jar of coins for laundry of \$15.75, how much M1 do you have?

Answer: You have \$200.75 of M1, comprised of the \$50 in cash, plus the \$135 in the checking account, plus the \$15.75 jar of coins.

Topic: Money in the United States Today, M1

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

2) If you hold \$25 in cash, have \$150 in a checking account, and have \$250 in a savings account, how much of M2 do you have?

Answer: All of the assets mentioned are included in M2, so you have $\$25 + \$150 + \$250 = \425 of M2.

Topic: Money in the United States Today, M2

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

3) The First National Bank of Townville has \$125,000 in U.S. government securities, \$200,000 in savings accounts, \$300,000 in checking accounts, \$50,000 in its reserve account at the Fed, \$10,000 of currency in its vault, and loans of \$250,000. What is the amount of its reserves?

Answer: Reserves include the bank's deposit in its reserve account at the Fed and the currency in its vault. Therefore the First National Bank of Townville has $\$50,000 + \$10,000 = \$60,000$ in reserves.

Topic: Reserves

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

4) The Second National Bank of Townville has \$400,000 in checking deposits, \$125,000 in savings deposits, \$500,000 in loans, \$20,000 in its reserve account at the Fed, and \$5,000 of currency in its vault. What is the amount of its reserves?

Answer: Reserves include the bank's deposit in its reserve account at the Fed and the currency in its vault. Therefore the Second National Bank of Townville has $\$20,000 + \$5,000 = \$25,000$ in reserves.

Topic: Reserves

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

5) The Second National Bank of Townville has \$400,000 in checking deposits, \$125,000 in savings deposits, \$500,000 in loans, \$20,000 in its reserve account at the Fed, and \$5,000 of currency in its vault. What is the amount of these assets and liabilities that is in M1?

Answer: The only deposit that is in M1 is the checking deposits, so the amount that is in M1 is checking deposits of \$400,000.

Topic: Banks' Balance Sheet

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

6) A bank has checking deposits of \$400, saving deposits of \$900, time deposits of \$900, loans of \$950, government securities of \$900, outstanding credit card balances of \$400, currency in its vault of \$40, and deposits in its reserve account at the Fed of \$40.

a) What is the amount of this bank's deposits that are in M1?

b) What is the amount of this bank's deposits that are in M2?

c) What is the amount of this bank's reserves?

Answer:

a) The only deposit that is in M1 is the checking deposits, so the amount of this bank's deposits that are in M1 is \$400.

b) Deposits in M2 include checking deposits, saving deposits, and time deposits. Therefore the amount of this bank's deposits that are in M2 equals $\$400 + \$900 + \$900 = \$2,200$.

c) Reserves are the sum of the currency in the bank's vault plus its deposits in its reserve account at the Fed. Therefore the bank's reserves are $\$40 + \$40 = \$80$.

Topic: Banks' Balance Sheet

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

7) A bank has reserves of \$50, deposits of \$100, loans of \$20, and government securities of \$30. Assume the desired reserve ratio is 20 percent.

a) How much does the bank have in excess reserves?

b) What can the bank do with its excess reserves? Name two options.

Answer:

a) The excess reserves are \$30, equal to the actual reserves of \$50 minus the desired reserves of \$20 (= 20 percent of \$100 of deposits).

b) The bank can use its excess reserves to make loans or buy more securities.

Topic: Banks' Balance Sheet

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

8) A bank reports reserves of \$100,000, government securities of \$50,000, loans of \$750,000, and checkable deposits of \$900,000. The desired reserve ratio is 10 percent. What is the amount of excess reserves for this bank? Show your work.

Answer: Excess reserves equal the actual reserves minus the desired reserves. The actual reserves are \$100,000. The bank wants to keep 10 percent of its checkable deposits as reserves, so the desired reserves are $(\$900,000) \times 0.10 = \$90,000$. So excess reserves equal $\$100,000 - \$90,000 = \$10,000$.

Topic: Banks' Balance Sheet

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

9) The desired reserve ratio is 10 percent. Fly By Night Bank has deposits of \$250,000 and reserves of \$25,000. What is the amount of its excess reserves?

Answer: The bank has no excess reserves. It wants to have $(\$250,000) \times (0.10) = \$25,000$ as reserves. Its actual reserves equal \$25,000. Therefore its excess reserves equal $\$25,000 - \$25,000$, or \$0.

Topic: Reserves: Actual and Required

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

10) If a bank receives an additional deposit of \$50,000 and the desired reserve ratio is 20 percent, what is the amount of new loans the bank can make?

Answer: The bank can make loans equal to its excess reserves. With the \$50,000 deposit, the bank's desired reserves are $(\$50,000) \times (0.20) = \$10,000$, so the bank has excess reserves of \$40,000. Therefore the bank can make \$40,000 of loans.

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

11) A bank receives new deposits equal to \$200,000 and the desired reserve ratio is 10 percent. What is the amount of new loans the bank can make?

Answer: The bank can make new loans equal to the amount of its excess reserves. The bank's desired reserves equal $(\$200,000) \times (0.10) = \$20,000$, leaving the bank with excess reserves of \$180,000. As a result, the bank can make \$180,000 in new loans.

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

12) The Fed buys \$50,000 of government securities from Commerce Bank. The desired reserve ratio is 25 percent. What is the change in Commerce Bank's total reserves and its excess reserves?

Answer: When the Fed buys \$50,000 of government securities from Commerce Bank, Commerce Bank's total reserves increase by \$50,000. However, because Commerce Bank's deposits have not changed, none of these additional reserves are desired reserves, so Commerce Bank's excess reserves also increase by \$50,000.

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 14

AACSB: Analytical Skills

13) The Federal Reserve reports that it has coins valued at \$10 billion, bank reserves at the Fed of \$15 billion, gold valued at \$10 billion, Federal Reserve notes of \$400 billion, and U.S. government securities of \$300 billion. What is the size of the monetary base?

Answer: The monetary base is the sum of coins, Federal Reserve notes, and banks' reserves at the Federal Reserve. Therefore the monetary base equals \$10 billion + \$400 billion + \$15 billion = \$425 billion.

Topic: Monetary Base

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Interest rate (percent per year)	Quantity of money demanded (trillions of 2005 dollars)
8	0.7
6	0.9
4	1.1
2	1.3

14) The above table has the demand for money schedule.

a) If the Fed supplies \$1.1 trillion dollars, what is the equilibrium interest rate?

b) Discuss how equilibrium is restored if the interest rate is greater than the equilibrium rate found in part (a).

Answer:

a) The equilibrium interest rate is 4 percent.

b) If the interest rate is greater than 4 percent, there is an excess supply of money. In this case, to be rid of their "extra" money, people buy bonds. The price of bonds rises and so the interest rate falls until it reaches its equilibrium value, 4 percent. At this interest rate, there is no longer an excess supply of money because the quantity demanded equals the quantity supplied.

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

Interest rate (percent per year)	Quantity of money demanded (trillions of 2005 dollars)
3	2.0
4	1.5
5	1.0
6	0.5

15) The above table has the demand for money schedule.

a) If the Fed sets the quantity of money equal to \$1.0 trillion, what is the equilibrium interest rate?

b) If the Fed wants the interest rate to be 4 percent, what must it do?

Answer:

a) If the Fed sets the quantity of money equal to \$1.0 trillion, the equilibrium interest rate is 5 percent.

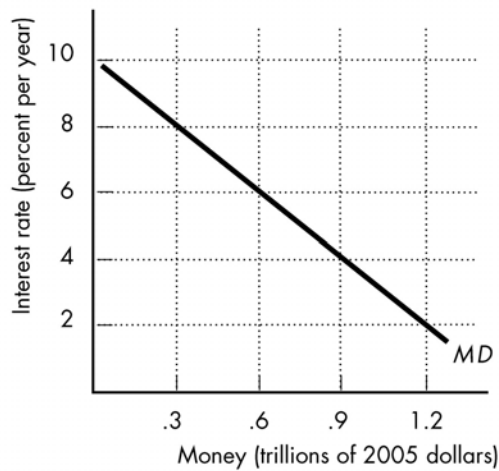
b) If the Fed wants the interest rate to be 4 percent, it must set the quantity of money equal to \$1.5 trillion.

Topic: Money Market Equilibrium

Skill: Analytical

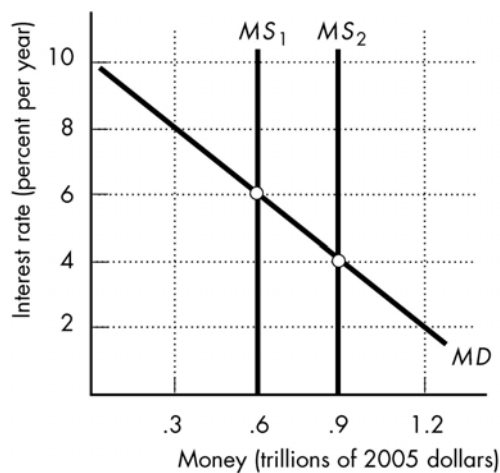
Question history: Previous edition, Chapter 8

AACSB: Analytical Skills



16) The above figure has the demand for money curve. Suppose the Fed initially sets the quantity of money equal to \$0.6 trillion. Draw the supply of money curve in the figure. What is the equilibrium interest rate? Now suppose the Fed increases the quantity of money to \$0.9 trillion. Draw the new supply curve. What is the new equilibrium interest rate?

Answer:



The initial supply of money curve is MS_0 and the equilibrium interest rate is 6 percent. When the Fed increases the quantity of money, the supply of money curve shifts to MS_1 and the equilibrium interest rate falls to 4 percent.

Topic: Money Market Equilibrium

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

17) The quantity of money is \$1 billion, the price level is 1.10, and real GDP is \$10 billion. What is the velocity of circulation?

Answer: The velocity of circulation equals 11.

Topic: Equation of Exchange

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

10 True or False

1) The most direct way in which money eliminates the need for a double coincidence of wants is through its use as a medium of exchange.

Answer: TRUE

Topic: Medium of Exchange

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) Barter eliminates the double coincidence of wants.

Answer: FALSE

Topic: Medium of Exchange

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) When Patty uses money to buy her lunch, she is showing the use of money as a "store of value."

Answer: FALSE

Topic: Store of Value

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) Credit cards are not part of the nation's money supply.

Answer: TRUE

Topic: Money in the United States Today

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

5) The money supply, as measured by M1, consists almost entirely of currency.

Answer: FALSE

Topic: Money in the United States Today, M1

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

6) Traveler's checks are included in M1 but not in M2.

Answer: FALSE

Topic: Money in the United States Today, M1 and M2

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

7) M1 is usually larger than than M2.

Answer: FALSE

Topic: Money in the United States Today, M1 and M2

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

8) A depository institution receives deposits from lenders and makes loans to borrowers.

Answer: TRUE

Topic: Depository Institutions

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

9) A depository institution creates liquidity and pools risk.

Answer: TRUE

Topic: Economic Functions of Depository Institutions

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

10) The Federal Reserve is divided into 7 districts.

Answer: FALSE

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11) The main policy-making body of the Federal Reserve System is the Federal Open Market committee.

Answer: TRUE

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

12) The FOMC is the agency that insures deposits up to \$250,000.

Answer: FALSE

Topic: The Structure of the Federal Reserve System

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

13) The most powerful individual in the Federal Reserve is the Chairman of the Board of Governors.

Answer: TRUE

Topic: The Fed's Power Center

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

14) If the Fed sells securities to commercial banks, there is no money multiplier effect.

Answer: FALSE

Topic: The Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

15) The desired reserve ratio helps determine the amount of money banks can create.

Answer: TRUE

Topic: The Money Multiplier

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

16) If actual reserves are 100 when deposits are 400, then definitely the desired reserve ratio is 0.25.

Answer: FALSE

Topic: The Money Multiplier

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

17) The term "currency drain" refers to an increase in currency held outside banks.

Answer: TRUE

Topic: Currency Drain

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

18) A currency drain occurs because people want to hold some of their money as currency rather than as deposits.

Answer: TRUE

Topic: Currency Drain

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

19) A change in the price level changes the amount of nominal money people demand.

Answer: TRUE

Topic: The Influences on Money Holding, The Price Level

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

20) The opportunity cost of holding money is the nominal interest rate.

Answer: TRUE

Topic: Influences on Money Holding, The Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

21) Suppose that nominal interest rates double. As a result, the quantity of money doubles as well.

Answer: FALSE

Topic: Influences on Money Holding, The Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

22) The increased use of automatic teller machines has decreased the demand for money.

Answer: TRUE

Topic: The Influences on Money Holding, Financial Innovation

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

23) If there is an excess quantity of money, people will buy bonds.

Answer: TRUE

Topic: Money Market Equilibrium

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

24) According to the quantity theory of money, in the long run, an increase in the quantity of money does not change real GDP but does raise the price level.

Answer: TRUE

Topic: The Long-Run Effects of a Change in the Quantity of Money

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

25) According to the quantity theory of money, in the long run an increase in the quantity of money creates an increase in the price level but does not increase real GDP.

Answer: TRUE

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

26) The quantity theory of money asserts that an increase in the quantity of money leads to an equal percentage increase in the price level in the long run.

Answer: TRUE

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

27) Assuming velocity is constant, a 10 percent increase in the quantity of money leads to a 10 percent increase in nominal GDP in both the short run and the long run.

Answer: TRUE

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

28) According to the quantity theory of money, inflation causes an increase in the money supply.

Answer: FALSE

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

29) International data supports the quantity theory of money conclusion that high money growth rates are associated with inflation.

Answer: TRUE

Topic: Predictions of the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

30) In comparing growth rates of money growth and inflation across countries, the long-run proposition of the quantity theory of money is supported.

Answer: TRUE

Topic: International Evidence on the Quantity Theory of Money

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

11 Extended Problems

1) The commercial banks in Fundland have

Reserves	\$500 million
Loans	\$3,500 million
Deposits	\$4,000 million
Total assets	\$5,000 million

The banks hold no excess reserves.

a) Calculate the banks' desired reserve ratio.

b) An immigrant arrives in Fundland with \$10 million, which she deposits in a bank. How much does the immigrant's bank lend initially?

Answer:

a) With no excess reserves, the desired reserve ratio is the fraction of banks' total deposits that are held in reserves. So in Fundland, the banks' desired reserve ratio is $500/4000 = 0.125$ or 12.5 percent.

b) With a desired reserve ratio of 12.5 percent, the bank keeps $\$10 \text{ million} \times 0.125 = \1.25 million on reserve. It then lends the rest, so it lends $\$10 \text{ million} - \1.25 million , which is \$8.75 million.

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

2) The commercial banks in Lendland have

Reserves	\$400 million
Loans	\$3,600 million
Deposits	\$4,000 million
Total assets	\$4,600 million

The banks hold no excess reserves.

a) Calculate the banks' reserve ratio.

b) An immigrant arrives in Lendland with \$5 million, which he deposits in a bank. How much does the immigrant's bank lend initially?

Answer:

a) With no excess reserves, the desired reserve ratio is the fraction of banks' total deposits that are held in reserves. So in Lendland, the banks' desired reserve ratio is $400/4000 = 0.1$ or 10 percent.

b) With a desired reserve ratio of 10 percent, the bank keeps $\$5 \text{ million} \times 0.10 = \0.5 million on reserve. It then lends the rest, so it lends $\$5 \text{ million} - \0.5 million , which is $\$4.5 \text{ million}$.

Topic: Reserves and Loans

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

3) In the economy of Briskland, the commercial banks have deposits of \$500 billion. Their reserves are \$50 billion, 80 percent of which is in deposits with the Central Bank. There is \$20 billion in Central Bank notes outside the banks, and there are no coins.

a) What is the monetary base?

b) If all the deposits are money, what is the total quantity of money?

c) What is the banks' reserve ratio?

d) What is the currency drain as a percentage of the quantity of deposits?

Answer:

a) The monetary base is the sum of Central Bank notes, \$20 billion, and deposits at the Central Bank. The deposits at the central bank are 80 percent of banks' reserves, so deposits at the central bank are $0.8 \times \$50 \text{ billion}$ which is \$40 billion. Then the monetary base is $\$20 \text{ billion} + \$40 \text{ billion} = \$60 \text{ billion}$

b) The quantity of money is Central Bank notes plus deposits, so the quantity of money is $\$20 \text{ billion} + \$500 \text{ billion} = \$520 \text{ billion}$

c) The banks' reserve ratio is the ratio of banks' reserve to deposits, which is $\$50/\$500 = 0.1$ or 10 percent.

d) The currency drain is Central Bank notes held outside the banks. In Briskland, the currency drain is \$20 billion, so as a percentage of the quantity of money, the currency drain is $\$20 \text{ billion}/\$520 \text{ billion} = 0.04$ or 4.0 percent.

Topic: Monetary Base

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

4) Friedmania is a country in which the quantity theory of money operates. The country has a constant population, capital stock, and technology so real GDP does not change. In 2010, real GDP was \$500 million, the price level, measured by the GDP deflator, was 150 and the velocity of circulation of money was 10. (Because the price level is measured by the GDP deflator, it must be divided by 100 before it is used in the equation of exchange.) In 2011, the quantity of money increased by 20 percent.

a) What was the quantity of money in 2010?

b) What was the velocity of circulation in 2011?

c) What was the price level in 2010?

Answer:

a) The equation of exchange states that the quantity of money, M , multiplied by the velocity of circulation, V , equals real GDP, Y , multiplied by the price level, P . In terms of a formula, the equation of exchange is that $M \times V = P \times Y$. Using this formula, $M = PY/V$, $[(150/100 \times \$500 \text{ billion})/10]$ gives the quantity of money as \$75 billion.

b) The quantity theory of money asserts that the velocity of circulation is not influenced by the quantity of money. So the velocity of circulation remains constant at 10.

c) From the equation of exchange, the price level is $P = MV/Y$. Because the quantity of money increased by 20 percent, the quantity of money in 2011 is $\$75 \text{ billion} \times 1.2 = \90 billion . So $P = [(\$90 \text{ billion} \times 100/\$500 \text{ million}) \times 100] = 180$. Another way to calculate the price level in 2011 is to notice that according to the quantity theory, a change in the quantity of money has no effect on velocity and real GDP. So if the quantity of money increases by 20 percent, to balance the equation of exchange, the price level must also increase by 20 percent. So from this approach, the price level in Friedmania is 150×1.2 , which is also equal to 180.

Topic: Quantity Theory of Money

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

5) Fisheria is a country in which the quantity theory of money operates. The country has a constant population, capital stock, and technology. In 2010, real GDP was \$300 million, the quantity of money was \$60, and the velocity of circulation of money was 10. In 2011, the price level rose by 20 percent.

a) What was the price level in 2010? (The price level is measured by the GDP deflator, which is 100 in 2000. So the price level from the equation of exchange needs to be multiplied by 100 to convert it to the GDP deflator.)

b) What was real GDP in 2011?

c) What was the velocity of circulation in 2011?

d) What was the quantity of money in 2011?

Answer:

a) The equation of exchange states that the quantity of money, M , multiplied by the velocity of circulation, V , equals real GDP, Y , multiplied by the price level, P . In terms of a formula, the equation of exchange is that $M \times V = P \times Y$. This formula shows that $P = MV/Y$. Using this result, the price level is $[(\$60 \times 10)/\$300] = 2.0$, which must be multiplied by 100 so that the price level is 200.

b) Real GDP does not change because the country has a constant population, capital stock, and technology, and, according to the quantity theory of money, real GDP is not influenced by changes in the quantity of money. So real GDP in 2011 is \$300 million.

c) The quantity theory of money asserts that the velocity of circulation is not influenced by the quantity of money. So the velocity of circulation remains constant at 10.

d) From the equation of exchange, the quantity of money is $M = PY/V$. Because the price level in 2011 increased by 20 percent, the price level in 2011 is $200 \times 1.2 = 240$. So using the equation of exchange formula, $M = [(240/100) \times \$300]/10 = \72 billion. Another way to calculate the quantity of money in 2011 is to notice that according to the quantity theory, a change in the quantity of money has no effect on velocity and real GDP. So if the price level rises by 20 percent, to balance the equation of exchange, the quantity of money must also increase by 20 percent. So from this approach, in 2011 the quantity of money in Fisheria is $\$60 \text{ billion} \times 1.2 = \72 billion.

Topic: Quantity Theory of Money

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

6) In the economy of Brightland, the commercial banks have deposits of \$600 billion. Their reserves are \$60 billion. All reserves are in deposits with the Central Bank and the commercial banks hold no excess reserves. There is \$120 billion in Central Bank notes outside the banks, and there are no coins.

a) What is the economy's monetary base?

b) What is the quantity of money in the economy?

c) Calculate the money multiplier.

d) Suppose the Central Bank of Brightland undertakes an open market purchase of securities of so that the monetary base increases by \$5 billion. By how much will the quantity of money change?

Answer:

a) The monetary base is the sum of Central Bank notes and deposits at the Central Bank, so the monetary base is \$120 billion + \$60 billion = \$180 billion

b) The quantity of money equals notes plus deposits, which is \$120 billion + \$600 billion = \$720 billion

c) The money multiplier is $(1 + c)/(r + c)$, where c is the ratio of currency to deposits and r is the desired reserve ratio. In Brightland, the ratio of currency to deposits is \$120 billion/\$600 billion = 0.2. Because there are no excess reserves, the desired reserve ratio is \$60 billion/\$600 billion = 0.1. So the money multiplier is $(1 + 0.2)/(0.1 + 0.2) = 4.0$.

d) The quantity of money in the economy increases by the change in the monetary base multiplied by the money multiplier, so the quantity of money increases by $\$5 \times 4 \text{ billion} = \20 billion

Topic: Requires Mathematical Note

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

12 Mathematical Note: The Money Multiplier

1) _____ in the desired reserve ratio will _____ the money multiplier.

- A) An increase; have no effect on
- B) An increase; decrease
- C) A decrease; decrease
- D) A decrease; will have no effect on

Answer: B

Topic: The Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

2) _____ in the currency drain _____ the money multiplier.

- A) A decrease; does not change
- B) An increase; increases
- C) A decrease; decreases
- D) An increase; decreases

Answer: D

Topic: The Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

3) If the desired reserve ratio rises, the money multiplier

- A) decreases.
- B) increases.
- C) stays the same.
- D) probably changes but more information is needed to determine if it increases or decreases.

Answer: A

Topic: The Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

4) The smaller the currency drain, the

- A) smaller the increase in the quantity of money from an increase in reserves.
- B) more likely it is that the banking system will hold a larger proportion of excess reserves.
- C) the smaller the effect of a change in the discount rate.
- D) larger the increase in the quantity of money from an increase in reserves.

Answer: D

Topic: The Money Multiplier

Skill: Conceptual

Question history: Previous edition, Chapter 8

AACSB: Reflective Thinking

5) The banking system has just experienced an increase in deposits of \$50,000. The currency drain ratio is 20 percent and the desired reserve ratio is 10 percent. What does the money multiplier equal?

- A) 4.00
- B) 3.33
- C) 0.25
- D) 10.00

Answer: A

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

6) In Zealand, banks' desired reserve ratio is 20 percent and there is no currency drain. The money multiplier equals _____.

- A) 0.50
- B) 0.20
- C) 20.0
- D) 5.0

Answer: D

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills

7) In Zealand, banks' desired reserve ratio is 20 percent and the currency drain also equals 20 percent. The money multiplier equals _____.

- A) 2.18
- B) 3.33
- C) 5.0
- D) 3.0

Answer: D

Topic: The Money Multiplier

Skill: Analytical

Question history: Previous edition, Chapter 8

AACSB: Analytical Skills