

Macroeconomics, 10e, Global Edition (Parkin)
Chapter 24 Finance, Saving, and Investment

1 Financial Institutions and Financial Markets

- 1) The term "capital," as used in macroeconomics, refers to
A) the plant, equipment, buildings, and inventories of raw materials and semi-finished goods.
B) financial wealth.
C) the sum of investment and government purchases of goods.
D) investment.

Answer: A

Topic: Capital

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 2) The term capital, as used in macroeconomics, refers to
A) the amount of money that someone can invest in a new venture.
B) the amount of money a firm can raise in the stock market.
C) physical capital.
D) All of the above answers are correct.

Answer: C

Topic: Capital

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 3) Which of the following items are considered physical capital?
i. shares of Ford stock traded on the New York Stock Exchange
ii. the Taco Bell store nearest you
iii. the rental cars owned by Hertz Rental-A-Car
iv. the salaries paid to Intel executives

A) ii and iii.

B) i and iv.

C) i, ii and iii.

D) i, ii and iv.

Answer: A

Topic: Capital

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

4) Gross investment

- A) is the purchase of new capital.
- B) includes only replacement investment.
- C) does not include additions to inventories.
- D) Both answers A and B are correct.

Answer: A

Topic: Gross Investment

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

5) The *total* amount spent on new capital in a time period is equal to

- A) wealth.
- B) gross investment.
- C) depreciation.
- D) net investment.

Answer: B

Topic: Gross Investment

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

6) In January 2010, Tim's Gyms, Inc. owned machines valued at \$1 million. During the year, the market value of the equipment fell by 30 percent. During 2010, Tim spent \$200,000 on new machines. During 2010, Tim's gross investment totalled

- A) \$1 million.
- B) \$300,000.
- C) \$200,000
- D) \$900,000.

Answer: C

Topic: Gross Investment

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

7) Net investment equals

- A) capital stock minus depreciation.
- B) gross investment minus depreciation.
- C) the total quantity of plant, equipment and buildings.
- D) gross investment/depreciation.

Answer: B

Topic: Net Investment

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

8) The increase in the capital stock equals the amount of

- A) gross investment.
- B) depreciation.
- C) net investment.
- D) private sector spending.

Answer: C

Topic: Net Investment

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

9) The capital stock increases whenever

- A) gross investment is exceeds net investment.
- B) net investment exceeds gross investment.
- C) gross investment is negative.
- D) net investment is positive.

Answer: D

Topic: Net Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

10) If the economy's capital stock increases over time,

- A) net investment is positive.
- B) depreciation is less than zero.
- C) depreciation exceeds gross investment.
- D) gross investment equals depreciation.

Answer: A

Topic: Net Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

11) If the economy's capital stock decreases over time,

- A) net investment is positive.
- B) depreciation is less than zero.
- C) depreciation exceeds gross investment.
- D) gross investment equals net investment.

Answer: C

Topic: Net Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

12) In January 2010, Tim's Gyms, Inc. owned machines valued at \$1 million. During the year, the market value of the equipment fell by 30 percent. During 2010, Tim spent \$200,000 on new machines. During 2010, Tim's net investment totalled

- A) \$1 million.
- B) \$300,000.
- C) \$200,000.
- D) \$100,000.

Answer: D

Topic: Net Investment

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

13) The Acme Stereo Company had a capital stock of \$24 million at the beginning of the year. At the end of the year, the firm had a capital stock of \$20 million. Thus its

- A) net investment was some amount but we need more information to determine the amount.
- B) net investment was \$4 million for the year.
- C) gross investment was zero.
- D) net investment was -\$4 million for the year.

Answer: D

Topic: Capital and Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

14) At the beginning of the year, Tom's Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom's net investment for the year totaled

- A) 1 machine.
- B) 2 machines.
- C) 3 machines.
- D) 6 machines.

Answer: A

Topic: Capital and Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

15) At the beginning of the year, Tom's Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom's gross investment for the year totaled

- A) 1 machine.
- B) 2 machines.
- C) 3 machines.
- D) 6 machines.

Answer: C

Topic: Capital and Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

16) At the beginning of the year, Tom's Tubes had a capital stock of 5 tube inflating machines. During the year, Tom scrapped 2 old machines and purchased 3 new machines. Tom's capital stock at the end of year equals

- A) 1 machine.
- B) 2 machines.
- C) 3 machines.
- D) 6 machines.

Answer: D

Topic: Capital and Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

17) Which of the following is FALSE about saving?

- A) Saving adds to wealth.
- B) Income left after paying taxes can either be consumed or saved.
- C) Saving equals wealth minus consumption expenditures.
- D) Saving is the source of funds used to finance investment.

Answer: C

Topic: Wealth and Saving

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

18) At the beginning of the year, your wealth is \$10,000. During the year, you have an income of \$90,000 and you spend \$80,000 on consumption. You pay no taxes. Your wealth at the end of the year is

- A) \$20,000.00.
- B) \$0.
- C) \$90,000.00.
- D) \$100,000.00.

Answer: A

Topic: Wealth and Saving

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

19) At the beginning of the year, your wealth is \$10,000. During the year, you have an income of \$80,000 and you spend \$90,000 on consumption. You pay no taxes. Your wealth at the end of the year is

- A) \$20,000.00.
- B) \$0.
- C) \$90,000.00.
- D) \$100,000.00.

Answer: B

Topic: Wealth and Saving

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

20) In January, suppose that a share of stock in Meyer, Inc. had a price of \$50 and that each share entitled its owner to \$2 of Meyer, Inc.'s profit. During the year, the price of a share of Meyer's stock rose to \$100. The interest rate paid on the share in January was _____ percent.

- A) 2
- B) 0.02
- C) 4
- D) 25

Answer: C

Topic: Interest Rate and Price of Asset

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

21) Suppose that a bond promises to pay its holder \$100 a year forever. If the price of the bond increases from \$1,000 to \$1,250, then the interest rate on the bond

- A) falls from 10 percent to 8 percent.
- B) rises from 8 percent to 10 percent.
- C) does not change because it is not affected by the price of the bond.
- D) falls from 10 percent to 6 percent.

Answer: A

Topic: Interest Rate and Price of Asset

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

22) Suppose a bond promises to pay its holder \$100 a year forever. The interest rate on the bond rises from 4 percent to 5 percent. The price of the bond

- A) falls from \$2,500 to \$2,000.
- B) does not change because it is not affected by the interest rate.
- C) falls from \$25,000 to \$20,000.
- D) rises from \$2,000 to \$2,500.

Answer: A

Topic: Interest Rate and Price of Asset

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

23) The *Restoring American Financial Stability Act of 2010*

- A) cut the federal government's ties with Fannie Mae and Freddy Mac.
- B) prohibits banks from selling mortgage backed securities, which were largely to blame for the financial market crisis in 2007-2008.
- C) eliminated the Federal Deposit Insurance Corporation.
- D) had restrictions that try to limit risky investment by banks.

Answer: D

Topic: Restoring American Financial Stability Act

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

24) All of the following are points of the *Restoring American Financial Stability Act of 2010* EXCEPT:

- A) creating a Consumer Financial Protection Bureau.
- B) requiring mortgage lenders to review income and credit histories of applicants to ensure they can afford payments.
- C) imposing tighter restrictions on banks to limit risky investments.
- D) requiring firms that create mortgage backed securities to keep at least 50 percent of their value as reserves.

Answer: D

Topic: Restoring American Financial Stability Act

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

25) The funds used to buy and operate physical capital are

- A) depreciation.
- B) financial capital.
- C) saving.
- D) wealth.

Answer: B

Topic: Study Guide Question, Financial Capital

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

26) This year Pizza Hut makes a total investment of \$1.3 billion in new stores. Its depreciation in this year is \$300 million. Pizza Hut's gross investment is _____ and its net investment is _____.

- A) \$1.3 billion; \$1.6 billion
- B) \$1.0 billion; \$1.3 billion
- C) \$1.3 billion; \$1.0 billion
- D) \$1.0 billion; \$0.7 billion

Answer: C

Topic: Study Guide Question, Gross and Net Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

27) If a bank's net worth is negative, then the bank definitely is

- A) liquid.
- B) insolvent.
- C) illiquid.
- D) solvent.

Answer: B

Topic: Study Guide Question, Insolvent

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

2 The Loanable Funds Market

1) Investment is financed by which of the following?

- I. Government spending
 - II. National saving
 - III. Borrowing from the rest of the world
- A) I, II, and III
 - B) I and II only
 - C) I and III only
 - D) II and III only

Answer: D

Topic: How Investment is Financed

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

2) U.S. investment is financed from

- A) private saving, government budget surpluses, and borrowing from the rest of the world.
- B) private saving, government budget deficits, and borrowing from the rest of the world.
- C) private borrowing, government budget deficits, and lending to the rest of the world.
- D) private saving and borrowing from the rest of the world only.

Answer: A

Topic: Financing Investment

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 3) A nation's investment must be financed by
- A) national saving only.
 - B) the government's budget deficit.
 - C) borrowing from the rest of the world only.
 - D) national saving plus borrowing from the rest of the world.

Answer: D

Topic: Financing Investment

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 4) National saving is defined as the amount of
- A) business saving.
 - B) household saving.
 - C) business saving and household saving.
 - D) private saving and government saving.

Answer: D

Topic: National Saving

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 5) National saving equals
- A) household saving + business saving.
 - B) household saving + business saving + government saving.
 - C) household saving + business saving + net taxes - government expenditure.
 - D) Both answers B and C are correct.

Answer: D

Topic: National Saving

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 6) If the government runs a budget deficit, then
- A) national saving is negative.
 - B) household but not business saving must pay for the deficit.
 - C) part of household and business saving finances the deficit.
 - D) national saving cannot fund investment.

Answer: C

Topic: National Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

7) If national saving (S) is \$100,000, net taxes (T) equal \$100,000 and government expenditure (G) is \$25,000, how much are households and businesses saving?

- A) \$25,000.
- B) \$225,000.
- C) -\$25,000.
- D) none of the above

Answer: A

Topic: National Saving

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

8) Suppose the United States spends more on foreign goods and services than foreigners spend on our goods and services and the United States sells no foreign assets. Then the

- A) United States must borrow an amount equal to national saving.
- B) United States must borrow an amount equal to imports minus exports.
- C) rest of the world may or may not finance the U.S. trade deficit.
- D) United States must borrow an amount equal to consumption expenditure plus investment.

Answer: B

Topic: Borrowing from the Rest of the World

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

9) If foreigners spend more on U.S.-made goods and services than we spend on theirs,

- A) foreigners must borrow from the United States or sell U.S. assets to make up the difference.
- B) all U.S. national saving remains in the United States
- C) we must borrow from foreigners because of low imports.
- D) funds flow in from abroad to help finance U.S. investment.

Answer: A

Topic: Borrowing from the Rest of the World

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

10) If our exports are \$2.2 billion and our imports are \$2.7 billion,

- A) the United States is lending to the rest of the world.
- B) U.S. national saving is too high.
- C) the United States is borrowing from the rest of the world.
- D) U.S. investment must decrease.

Answer: C

Topic: Borrowing from the Rest of the World

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

11) Suppose Country A had net taxes of \$30 million and government expenditures of \$35 million. In addition, household saving in Country A totalled \$5 million while consumption was \$80 million. The government of Country A is running a budget _____ and national saving is _____ million.

- A) surplus; \$5
- B) deficit; -\$5
- C) deficit; \$5
- D) surplus; \$25

Answer: B

Topic: Financing Investment

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

Item	Millions of dollars
Personal consumption expenditure	80
Government expenditure on goods and services	30
Net taxes	35
Gross private domestic investment	20
Imports of goods and services	10
Exports of goods and services	20

12) Use the information in the table above to calculate the value of private saving.

- A) -\$15 million
- B) \$40 million
- C) \$25 million
- D) \$20 million

Answer: C

Topic: Financing Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

13) Use the information in the table above to calculate the value of government saving.

A) \$15 million

B) -\$5 million

C) \$5 million

D) \$45 million

Answer: C

Topic: Financing Investment

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

14) Which of the following is TRUE regarding the real interest rate?

I. The real interest rate is the opportunity cost of borrowed funds.

II. The real interest rate equals the nominal interest rate adjusted for inflation.

A) I

B) II

C) both I and II

D) neither I nor II

Answer: C

Topic: Real Interest Rate

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

15) Approximately, the real interest rate _____ the inflation rate _____ the nominal interest rate.

A) plus; equals

B) equals; plus

C) equals; minus

D) minus; equals

Answer: A

Topic: Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

16) The _____ interest rate approximately equals the _____ interest rate minus _____.

A) nominal; real; depreciation

B) nominal; real; the inflation rate

C) real; nominal; depreciation

D) real; nominal; the inflation rate

Answer: D

Topic: Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

17) The real interest rate

A) can never be negative.

B) is approximately equal to the nominal interest rate plus the inflation rate.

C) is approximately equal to the nominal interest rate minus the inflation rate.

D) is positively related to the inflation rate.

Answer: C

Topic: Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

18) The nominal interest rate minus the real interest rate approximately equals the

A) rate of increase in the amount of investment.

B) inflation rate.

C) the rate of increase in the income.

D) the rate the bank receives to cover lending costs.

Answer: B

Topic: Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

19) The nominal interest rate approximately equals which of the following?

A) the real interest rate minus the inflation rate

B) the real interest rate plus the inflation rate

C) the real interest rate minus the growth rate of real GDP

D) the real interest rate plus the growth rate of real GDP

Answer: B

Topic: Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

20) If you lend a dollar for a year and at the end of the year the price level has risen by 10 percent,

A) the purchasing power of your loan has risen over the year regardless of the interest rate at which you lent it.

B) the purchasing power of your loan has remained constant over the year regardless of the interest rate at which you lent it.

C) you must have earned a nominal interest rate of 10 percent to maintain the purchasing power of your loan.

D) you must have earned a nominal interest rate of 5 percent to maintain the purchasing power of your loan.

Answer: C

Topic: Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

21) When the inflation rate is zero, the

A) real interest rate is greater than the nominal interest rate.

B) real interest rate is less than the nominal interest rate.

C) nominal interest rate is zero.

D) real interest rate equals the nominal interest rate.

Answer: D

Topic: Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

22) When the inflation rate is positive, the

A) real interest rate is greater than the nominal interest rate.

B) real interest rate is less than the nominal interest rate.

C) nominal interest rate is zero.

D) real interest rate equals the nominal interest rate.

Answer: B

Topic: Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 23) When the inflation rate is negative, the
- A) real interest rate is greater than the nominal interest rate.
 - B) real interest rate is less than the nominal interest rate.
 - C) nominal interest rate is zero.
 - D) real interest rate equals the nominal interest rate.

Answer: A

Topic: Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 24) People expect an inflation rate of 5 percent and the real interest rate is positive. Then the nominal interest rate will be
- A) more than 5 percent.
 - B) 5 percent.
 - C) less than 5 percent.
 - D) Without more information it is impossible to tell if the nominal interest rate will be more than, less than, or equal to 5 percent.

Answer: A

Topic: Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

- 25) People know that the inflation rate will increase from 3 percent to 5 percent. As a result
- A) the nominal interest rate falls by 2 percentage points.
 - B) the nominal interest rate is constant.
 - C) the nominal interest rate rises by 2 percentage points.
 - D) the real interest rate rises by 2 percentage points.

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

- 26) Suppose that you took out a \$1000 loan in January and had to pay \$75 in annual interest. During the year, inflation was 6 percent. Which of the following statements is correct?
- A) The nominal interest rate is 7.5 percent and the real interest rate is 1.5 percent.
 - B) The nominal interest rate is 7.5 percent and the real interest rate is 13.5 percent.
 - C) The real interest rate is 7.5 percent and the nominal interest rate is 1.5 percent.
 - D) The real interest rate is 6 percent and the nominal interest rate is 7.5 percent.

Answer: A

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

27) People know that the inflation rate will decrease from 7 percent to 3 percent. As a result

- A) the nominal interest rate falls by 4 percentage points.
- B) the nominal interest rate is constant.
- C) the nominal interest rate rises by 4 percentage points.
- D) the nominal interest rate equals 3 percent.

Answer: A

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

28) If people expect an inflation rate of 3.3 percent, and the real interest rate is 3 percent, the nominal interest rate equals (approximately)

- A) 0.3 percent.
- B) 8.6 percent.
- C) 6.3 percent.
- D) 9.9 percent.

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

29) If the nominal interest rate is 8 percent and inflation is 3 percent, approximately what is the real interest rate?

- A) 11 percent
- B) 8 percent
- C) 5 percent
- D) 3 percent

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

30) If the nominal interest rate is 7 percent and the inflation rate is 1 percent, the real interest rate is approximately

- A) 7 percent.
- B) 6 percent.
- C) 8 percent.
- D) -6 percent.

Answer: B

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

31) If the nominal interest rate is 8 percent and the inflation rate is 2 percent, the real interest rate is approximately

- A) 4 percent.
- B) 6 percent.
- C) 0.25 percent.
- D) 10 percent.

Answer: B

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

32) If the nominal interest rate is 11 percent and the inflation rate is 9 percent, then the real interest rate is approximately

- A) 2 percent.
- B) 20 percent.
- C) 4 percent.
- D) 18 percent.

Answer: A

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

33) If the nominal interest rate is 8 percent and the current inflation rate is 3 percent, approximately what is the real interest rate?

- A) 11 percent
- B) 8 percent
- C) 5 percent
- D) 3 percent

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

34) Assume you save \$1,000 in a bank account that pays 8 percent interest per year and the inflation rate is 3 percent. At the end of the year you have earned

- A) a nominal return of \$50.
- B) a negative real return.
- C) a real return of \$50.
- D) a real return of \$80.

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

35) The real interest rate is 4 percent a year. When the inflation rate is zero, the nominal interest rate is approximately _____ percent a year; and when the inflation rate is 2 percent a year, the nominal interest rate is approximately _____ percent a year.

- A) 0; 2
- B) 4; 6
- C) 6; 8
- D) 6; 4

Answer: B

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

36) Initially the nominal interest rate is 8 percent and the inflation rate is 5 percent. People know that the inflation rate increases to 10 percent. What is the new nominal interest rate?

- A) 8 percent
- B) 3 percent
- C) 13 percent
- D) 11 percent

Answer: C

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

37) Suppose that, initially, the nominal interest rate is 6 percent and the inflation rate is 3 percent. If the inflation rate increases to 6 percent, what will be the new nominal interest rate?

- A) 6 percent
- B) 1 percent
- C) 11 percent
- D) 9 percent

Answer: D

Topic: Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

38) A firm's decision to invest in a project is based on the

- A) real interest rate and expected total revenue.
- B) nominal interest rate and expected total revenue.
- C) nominal interest rate and the expected profit.
- D) real interest rate and the expected profit.

Answer: D

Topic: Investment Decisions

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

39) Suppose a firm has an investment project which will cost \$200,000 and result in \$30,000 profit. The firm will not undertake the project if the interest rate is _____.

- A) greater than 15 percent.
- B) greater than 10 percent.
- C) greater than 5 percent.
- D) positive.

Answer: A

Topic: Investment Demand

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

40) Other things remaining the same, the greater the expected profit,

- A) the less the amount of investment.
- B) the greater the amount of investment.
- C) the steeper is the investment demand curve.
- D) the flatter is the investment demand curve.

Answer: B

Topic: Expected Profit

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

41) Which of the following are major influences on the expected profit from an investment?

- I. technology advances
- II. stock market behavior
- III. accounting practices

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

Answer: A

Topic: Expected Profit

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

42) The expected profit from an investment will change with

- A) a change in the real interest rate.
- B) a change in technology.
- C) Both A and B are correct.
- D) Neither A nor B is correct.

Answer: B

Topic: Expected Profit

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

43) The _____ the expected profit, the greater is the _____.

- A) lower; investment demand
- B) higher; investment demand
- C) lower; capital stock
- D) None of the above answers is correct

Answer: B

Topic: Expected Profit

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

44) As the _____ interest rate increases, the quantity of loanable funds demanded _____.

- A) real; increases
- B) real; decreases
- C) nominal; increases
- D) nominal; decreases

Answer: B

Topic: The Real Interest Rate and Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

45) Which of the following explains why the demand for loanable funds is negatively related to the real interest rate?

- A) A lower real interest rate makes more investment projects profitable.
- B) Consumers are willing to spend less and hence save more at higher real interest rates.
- C) Interest rate flexibility in financial markets assures an equilibrium in which saving equals investment.
- D) All of the above are reasons why the demand for loanable funds is negatively related to the real interest rate.

Answer: A

Topic: The Real Interest Rate and Investment

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

46) The demand for loanable funds is the relationship between loanable funds and the _____ other things remaining the same.

- A) real interest rate
- B) nominal interest rate
- C) inflation rate
- D) price level

Answer: A

Topic: Demand for Loanable Funds

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 47) The demand for loanable funds curve is
- A) downward sloping when plotted against the real interest rate.
 - B) vertical at the full employment level of investment.
 - C) constant at the maximum expected profit rate.
 - D) upward sloping when plotted against the real interest rate.

Answer: A

Topic: Demand for Loanable Funds Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 48) The demand for loanable funds curve shows that as the _____ interest rate increases, there will be a _____ curve.

- A) nominal; rightward shift in
- B) real; rightward shift in
- C) nominal; movement down along
- D) real; movement up along.

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 49) If the real interest rate increases from 3 percent to 5 percent,
- A) the nominal interest rate will also increase.
 - B) the demand for loanable funds curve will shift rightward.
 - C) there will be a movement up along the demand for loanable funds curve.
 - D) the supply of loanable funds curve will shift rightward.

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 50) A rise in the real interest rate
- A) shifts the demand for loanable funds curve rightward.
 - B) shifts the demand for loanable funds curve leftward.
 - C) creates a movement upward along the demand for loanable funds curve.
 - D) creates a movement downward along the demand for loanable funds curve.

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

51) A decrease in the real interest rate leads to

- A) an increase in investment demand so that the demand for loanable funds curve shifts rightward.
- B) a fall in the capital stock.
- C) an increase in the expected profit.
- D) a movement downward along the demand for loanable funds curve.

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

52) When the real interest rate rises

- A) there is a downward movement along the demand for loanable funds curve.
- B) there is an upward movement along the demand for loanable funds curve.
- C) the demand for loanable funds curve shifts rightward.
- D) the demand for loanable funds curve shifts leftward.

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

53) The quantity of loanable funds demanded increases so there is a movement downward along the demand for loanable funds curve when

- A) the expected profit from investment decreases.
- B) business expectations become more optimistic.
- C) the real interest rate falls.
- D) the pool of loanable funds falls.

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

54) A rise in the real interest rate

- A) decreases the demand for loanable funds.
- B) increases the demand for loanable funds.
- C) decreases the quantity of loanable funds demanded.
- D) increases the quantity of loanable funds demanded.

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

55) A decrease in the real interest rate leads to a _____ the demand for loanable funds curve, and a decrease in the expected profit leads to a _____ the demand for loanable funds curve.

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

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

56) A decrease in the demand for loanable funds and a leftward shift of the demand for loanable funds curve results from

- A) an increase in the real interest rate.
- B) technological improvements.
- C) tax cuts.
- D) decreases in the expected profit.

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

57) Greater optimism about the expected profits from investment projects

- A) shifts the demand for loanable funds curve rightward.
- B) shifts the demand for loanable funds curve leftward.
- C) causes a movement upward along the demand for loanable funds curve.
- D) causes a movement downward along the demand for loanable funds curve.

Answer: A

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

58) Due to the recession in 2008, firms decreased their profit expectations. As a result, there was a _____ shift in the _____ loanable funds curve.

- A) rightward; supply of
- B) leftward; demand for
- C) rightward; demand for
- D) rightward, supply of

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

59) Which of the following shifts the demand for loanable funds curve leftward?

- A) a fall in the real interest rate
- B) a rise in the real interest rate
- C) a decrease in the taxes paid by the business
- D) a decrease in the expected profit

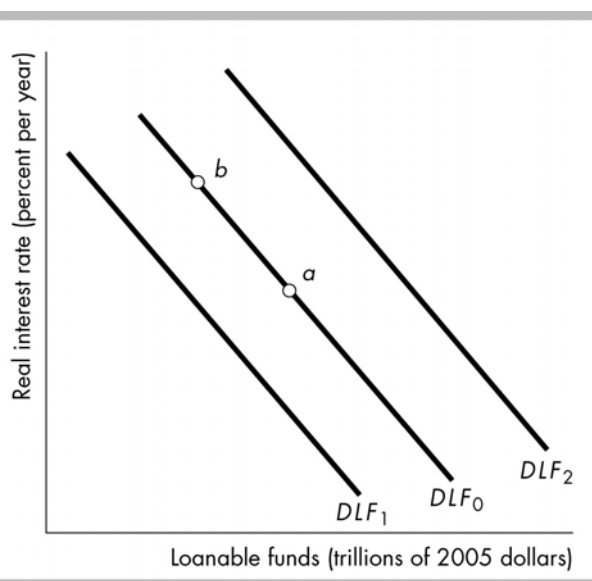
Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking



60) In the above figure, the economy is at point a on the initial demand for loanable funds curve DLF_0 . What happens if the real interest rate rises?

- A) There is a movement to a point such as b on the demand for loanable funds curve DLF_0 .
- B) The demand for loanable funds curve shifts rightward to a curve such as DLF_2 .
- C) The demand for loanable funds curve shifts leftward to a curve such as DLF_1 .
- D) none of the above

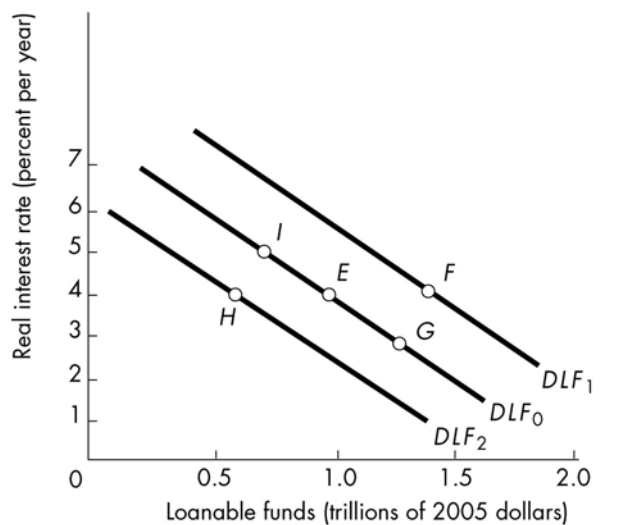
Answer: A

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills



61) In the above figure, a decrease in the real interest rate will result in a movement from point *E* to

- A) point *F*.
- B) point *G*.
- C) point *H*.
- D) point *I*.

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

62) In the above figure, an increase in the expected profit will result in a movement from point *E* to

- A) point *F*.
- B) point *G*.
- C) point *H*.
- D) point *I*.

Answer: A

Topic: Demand for Labor Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

63) In the above figure, a decrease in the expected profit will result in a movement from point *E* to

- A) point *F*.
- B) point *G*.
- C) point *H*.
- D) point *I*.

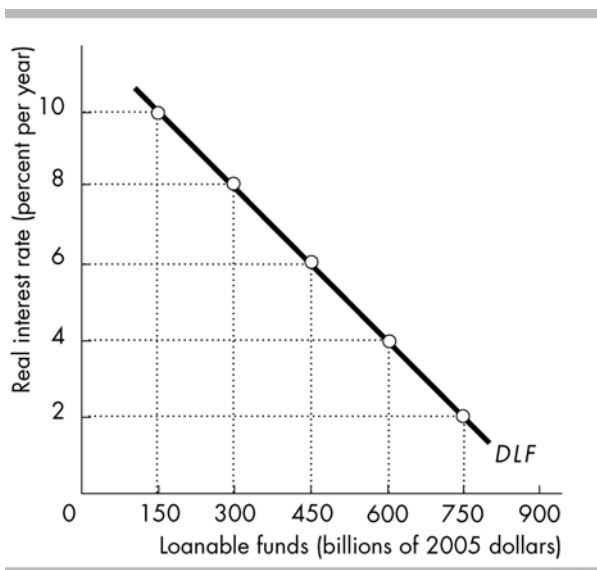
Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills



64) In the above figure, if the real interest rate is 6 percent, the quantity of loanable funds demanded is

- A) \$150 billion.
- B) \$300 billion.
- C) \$450 billion.
- D) \$600 billion.

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

65) In the above figure, the demand for loanable funds curve is drawn for the average expected profit. If the real interest rate is constant at 6 percent and the expected profit falls, the amount of loanable funds demanded will be

- A) less than \$450 billion.
- B) \$450 billion.
- C) between \$450 billion and \$600 billion.
- D) greater than \$600 billion.

Answer: A

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

66) In the above figure, the demand for loanable funds curve is drawn for the average expected profit. If the real interest rate is constant at 6 percent and the expected profit rises, the amount of loanable funds demanded will be

- A) less than \$450 billion.
- B) \$450 billion.
- C) between \$300 billion and \$450 billion.
- D) greater than \$450 billion.

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

67) In the above figure, new expectations of booming business conditions and a higher expected profit will

- A) shift the demand for loanable funds curve leftward.
- B) shift the demand for loanable funds curve rightward.
- C) have no effect on the demand for loanable funds curve.
- D) make the demand for loanable funds curve become horizontal.

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

68) In the above figure, technological progress that increases the expected profit will

- A) shift the demand for loanable funds curve leftward.
- B) shift the demand for loanable funds curve rightward.
- C) have no effect on the demand for loanable funds curve.
- D) make the demand for loanable funds curve become horizontal.

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

69) All of the following are sources of loanable funds except

- A) business investment.
- B) private saving.
- C) government budget surplus.
- D) international borrowing.

Answer: A

Topic: Supply of Loanable Funds

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

70) Which of the following are included in the supply of loanable funds?

- i. private saving
- ii. government budget surplus
- iii. international borrowing

A) i, ii and iii.

B) i and iii.

C) ii and iii.

D) i and ii.

Answer: A

Topic: Supply of Loanable Funds

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

71) In the loanable funds market, the supply comes from

- A) saving, the government budget surplus and international borrowing
- B) only saving and the government budget surplus
- C) only saving
- D) only the government budget surplus and international borrowing

Answer: A

Topic: Supply of Loanable Funds

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

72) Which of the following influences household saving?

- I. The real interest rate.
- II. Disposable income.
- III. Expected future income.

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

Answer: D

Topic: Saving Decisions

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

73) Which of the following is NOT a determinant of household saving?

- A) the nominal interest rate
- B) disposable income
- C) the household's wealth
- D) expected future income

Answer: A

Topic: Household Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

74) Saving by households

- A) decreases when the real interest rate rises.
- B) increases when the real interest rate rises.
- C) increases when the real interest rate falls.
- D) is unaffected by the real interest rate.

Answer: B

Topic: The Real Interest Rate and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

75) The quantity of _____ by households will be less _____.

- A) saving; the higher is disposable income
- B) saving; the lower is the real interest rate
- C) consumption; the lower is the inflation rate
- D) consumption; the higher is disposable income

Answer: B

Topic: The Real Interest Rate and Saving

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

76) If the real interest rate rises, people

- A) save more.
- B) save less.
- C) earn a higher real wage rate.
- D) decrease their expected future income.

Answer: A

Topic: The Real Interest Rate and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

77) If households' disposable income decreases, then

- A) households' saving will decrease.
- B) households' saving will increase.
- C) investment will increase.
- D) Both B and C are correct.

Answer: A

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

78) Households will choose to save more if

- A) income is expected to decrease in the future.
- B) current disposable income increases.
- C) Both answers A and B are correct.
- D) Neither answer A nor B is correct.

Answer: C

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

79) Which of the following have a positive relationship with household saving?

- I. the real interest rate
- II. disposable income
- III. expected future income

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

Answer: A

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

80) Which of the following is correct?

- A) As disposable income increases, the real interest rate increases.
- B) As disposable income decreases, saving decreases.
- C) As saving decreases, disposable income increases.
- D) As saving increases, investment by households decreases.

Answer: B

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

81) _____ increases households' saving.

- A) A decrease in the real interest rate
- B) A tax cut that increases disposable income
- C) Higher expected future income
- D) A stock market boom that increases the purchasing power of households' wealth

Answer: B

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

82) The greater a household's _____ the less is its saving.

- A) return from saving
- B) wealth
- C) disposable income
- D) expected future profits

Answer: B

Topic: Wealth and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

83) Suppose Molly has an income of \$35,000 annually and has inherited a savings account of \$20,000. Wyatt has a job that pays \$35,000 annually, but has debts totaling \$6,000. Which of the following is true?

- A) We can expect Wyatt and Molly to save the same proportion of their incomes this year.
- B) We can expect Molly to save more than Wyatt this year.
- C) We can expect Wyatt to save more than Molly this year.
- D) We can expect Wyatt and Molly to have equal amounts of consumption this year.

Answer: C

Topic: Wealth and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

84) If households expect an increase in their future incomes, they will save

- A) less and consume more today
- B) more and consume less today
- C) and consume more today
- D) and consume less today

Answer: A

Topic: Expected Future Income and Saving

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

85) Which of the following is true regarding the effect expected future income has on saving?

- I. As expected future income increases, saving increases.
 - II. Young people typically save very little.
 - III. Middle aged people, earning higher incomes, are not very big savers.
- A) I and III
 - B) II only
 - C) III only
 - D) II and III

Answer: B

Topic: Expected Future Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

86) Sarah and Diane are both billing clerks for the local trucking company earning \$17,000 per year. Sarah is attending college, plans to graduate in one year and earn \$55,000 as an economist. Diane is not in college or undergoing any specialized training and will have the same job next year. According to economic theory, which of the two individuals would tend to have a higher current savings rate?

- A) Diane
- B) Sarah
- C) Both will have the same saving rate
- D) Economic theory sheds no light on this question

Answer: A

Topic: Expected Future Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

87) If two households have the same disposable income in the current year, the household with the

- A) higher expected future income will consume a larger portion of its current income today.
- B) lower expected future income will consume more today while it has the money.
- C) lower expected future income will spend a larger portion of its current income on consumption today because it will increase its saving in the future.
- D) none of the above

Answer: A

Topic: Expected Future Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

88) The supply of loanable funds is the relationship between loanable funds and _____ other things remaining the same.

- A) real GDP
- B) the price level
- C) the real interest rate
- D) the inflation rate

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

89) Changes in all of the following *shift* the supply curve of loanable funds EXCEPT

- A) the real interest rate.
- B) wealth.
- C) disposable income.
- D) expected future income.

Answer: A

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

90) Which of the following will shift the supply of loanable funds curve leftward?

- A) a decrease in the real interest rate
- B) a decrease in real wealth
- C) a decrease in disposable income
- D) a decrease in expected future income

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

91) An increase in _____ will shift the supply of loanable funds curve _____.

A) expected future income; rightward.

B) wealth; leftward.

C) disposable income; leftward.

D) default risk; rightward

Answer: B

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

92) As a result of the recession in 2008, the default risk increased. How did this change affect the loanable funds market?

A) There was a movement up along the supply of loanable funds curve.

B) There was a leftward shift in the supply of loanable funds curve.

C) There was a movement down along the demand for loanable funds curve.

D) There was a rightward shift in the supply of loanable funds curve.

Answer: B

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

93) When the real interest rate increases,

A) the supply of loanable funds curve shifts rightward.

B) the supply of loanable funds curve shifts leftward.

C) there is a movement upward along the supply of loanable funds curve.

D) there is a movement downward along the supply of loanable funds curve.

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

94) An increase in the real interest rate results in a

A) rightward shift in the supply of loanable funds curve.

B) leftward shift in the supply of loanable funds curve.

C) movement along the supply of loanable funds curve.

D) None of the above.

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

95) Which of the following is true?

- I. As the real interest rate increases, people increase the quantity they save.
- II. The supply of loanable funds curve is downward sloping.
- III. As disposable income increases, the supply of loanable funds curve becomes steeper.

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

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

96) In the loanable funds market, an increase in wealth shifts the _____ loanable funds curve _____.

- A) supply of; rightward
- B) supply of; leftward
- C) demand for; rightward
- D) demand for; leftward

Answer: A

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

97) A decrease in disposable income _____.

- A) has no effect on the supply of loanable funds curve
- B) shifts the supply of loanable funds curve rightward
- C) shifts the supply of loanable funds curve leftward
- D) results in movement up the supply of loanable funds curve

Answer: B

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

98) If households believe their incomes will fall in the future, the result is a

- A) rightward shift in the supply of loanable funds curve.
- B) leftward shift in the supply of loanable funds curve.
- C) movement along the supply of loanable funds curve.
- D) movement along the demand for loanable funds curve.

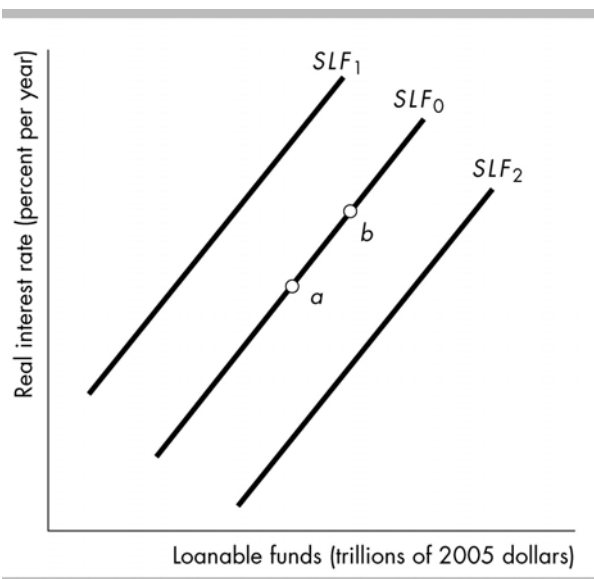
Answer: A

Topic: Supply of Loanable Funds

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking



99) In the above figure, the economy is at point *a* on the initial supply of loanable funds curve *SLF*₀. What happens if disposable income decreases?

- A) Nothing; the economy would remain at point *a*.
- B) There would be a movement to a point such as *b* on supply of loanable funds curve *SLF*₀.
- C) The supply of loanable funds curve would shift rightward to a curve such as *SLF*₂.
- D) The supply of loanable funds curve would shift leftward to a curve such as *SLF*₁.

Answer: D

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

100) In the above figure, the economy is at point *a* on the initial supply of loanable funds curve *SLF*₀. What happens if the real interest rate rises?

- A) Nothing; the economy would remain at point *a*.
- B) There would be a movement to a point such as *b* on supply of loanable funds curve *SLF*₀.
- C) The supply of loanable funds curve would shift rightward to a curve such as *SLF*₂.
- D) The supply of loanable funds curve would shift leftward to a curve such as *SLF*₁.

Answer: B

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

101) In the above figure, the economy is at point *a* on the initial supply of loanable funds curve *SLF*₀. What happens if the interest rate rises?

- A) There is a movement to a point such as *b* on supply of loanable funds curve *SLF*₀.
- B) The supply of loanable funds curve shifts rightward to a curve such as *SLF*₂.
- C) The supply of loanable funds curve shifts leftward to a curve such as *SLF*₁.
- D) none of the above

Answer: A

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

102) In the above figure, the economy is at point *a* on the initial supply of loanable funds curve *SLF*₀. What happens if real wealth decreases?

- A) Nothing; the economy would remain at point *a*.
- B) There would be a movement to a point such as *b* on supply of loanable funds curve *SLF*₀.
- C) The supply of loanable funds curve would shift rightward to a curve such as *SLF*₂.
- D) The supply of loanable funds curve would shift leftward to a curve such as *SLF*₁.

Answer: C

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

103) In the loanable funds market, as the interest rate rises the _____ and the _____.

- A) quantity of loanable funds supplied increases; quantity of loanable funds demanded decreases
- B) quantity of loanable funds supplied decreases; quantity of loanable funds demanded increases
- C) supply of loanable funds increases; demand for loanable funds decreases
- D) supply of loanable funds decreases; demand for loanable funds increases

Answer: A

Topic: Equilibrium in the Loanable Funds Market

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

104) Suppose the current real interest rate is 4 percent and the equilibrium real interest rate is 3 percent. Then

- A) prices rise and inflation occurs.
- B) there is a surplus of loanable funds.
- C) there is a shortage of loanable funds.
- D) there is neither a shortage nor surplus of loanable funds.

Answer: B

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

105) An increase in the real interest rate _____ the quantity of loanable funds supplied and _____ the quantity of loanable funds demanded.

- A) increases; increases
- B) increases; decreases
- C) decreases; increases
- D) decreases; decreases

Answer: B

Topic: Determining the Real Interest Rate

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

106) When the actual real interest rate is less than the equilibrium real interest rate,

- A) the equilibrium real interest rate will rise.
- B) borrowers find it difficult to borrow.
- C) there is a shortage of loanable funds.
- D) Both answers B and C are correct.

Answer: D

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Reflective Thinking

107) If the quantity of loanable funds supplied exceeds the quantity of loanable funds demanded, then _____.

- A) the real interest rate will rise
- B) firms will decrease their investment demand
- C) people will save more
- D) the real interest rate will fall

Answer: D

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

108) If the real interest rate is above the equilibrium real interest rate,

A) lenders will be unable to find borrowers willing to borrow all of the available funds and the real interest rate will fall.

B) borrowers will be unable to borrow all of the funds they want to borrow and the real interest rate will rise.

C) lenders will be unable to find borrowers willing to borrow all of the available funds and the real interest rate will rise.

D) borrowers will be unable to borrow all of the funds they want to borrow and the real interest rate will fall.

Answer: A

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

109) If the real interest rate is below the equilibrium real interest rate,

A) lenders will be unable to find borrowers willing to borrow all of the available funds and the real interest rate will fall.

B) borrowers will be unable to borrow all of the funds they want to borrow and the real interest rate will rise.

C) lenders will be unable to find borrowers willing to borrow all of the available funds and the real interest rate will rise.

D) borrowers will be unable to borrow all of the funds they want to borrow and the real interest rate will fall.

Answer: B

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

110) If the real interest rate is below the equilibrium real interest rate,

A) lenders will be unable to find borrowers willing to borrow all of the available funds and the supply of loanable funds curve will shift leftward.

B) borrowers will be unable to borrow all of the funds they want to borrow and the demand for loanable funds curve will shift rightward.

C) a shortage of loanable funds will cause the real interest rate to rise.

D) borrowers will be unable to borrow all of the funds they want to borrow and the demand for loanable funds curve will shift leftward.

Answer: C

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

111) In the loanable funds market, if the interest rate is above the equilibrium level

- A) there is a shortage of loanable funds.
- B) there is a surplus of loanable funds.
- C) expected profit falls.
- D) government expenditure decreases.

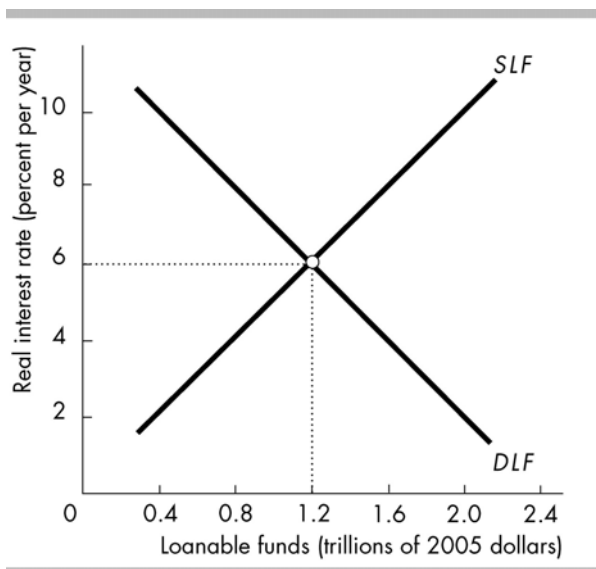
Answer: B

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking



112) In the above figure, if the real interest rate is 8, there is

- A) underproduction in this economy.
- B) a surplus of loanable funds.
- C) a shortage of loanable funds.
- D) a shortage in available funds for investment.

Answer: B

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

113) In the above figure, if the real interest rate is 8 percent, then there is

- A) an increase in the equilibrium interest rate.
- B) a rightward shift in the *DLF* curve.
- C) a leftward shift in the *SLF* curve.
- D) a surplus of loanable funds.

Answer: D

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

114) In the above figure, if the real interest rate is 4 percent, then there

- A) there is a surplus of loanable funds.
- B) is equilibrium in the loanable funds market.
- C) the real interest rate will rise.
- D) the demand curve for loanable funds will shift rightward.

Answer: C

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

115) An increase in disposable income shifts the supply of loanable funds curve

- A) leftward and decreases the real interest rate.
- B) leftward and increases the real interest rate.
- C) rightward and decreases the real interest rate.
- D) rightward and increases the real interest rate.

Answer: C

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

116) Technological progress that increases the expected profit shifts the demand for loanable funds curve

- A) leftward and reduces the real interest rate.
- B) rightward and increases the real interest rate.
- C) rightward and reduces the real interest rate.
- D) leftward and increases the real interest rate.

Answer: B

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

117) Suppose that expected profit decreases. This change means

- A) the demand curve for loanable funds shifts leftward and the real interest rate falls.
- B) the supply curve for loanable funds shifts rightward and the nominal interest rate rises.
- C) there is a movement down along the demand curve for loanable funds.
- D) the real interest rate rises as saving increases.

Answer: A

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

118) If disposable income increases, people will decide to _____ saving, the supply of loanable funds will _____ and the real interest rate will _____.

- A) increase; decrease; rise.
- B) decrease; decrease; rise.
- C) increase; increase; fall.
- D) decrease; increase; fall.

Answer: C

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

119) Suppose the real interest rate rises and the quantity of loanable funds decreases. These changes could have been the result of

- A) firms expecting higher future profits.
- B) an increase in disposable income.
- C) an increase in household wealth.
- D) a decrease in the default risk.

Answer: C

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

120) Suppose the real interest rate rises and the quantity of loanable funds increases. These changes could have been the result of

- A) firms expecting higher future profits.
- B) firms expecting lower future profits.
- C) households expecting higher future income.
- D) in increase in the default risk.

Answer: A

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: New 10th edition

AACSB: Analytical Skills

121) Suppose the market for loanable funds is in equilibrium. If disposable income increases, the equilibrium real interest rate _____ and the quantity of loanable funds _____.

- A) falls; increases
- B) falls; decreases
- C) rises; decreases
- D) rises; increases

Answer: A

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

122) Suppose the market for loanable funds is in equilibrium. If the expected profit falls, the equilibrium real interest rate _____ and the quantity of loanable funds _____.

- A) falls; decreases
- B) falls; increases
- C) rises; increases
- D) rises; decreases

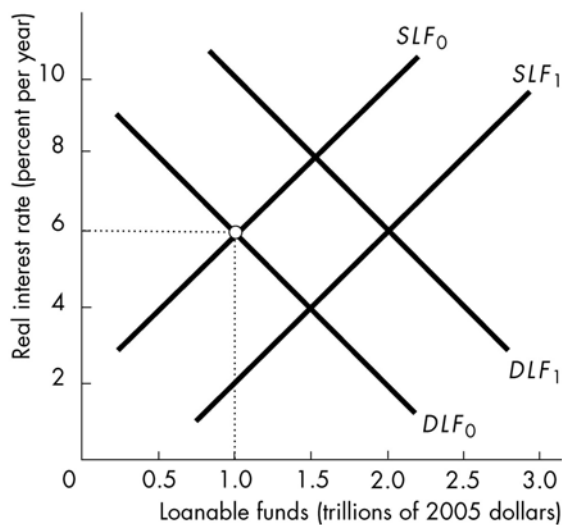
Answer: B

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills



123) In the above figure, the initial supply of loanable funds curve is SLF_0 and the initial demand for loanable funds curve is DLF_0 . An economic expansion that raises disposable income and the expected profit would

- A) only shift the supply of loanable funds curve rightward to a curve such as SLF_1 .
- B) shift the supply of loanable funds curve rightward to a curve such as SLF_1 , and shift the demand for loanable funds curve rightward to a curve such as DLF_1 .
- C) only shift the demand for loanable funds curve rightward to a curve such as DLF_1 .
- D) have no effect on either the demand for loanable funds curve or the supply of loanable funds curve.

Answer: B

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

124) In the above figure, the initial supply of loanable funds curve is SLF_0 and the initial demand for loanable funds curve is DLF_0 . An increase in the expected profit would

- A) only shift the supply of loanable funds curve rightward to a curve such as SLF_1 .
- B) shift the supply of loanable funds curve rightward to a curve such as SLF_1 , and shift the demand for loanable funds curve rightward to a curve such as DLF_1 .
- C) only shift the demand for loanable funds curve rightward to a curve such as DLF_1 .
- D) have no effect on either the demand for loanable funds curve or the supply of loanable funds curve.

Answer: C

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

125) In the above figure, the initial supply of loanable funds curve is SLF_0 and the demand for loanable funds investment curve is DLF_0 . An increase in the real interest rate to 7 percent could be caused by

- A) an increase in investment demand.
- B) a decrease in the expected profit.
- C) an increase in people's disposable incomes.
- D) an expansion that increased both saving and investment by the same amount.

Answer: A

Topic: Changes in the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

126) A fall in the real interest rate

- A) results in a movement along the demand for loanable funds curve.
- B) shifts the demand for loanable funds curve rightward.
- C) shifts the demand for loanable funds curve leftward.
- D) has no effect on the demand for loanable funds curve

Answer: A

Topic: Study Guide Question, Investment Demand Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

127) A decrease in disposable income shifts the _____.

- A) demand for loanable funds curve rightward
- B) demand for loanable funds curve leftward
- C) supply of loanable funds curve leftward
- D) supply of loanable funds curve rightward

Answer: A

Topic: Study Guide Question, Saving Supply Curve

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

3 Government in the Loanable Funds Market

1) If net taxes exceed government expenditures, the government sector has a budget _____ and government saving is _____.

- A) surplus; positive
- B) surplus; negative
- C) deficit; positive
- D) deficit; negative

Answer: A

Topic: Government Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

2) When a government has a budget surplus, the surplus

- A) helps finance investment.
- B) crowds-out private saving.
- C) must be subtracted from private saving to get total saving.
- D) increases the world real interest rate.

Answer: A

Topic: Government Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

3) If the government's budget deficit increases and the Ricardo-Barro effect does not apply,

- A) the real interest rate rises.
- B) investment increases
- C) investment decreases
- D) Both answers A and C are correct.

Answer: D

Topic: Direct Effect of Government Saving

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

4) The idea that a government budget deficit decreases investment is called

- A) government dissaving.
- B) the crowding-out effect.
- C) the Ricardo-Barro effect.
- D) the capital investment effect.

Answer: B

Topic: Crowding-Out Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 5) The term "crowding out" relates to the decrease in
- A) consumption expenditure from an increase in investment.
 - B) the real interest rate from a government budget deficit.
 - C) private investment from a government budget deficit.
 - D) saving from an increase in disposable income.

Answer: C

Topic: Crowding Out Effect

Skill: Recognition

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 6) The crowding out effect refers to
- A) government spending crowding out private spending.
 - B) private saving crowding out government saving.
 - C) government investment crowding out private investment.
 - D) private investment crowding out government saving.

Answer: C

Topic: Crowding Out Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 7) If the government has a budget deficit, crowding out might occur. Crowding out leads to all of the following EXCEPT
- A) a higher real interest rate.
 - B) a decreased quantity of investment.
 - C) a smaller capital stock in the future.
 - D) decreased private saving.

Answer: D

Topic: Crowding Out Effect

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

- 8) If the government begins to run a larger budget deficits, then assuming there is no Ricardo-Barro effect, the demand for loanable funds _____ and the real interest rate _____.

- A) decreases; falls
- B) decreases; rises
- C) increases; rises
- D) increases; falls

Answer: C

Topic: Crowding Out Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

9) In the absence of a Ricardo-Barro effect, a government budget deficit _____ the demand for loanable funds and _____ investment.

- A) increases; increases
- B) increases; decreases
- C) decreases; increases
- D) decreases; decreases

Answer: B

Topic: Crowding Out Effect

Skill: Analytical

Question history: Modified 10th edition

AACSB: Reflective Thinking

10) In the absence of the Ricardo-Barro effect, an increase in the government deficit results in a _____ real interest rate and a _____ equilibrium quantity of investment.

- A) higher; higher
- B) higher; lower
- C) lower; higher
- D) lower; lower

Answer: B

Topic: Crowding Out Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

11) In the absence of a Ricardo-Barro effect, a government budget deficit _____ the demand for loanable funds, _____ the real interest rate, and _____ investment.

- A) increases; decreases; crowds out
- B) increases; decreases; increases
- C) decreases; increases; increases
- D) decreases; increases; crowds out

Answer: D

Topic: Crowding Out Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

12) If China's government runs a budget surplus and there is no Ricardo-Barro effect, there will be _____ in the supply of loanable funds, private saving _____ and investment _____.

- A) an increase; decreases; increases
- B) a decrease; increases; increases
- C) an increase; increases; increases
- D) a decrease; decrease; increases

Answer: A

Topic: Crowding Out Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

13) France's government is running a budget deficit. With no Ricardo-Barro effect, which of the following events will occur?

- i. The supply curve of loanable funds will shift leftward.
- ii. A higher real interest rate crowds out investment.
- iii. Saving increases.

- A) i and ii.
- B) ii and iii.
- C) i only.
- D) iii only.

Answer: B

Topic: Crowding Out Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

14) The tendency for private saving to increase in response to growing government deficits is known as the

- A) crowding out effect.
- B) money illusion effect.
- C) Keynes effect.
- D) Ricardo-Barro effect.

Answer: D

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 15) According to the Ricardo-Barro effect,
- A) government deficits raise the real interest rate.
 - B) taxpayers fail to foresee that government deficits imply higher future taxes.
 - C) households increase their personal saving when governments run budget deficits.
 - D) government budget deficits increase households' expected future disposable income.

Answer: C

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 16) The Ricardo-Barro effect of a government budget deficit refers to
- A) a change in private savings supply.
 - B) a large crowding out effect from a government budget deficit.
 - C) a large crowding out effect from a government budget surplus.
 - D) the international impact of government deficits.

Answer: A

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 17) The Ricardo-Barro effect holds that
- A) equal increases in taxes and government expenditures have no effect on equilibrium real GDP.
 - B) government budget deficits have no effect on the real interest rate.
 - C) a government budget deficit crowds out private investment.
 - D) a government budget deficit induces a decrease in saving that magnifies the crowding out effect.

Answer: B

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

18) The Ricardo-Barro effect says that

A) government budget deficits have no crowding out effect because taxpayers increase their savings to match the quantity of loanable funds demanded by the government.

B) government budget deficits crowd out private investment and thereby lower the real interest rate.

C) government budget deficits resulting from an increase in government expenditure have no effect on investment but government deficits resulting from a decrease in taxes crowd out investment.

D) government budget deficits cause households to save more in anticipation of higher taxes, which causes higher real interest rates.

Answer: A

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: New 10th edition

AACSB: Reflective Thinking

19) According to the Ricardo-Barro effect, government deficits

A) lead to a rise in the equilibrium real interest rate, crowding out investment.

B) lead to simultaneous increases in private saving and no effect on the equilibrium real interest rate and investment.

C) lead to simultaneous decreases in private saving and decreases in the equilibrium real interest rate and investment.

D) lead to a fall in the equilibrium real interest rate and a rise in investment.

Answer: B

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

20) According to the Ricardo-Barro effect,

A) the government budget has no effect on the real interest rate.

B) a government budget deficit crowds out private investment.

C) financing government spending with taxes has a less severe effect on private investment than financing through government borrowing.

D) None of the above answers are correct.

Answer: A

Topic: Ricardo-Barro Effect

Skill: Recognition

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

21) The Ricardo-Barro effects assets that government

- A) saving affects private saving.
- B) budget deficits crowd out private borrowing.
- C) expenditure affects private expenditure.
- D) taxation raises interest rates.

Answer: A

Topic: Ricardo-Barro Effect

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

22) If the Ricardo-Barro effect occurs, an _____ in saving finances the government budget deficit and the real interest rate _____.

- A) increase; remains the same
- B) decrease; increases
- C) increase; falls
- D) decrease; remains the same

Answer: A

Topic: Ricardo-Barro Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

23) If the Ricardo-Barro effect is present, a government budget deficit raises the equilibrium real interest rate by _____ and decreases the equilibrium quantity of investment by _____ than if the Ricardo-Barro effect is absent.

- A) more; more
- B) more; less
- C) less; more
- D) less; less

Answer: D

Topic: Ricardo-Barro Effect

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

24) A decrease in the government budget deficit decreases the _____ loanable funds and an increase in the government budget surplus increases the _____ loanable funds.

- A) demand for; demand for
- B) demand for; supply of
- C) supply of; demand for
- D) supply of; supply of

Answer: B

Topic: Study Guide Question, Government Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

4 The Global Loanable Funds Market

1) In the global loanable funds market,

A) funds flow into countries with the highest risk-adjusted interest rates and out of countries with the lowest risk-adjusted interest rates.

B) funds flow into countries with the lowest risk-adjusted interest rates and out of countries with the highest risk-adjusted interest rates.

C) when funds leave a country, a shortage of funds lowers the real interest rate.

D) when funds enter a country, a surplus of funds raises the real interest rate.

Answer: A

Topic: World Real Interest Rate

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

2) Real interest rates around the world tend to

A) be quite different because no two countries are exactly the same.

B) be equal after adjusting for differences in risk because financial capital seeks the highest possible return.

C) differ because inflation rates differ across countries.

D) be equal because trading partners would not do business otherwise.

Answer: B

Topic: World Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

3) In the global loanable funds market,

A) loans of equal risk will have equal interest rates.

B) riskier loans will have lower real interest rates than safer loans.

C) interest rates for all types of loans will be equal.

D) safer loans will have higher real interest rates than riskier loans.

Answer: A

Topic: World Real Interest Rate

Skill: Conceptual

Question history: New 10th edition

AACSB: Reflective Thinking

4) The real interest rate is _____ in the United States compared to Zimbabwe because _____.

- A) lower; there is a lower risk premium in the United States.
- B) higher; more firms want to borrow financial capital in the United States.
- C) lower; the United States is a net borrower.
- D) higher; Zimbabwe is a net borrower.

Answer: A

Topic: World Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

5) Suppose that Country A (a small country) has exports of \$40 million and imports of \$50 million. As a result, Country A will _____ funds from the rest of the world and engage in net foreign _____.

- A) receive; lending
- B) send; lending
- C) receive; borrowing
- D) send; borrowing

Answer: C

Topic: International Lending and Borrowing

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

6) A small country is a net foreign borrower if its real interest rate without foreign borrowing is _____ the world real interest rate.

- A) higher than
- B) equal to
- C) lower than
- D) not comparable to

Answer: A

Topic: International Lending and Borrowing

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

7) A small country is a net foreign borrower and its supply of loanable funds increases. As a result, the equilibrium quantity of loanable funds used in the country _____ and the country's foreign borrowing _____.

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

Answer: A

Topic: International Lending and Borrowing

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

8) A small country is a net foreign borrower and its demand for loanable funds increases. As a result, the equilibrium quantity of loanable funds used in the country _____ and the country's foreign borrowing _____.

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

Answer: C

Topic: International Lending and Borrowing

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

9) A small country is a net foreign lender and its supply of loanable funds increases. As a result, the equilibrium quantity of loanable funds used in the country _____ and the country's foreign lending _____.

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

Answer: C

Topic: Study Guide Question, International Lending and Borrowing

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

- 10) If the world real interest rate falls, then a country that is a net foreign lender
- A) increases the amount of its lending.
 - B) does not change the amount of its lending.
 - C) decreases the amount of its lending.
 - D) None of the above answers is correct because lending might increase, decrease, or not change.

Answer: C

Topic: Study Guide Question, International Lending and Borrowing

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

5 News Based Questions

- 1) In November 2008, automobile executives from Ford, GM and Chrysler testified to Congress that their firms needed a \$25 billion bailout to prevent bankruptcies. The executives stated that part of the cash would be used to re-design production lines. The \$25 billion is _____ and the re-designed production lines are _____.

- A) financial capital; physical capital
- B) gross investment; physical capital
- C) physical capital; financial capital
- D) net investment; gross investment

Answer: A

Topic: Financial Capital and Physical Capital

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

- 2) In 2007, France's GDP totaled \$1.9 trillion and in 2006 GDP was \$1.8 trillion. The total amount spent on new capital in 2007 was \$357 billion and in 2006 was \$335 billion. To calculate the amount of net investment in France for these years, you need to know _____.

- A) saving
- B) depreciation
- C) the amount of financial capital available.
- D) the aggregate production function.

Answer: B

Topic: Net Investment

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

3) In 2007, France's GDP totalled \$1.9 trillion and in 2006 GDP was \$1.8 trillion. The total amount spent on new capital in 2007 was \$357 billion and in 2006 was \$335 billion. Suppose that depreciation is 12 percent of GDP. _____ investment in 2006 was _____ billion.

- A) Gross; \$357
- B) Gross; \$216
- C) Gross; \$335
- D) Net; \$216

Answer: C

Topic: Net Investment

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

4) In 2007, France's GDP totalled \$1.9 trillion and in 2006 GDP was \$1.8 trillion. The total amount spent on new capital in 2007 was \$357 billion and in 2006 was \$335 billion. Suppose that depreciation is 12 percent of GDP. _____ investment in 2007 was _____ billion.

- A) Gross; \$216
- B) Gross; \$129
- C) Net; \$228
- D) Net; \$129

Answer: D

Topic: Net Investment

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

5) In November 2008, Grand Canyon Education chose to finance expansion by offering ownership in its firm. These owners of Grand Canyon Education are entitled to a share of the firm's profits. This financing is an example of _____.

- A) a mortgage
- B) a bond
- C) issuing stock.
- D) gross investment

Answer: C

Topic: Financial Institutions & Financial Markets

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

6) The University of Central Florida (UCF) wanted "to create a town center where students can live, eat, study and revel in college traditions like football." In addition, the university needed funding to build dorms that would house 2000 students. UCF was able to secure financing by promising to pay a lender a specific amount of money on specific dates. This transaction takes place in the _____ market for _____ capital.

www.sptimes.com 10/14/2007

- A) loan; physical
- B) bond; financial
- C) stock; financial
- D) loan; financial.

Answer: B

Topic: Financial Institutions & Financial Markets

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

7) A share of Apple stock has a price of \$82.58 and gives \$5.36 of Apple profit to its owner . The interest rate on this share

- A) 6.4 percent.
- B) \$15.41.
- C) 15.4 percent
- D) \$6.41.

Answer: A

Topic: Interest Rate and Price of Asset

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

8) In 2007, the interest rate banks in France charge each other for loans was 4.86 percent. The inflation rate in France in 2007 was 2.8 percent. The real interest rate in France is

- A) 7.62 percent
- B) 2.06 percent.
- C) 0.58 percent.
- D) 13.6 percent.

Answer: B

Topic: Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

9) In January 2009, you can put your savings in a Bank of America account and be paid 2 percent per year. During 2009, suppose the inflation rate is 3.4 percent. In 2009 you earned a real interest rate of

- A) 0.59 percent.
- B) 6.8 percent.
- C) 1.4 percent.
- D) -1.4 percent.

Answer: D

Topic: Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

10) The table below shows data for the United States.

	Nominal Interest Rate	Inflation Rate
2006	5.25	4
2007	5	2
2008	4.5	4.3

Between 2006 and 2007, the real interest rate _____ and caused a _____ the demand for loanable funds curve.

- A) increased; rightward shift.
- B) decreased; leftward.
- C) increased; movement upward along
- D) decreased; downward along

Answer: C

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

11) The table below shows data for the U.S.

	Nominal Interest Rate	Inflation Rate
2006	5.25	4
2007	5	2
2008	4.5	4.3

Between 2007 and 2008 the real interest rate _____ and caused a _____ the demand for loanable funds curve.

- A) increased; rightward shift.
- B) decreased; movement down along.
- C) increased; movement up along.
- D) decreased; leftward shift.

Answer: B

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

12) In 2008, the financial and housing crisis caused firms to decrease their profit expectations. As a result, there was a _____ in the _____ for loanable funds curve.

- A) leftward shift; demand.
- B) movement upward along; demand.
- C) leftward shift; supply.
- D) movement downward along; supply.

Answer: A

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

13) In 2010, the United States and foreign economies start to recover from the recession. U.S. firms increase their profit expectations. As a result, the demand for loanable funds curve shifts _____ and the real interest rate _____.

- A) leftward; decreases.
- B) rightward; decreases.
- C) leftward; increases.
- D) rightward; increases.

Answer: D

Topic: Demand for Loanable Funds Curve

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

14) In 2008, the many people became unable to make payments on their mortgages and instead defaulted on them. As a result, the _____ of loanable funds curve shifts _____ and real interest rate _____.

- A) supply; leftward; increases
- B) demand; leftward; increases.
- C) supply; rightward; falls.
- D) demand; rightward; decreases.

Answer: A

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

15) During the financial crisis in 2007 and 2008, financial institutions believed that default risks were higher. As a result, there was _____ in the supply of loanable funds and a _____ in the real interest rate.

- A) a decrease; fall
- B) an increase; rise
- C) an increase; rise
- D) a decrease; rise

Answer: D

Topic: Supply of Loanable Funds Curve

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

16) In 2007, Singapore's government ran a budget surplus of \$4.5 billion. The budget surplus _____ loanable funds and _____ the real interest rate.

- A) increased the supply of; lowered
- B) decreased the demand for; lowered
- C) increased the supply of; raised
- D) increased the demand for; raised

Answer: A

Topic: Government in the Market for Loanable Funds

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

17) In 2008, Germany had a budget deficit of 37 billion euros. This will budget deficit _____ the supply of loanable funds and _____ the real interest rate.

- A) increased; lowered
- B) decreased; raised
- C) decreased; lowered
- D) increased; raised

Answer: B

Topic: Government in the Market for Loanable Funds

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

18) In 2008, Germany had a budget deficit of 37 billion euros. This deficit resulted in

- A) a rightward shift of the supply of loanable funds curve.
- B) a leftward shift of the demand for loanable funds curve.
- C) a crowding out effect in which investment decreases.
- D) the Ricardo-Barro effect and an increase in the interest rate.

Answer: C

Topic: Government in the Market for Loanable Funds

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

19) In 2007, France's exports totaled \$490 billion and its imports totaled \$529 billion. As a result, the

- i. rest of the world supplies funds to France.
- ii. quantity of loanable funds in France is less than the supply.
- iii. Ricardo-Barro effect occurs in France.

- A) i only.
- B) i and ii.
- C) i, ii and iii.
- D) ii and iii only.

Answer: A

Topic: Global Loanable Funds Market

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

20) In 2007, France's exports totalled \$490 billion and its imports totalled \$529 billion. As a result, France is an international _____ and financial funds from around the world _____ France's market for loanable funds.

- A) borrower; leaves
- B) borrower; enters
- C) lender; leaves
- D) lender; enters

Answer: C

Topic: Global Loanable Funds Market

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

21) In 2008, Australia had a government budget surplus of \$21.7 billion. This budget surplus shifts the demand for loanable funds curve _____

- A) leftward and lowers the real interest rate.
- B) leftward and creates a crowding-out effect.
- C) rightward and creates a crowding-out effect.
- D) rightward and creates a Ricardo-Barro effect.

Answer: A

Topic: Government in the Market for Loanable Funds

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

6 Essay Questions

1) Begin with the formula showing how households can divide their income. Then use this formula and the expenditure approach to GDP to show how investment is financed from three sources.

Answer: The formula showing how households can divide their income is $Y = C + S = T$, where Y is income, C is consumption expenditure and T is taxes. According to the expenditure approach income, $GDP = C + I + G + X - M$. But income, Y , equals GDP. So, setting the equalities equal to one another and removing C since it is on both sides gives $I + G + X - M = S + T$. Moving G , X and M to the right hand side gives the final result: $I = S + (T - G) + (M - X)$. Here we see that investment is financed by private saving, S , government saving, $(T - G)$, and borrowing from the rest of the world, $(M - X)$.

Topic: How Investment is Financed

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

2) What is the approximate relationship among the real interest rate, the inflation rate, and the nominal interest rate?

Answer: The real interest rate equals the nominal interest rate minus the inflation rate.

Topic: The Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

3) What is the influence of the expected profit and the real interest rate on the amount of investment firms make?

Answer: Firms make a decision about whether to undertake an investment based upon the benefit of the investment, the expected profit, versus the opportunity cost of making the investment, the real interest rate. For any particular investment firms compare the expected profit to the real interest rate. If the expected profit exceeds the real interest rate the firm will undertake the investment. If the expected profit is less than the real interest rate the firm will not undertake the investment.

Topic: Investment Decisions

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

4) "An increase in the real interest rate increases the quantity of investment." Is the previous statement correct or incorrect?

Answer: The statement is false. The interest rate is the opportunity cost of the funds used to make an investment. Hence an increase in the interest rate decreases the quantity of investment demanded.

Topic: The Real Interest Rate and Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

5) Explain the relationship between the real interest rate and the demand for loanable funds. Compare that relationship to the relationship between expected profit and the demand for loanable funds.

Answer: The real interest rate determines the quantity of loanable funds demanded. There is an inverse relationship between the real interest rate and the quantity of loanable funds demanded. Expected profit affects investment and, because investment is a major source of the demand for loanable funds, the expected profit rate affects the demand for loanable funds. An increase in the expected profit from investing increases investment and thereby increases the demand for loanable funds. Hence there is a positive relationship between the demand for loanable funds and the expected profit rate.

Topic: The Real Interest Rate and Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

6) How does an increase in the expected profit affect investment demand and the demand for loanable funds curve?

Answer: An increase in the expected profit increases investment. Because investment demand is a large part of the demand for loanable funds, an increase in the expected profit shifts the demand for loanable funds curve rightward.

Topic: Expected Profit

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills

7) What are the factors that change investment demand and shift the demand for loanable funds curve?

Answer: Investment demand changes with the changes in the expected profit. The expected profit depends on technological change. Investment increases and so the demand for loanable funds curve shifts rightward when technology advances.

Topic: Investment Demand Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

8) How does the real interest affect households' decisions about saving?

Answer: All disposable income is either used for consumption or saving. The opportunity cost of consumption is the amount of foregone interest you could earn if you saved. The return to saving is the real interest rate, so the higher the real interest rate, the greater the opportunity cost of consuming and not saving. As a result, an increase in the real interest rate leads to an increase in the quantity households save.

Topic: Saving Decisions

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

9) How does expected future income affect saving supply?

Answer: Expected future income affects saving supply because the lower a household's expected future income, the greater is its (current) saving supply.

Topic: Expected Future Income and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

10) What is the relationship between the real interest rate, the supply of loanable funds and the demand for loanable funds?

Answer: The supply of loanable funds has a positive relationship between the real interest rate and the quantity of loanable funds supplied. In a figure, a supply of loanable funds curve has a positive slope. Similarly, the demand for loanable funds is the relationship between the real interest rate and the amount of loanable funds demanded. In a figure, a demand for loanable funds curve has a negative slope.

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

11) Does a change in the real interest rate shift the supply of loanable funds curve? Explain your answer.

Answer: A change in the real interest rate does not shift the supply of loanable funds curve. Instead, the change in the real interest rate results in a change in the quantity of loanable funds supplied and a movement along the supply of loanable funds curve. The supply of loanable funds curve shifts if some factor that influences the supply of loanable funds *other than* the real interest rate changes.

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

12) What are the factors that change the supply of saving and shift the supply of loanable funds curve?

Answer: There are three main factors that influence saving: disposable income, wealth, expected future disposable income, and default risk. The higher disposable income, the more people save, so an increase in disposable income shifts the supply of loanable funds curve rightward. The higher people's wealth, the less they save because they feel richer and do not see the need to save. Thus an increase wealth shifts the supply of loanable funds curve leftward. The higher the expected future disposable income, the less people save today. Thus an increase in the expected future disposable income shifts the supply of loanable funds curve leftward. Finally the higher the default risk, the less people save and so the supply of loanable funds curve shifts leftward.

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

13) Explain how each of the following events affect the supply of loanable funds curve:

- a) The economy is in a recession so people's disposable income is lower.
- b) The stock market is booming so the people's wealth is higher.
- c) Fewer college graduates are finding jobs so expected future income is lower.
- d) The real interest rate increases.

Answer:

- a) Disposable income is lower, so saving is decreased. The supply of loanable funds curve shifts leftward.
- b) People are wealthier, so they save less. The supply of loanable funds curve shifts leftward.
- c) Expected future income is lower, so people save more. The supply of loanable funds curve shifts rightward.
- d) The quantity of saving increases. There is an upward movement along the supply of loanable funds curve but no shift in the curve.

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

14) "When there is a shortage of loanable funds, the real interest rate will increase." Explain whether the previous statement is correct or not.

Answer: The statement is correct. The shortage of loanable funds means that there are firms and others attempting to obtain loans who cannot do so. As a result, the real interest rate rises until equilibrium is attained.

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

15) In the loanable funds market, what variable changes to eliminate a shortage of loanable funds and how is the shortage eliminated?

Answer: The real interest rate changes to eliminate the shortage of loanable funds. A shortage of loanable funds means that businesses and others want to borrow more than households and others are willing to loan so that the quantity of loanable funds demanded exceeds the quantity of loanable funds supplied. This shortage means that some businesses are willing to pay a higher interest rate. The real interest rate rises, and as it does so, the quantity of loanable funds demanded decreases and the quantity of loanable funds supplied increases. Both changes help eliminate the shortage of loanable funds and so the real interest rate rises until it reaches its equilibrium value.

Topic: Determining the Real Interest Rate

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Communication

7 Numeric and Graphing Questions

Real interest rate (percent per year)	Loanable funds demanded (trillions of 2005 dollars)	Loanable funds supplied (trillions of 2005 dollars)
10	0.7	1.5
8	0.9	1.3
6	1.1	1.1
4	1.4	0.9
2	1.7	0.7

1) The table above shows the loanable funds supply and demand schedules.

- a) What is the equilibrium real interest rate and the equilibrium quantity of loanable funds?
- b) If the real interest rate is 4 percent, is there a shortage or surplus? What will happen in the market?

Answer:

- a) The equilibrium real interest rate is 6 percent and the equilibrium quantity of loanable funds is \$1.1 trillion.
- b) If the real interest rate is 4 percent, there is a shortage of loanable funds. The shortage means that the quantity of funds demanded for investment exceeds the quantity supplied, so the real interest rate will rise to its equilibrium of 6 percent.

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Modified 10th edition

AACSB: Analytical Skills

8 True or False

1) Expected profit and the real interest rate affect investment decisions.

Answer: TRUE

Topic: Investment Decisions

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

2) The nominal interest rate is approximately equal to the real interest rate minus the inflation rate.

Answer: FALSE

Topic: The Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

3) There is a positive relationship between the demand for loanable funds and the real interest rate.

Answer: FALSE

Topic: The Real Interest Rate and Investment

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

4) The real interest rate has a positive relationship with the supply of loanable funds.

Answer: TRUE

Topic: The Real Interest Rate and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

5) If Ann's disposable income increases, her saving decreases.

Answer: FALSE

Topic: Disposable Income and Saving

Skill: Conceptual

Question history: Modified 10th edition

AACSB: Reflective Thinking

6) As the purchasing power of wealth increases, saving decreases.

Answer: TRUE

Topic: Wealth and Saving

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

7) The supply of loanable funds curve shifts leftward if the real interest rate rises.

Answer: FALSE

Topic: Supply of Loanable Funds Curve

Skill: Conceptual

Question history: Previous edition, Chapter 7

AACSB: Reflective Thinking

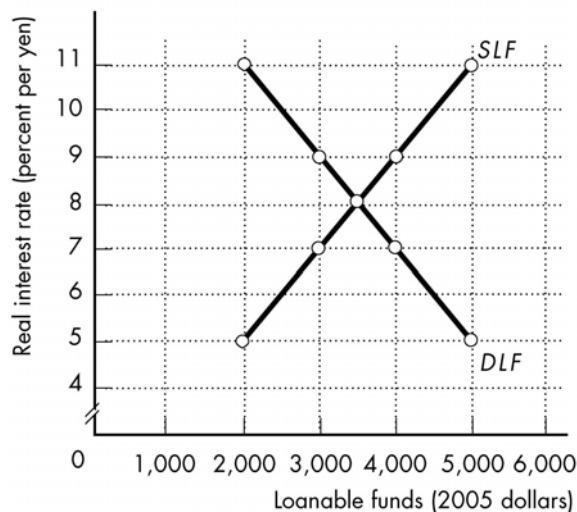
9 Extended Problems

Real interest rate (percent per year)	Supply of loanable funds (2005 dollars)	Demand for loanable funds (2005 dollars)
5	2,000	5,000
7	3,000	4,000
9	4,000	3,000
11	5,000	2,000

1) The economy of Dream Island, which is isolated from the rest of the world, has the supply of loanable funds schedule and the demand for loanable funds schedule shown in the table above. As it happens, all of the supply of loanable funds are from households' saving and the entire demand for loanable funds is from firms' investment demand.

- Draw the demand and supply curves.
- What is the equilibrium real interest rate?
- What is equilibrium investment? Equilibrium saving?
- Describe the situation in Dream Island's loanable funds market when the real interest rate is 10 percent. Is there a shortage of loanable funds? A surplus of loanable funds?
- Describe the situation in Dream Island's capital market when the real interest rate is 6 percent. Is there a shortage of loanable funds? A surplus of loanable funds?

Answer:



- See the figure above.
- The equilibrium real interest rate is the interest rate at which the quantity of loanable funds demanded (which is the quantity of investment demanded) equals the quantity of loanable funds supplied (which is the quantity of saving supplied). As the figure shows, in the economy of Dream Island, the equilibrium real interest rate is 8 percent.

c) The equilibrium amount of investment equals 3,500 dollars. The equilibrium amount of saving is the same, \$3,500.

d) When the real interest rate is 10 percent, the quantity of loanable funds supplied (which is the quantity of saving supplied), \$4,500, exceeds the quantity of loanable funds demanded (which is the quantity of investment demanded), \$2,500. So there is a surplus of loanable funds. Borrowers have an easy time finding the loans they want, but lenders are unable to lend all the funds they have available. As a result, the real interest rate falls until the quantity of loanable funds supplied equals the quantity of loanable funds demanded.

e) When the real interest rate is 6 percent, the quantity of loanable funds supplied (which is the quantity of saving supplied) \$2,500, is less than the quantity of loanable funds demanded (which is the quantity of investment demanded), \$4,500. There is a shortage of loanable funds. Borrowers can't find the loans they want, but lenders are able to lend all the funds they have available. As a result, the real interest rate rises until the quantity of loanable funds supplied equals the quantity of loanable funds demanded.

Topic: Determining the Real Interest Rate

Skill: Analytical

Question history: Previous edition, Chapter 7

AACSB: Analytical Skills