CHAPTER 6
MONEY GROWTH AND INFLATION

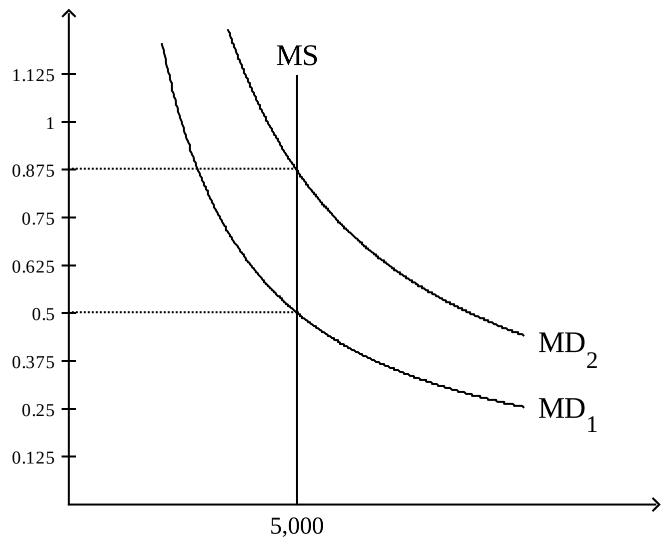
1. Inflation can be measured by the
   a. change in the consumer price index.
   b. percentage change in the consumer price index.
   c. percentage change in the price of a specific commodity.
   d. change in the price of a specific commodity.

2. If the price level increased from 120 to 126, then what was the inflation rate?
   a. 3 percent
   b. 5 percent
   c. 6 percent
   d. None of the above is correct.
3. If *P* denotes the price of goods and services measured in terms of money, then
   a. 1/*P* represents the value of money measured in terms of goods and services.
   b. *P* can be regarded as the "overall price level."
   c. an increase in the value of money is associated with a decrease in *P*.
   d. All of the above are correct.
4. With the value of money on the vertical axis, the money supply curve is
   a. upward-sloping.
   b. downward-sloping.
   c. horizontal.
   d. vertical.
5. When the money market is drawn with the value of money on the vertical axis, a decrease in the price level causes a
   a. movement to the right along the money demand curve.
   b. movement to the left along the money demand curve.
   c. shift to the right of the money supply curve.
   d. shift to the left of the money supply curve.
6. When the money market is drawn with the value of money on the vertical axis, if money demand shifts leftward, then initially there is an
   a. excess demand for money which causes the price level to rise.
   b. excess demand for money which causes the price level to fall.
   c. excess supply of money which causes the price level to rise.
   d. excess supply of money which causes the price level to fall.
7. The price level falls if either
   a. money demand or money supply shifts rightward.
   b. money demand shifts rightward or money supply shifts leftward.
   c. money demand shifts leftward or money supply shifts rightward.
   d. money demand or money supply shifts leftward.
8. Money demand depends on
   a. the price level and the interest rate.

   b. the price level but not the interest rate.
   c. the interest rate but not the price level.
   d. neither the price level nor the interest rate.

9. If M = 3,000, P = 2, and Y = 12,000, what is velocity?
   a. ½
   b. 2
   c. 4
   d. 8
10. According to the classical dichotomy, which of the following is affected by monetary factors?
    a. nominal wages
    b. the price level
    c. nominal GDP
    d. All of the above are correct.
11. Which of the following combinations of real interest rates and inflation implies a nominal interest rate of 7 percent?
    a. a real interest rate of 2.5 percent and an inflation rate of 2 percent
    b. a real interest rate of 4 percent and an inflation rate of 11 percent
    c. a real interest rate of 6 percent and an inflation rate of 1 percent
    d. a real interest rate of 5.5 percent and an inflation rate of 3 percent
12. When the money market is drawn with the value of money on the vertical axis, an increase in the price level causes a
    a. shift to the right of the money demand curve.
    b. shift to the left of the money demand curve.
    c. movement to the left along the money demand curve.
    d. movement to the right along the money demand curve.
13. Suppose the money market, drawn with the value of money on the vertical axis, is in equilibrium. If the money supply increases, then at the old value of money there is an
    a. excess demand for money that will result in an increase in spending.
    b. excess demand for money that will result in a decrease in spending.
    c. excess supply of money that will result in an increase in spending.
    d. excess supply of money that will result in a decrease in spending.

Figure 6-1. On the graph, MS represents the money supply and MD represents money demand. The usual quantities are measured along the axes.


MS
1.125
1
0.875
0.75
0.625
0.5
0.375
0.25
0.125
MD2
MD1
5,000

14. **Refer to Figure 6-1**. What quantity is measured along the horizontal axis?
    a. the price level
    b. the real interest rate
    c. the value of money
    d. the quantity of money

15. **Refer to Figure 6-1**. If the relevant money-demand curve is the one labeled MD_1, then the equilibrium value of money is
    a. 0.5 and the equilibrium price level is 2.
    b. 2 and the equilibrium price level is 0.5.
    c. 0.5 and the equilibrium price level cannot be determined from the graph.
    d. 2 and the equilibrium price level cannot be determined from the graph.

16. **Refer to Figure 6-1**. If the relevant money-demand curve is the one labeled MD_1, then
    a. when the money market is in equilibrium, one dollar purchases one-half of a basket of goods and services.
    b. when the money market is in equilibrium, one unit of goods and services sells for 2 dollars.
    c. there is an excess demand for money if the value of money in terms of goods and services is 0.375.
    d. All of the above are correct.

17. **Refer to Figure 6-1**. Which of the following events could explain a shift of the money-demand curve from MD_1 to MD_2?
    a. an increase in the value of money
    b. a decrease in the price level
    c. an open-market purchase of bonds by the Federal Reserve
    d. None of the above is correct.

18. **Refer to Figure 6-1**. Suppose the relevant money-demand curve is the one labeled MD_1; also suppose the velocity of money is 3. If the money market is in equilibrium, then the economy's real GDP amounts to
    a. 5,000.
    b. 7,500.
    c. 10,000.
    d. 15,000.

19. **Refer to Figure 6-1**. Suppose the relevant money-demand curve is the one labeled MD_1; also suppose the economy's real GDP is 30,000 for the year. If the money market is in equilibrium, then how many times per year is the typical dollar bill used to pay for a newly produced good or service?
    a. 4

b. 6
c. 8
d. 12

20. **Refer to Figure 6-1**. At the end of 2007 the relevant money-demand curve was the one labeled MD_2. At the end of 2008 the relevant money-demand curve was the one labeled MD_1. Assuming the economy is always in equilibrium, what was the economy's approximate inflation rate for 2008?
    a. -43 percent
    b. -57 percent
    c. 57 percent
    d. 75 percent
21. According to the principle of monetary neutrality, a decrease in the money supply will not change
    a. nominal GDP.
    b. the price level.
    c. unemployment.
    d. All of the above are correct.
22. According to the classical dichotomy, when the money supply doubles, which of the following also doubles?
    a. the price level
    b. nominal wages
    c. nominal GDP
    d. All of the above are correct.
23. The velocity of money is
    a. the rate at which the Fed puts money into the economy.
    b. the same thing as the long-term growth rate of the money supply.
    c. the money supply divided by nominal GDP.
    d. the average number of times per year a dollar is spent.
24. Based on the quantity equation, if $M = 100$, $V = 3$, and $Y = 200$, then $P =$
    a. 1.
    b. 1.5.
    c. 2.
    d. None of the above is correct.
25. According to the assumptions of the quantity theory of money, if the money supply increases by 5 percent, then
    a. nominal and real GDP would rise by 5 percent.
    b. nominal GDP would rise by 5 percent; real GDP would be unchanged.
    c. nominal GDP would be unchanged; real GDP would rise by 5 percent.
    d. neither nominal GDP nor real GDP would change.
26. The money supply in Muckland is $100 billion. Nominal GDP is $800 billion and real GDP is $400 billion. What are the price level and velocity in Muckland?
    a. The price level and velocity are both 8.

b. The price level is 2 and velocity is 8.
c. The price level and velocity are both 4.
d. The price level is 4 and velocity is 8.

27. The nominal interest rate is 3 percent and the inflation rate is 2 percent. What is the real interest rate?
    a. 6 percent
    b. 5 percent
    c. 1.5 percent
    d. 1 percent
28. Whitney puts money in a savings account at her bank earning 3.5 percent. One year later she takes her money out and notes that while her money was earning interest, prices rose 1.5 percent. Whitney earned a nominal interest rate of
    a. 3.5 percent and a real interest rate of 5 percent.
    b. 3.5 percent and a real interest rate of 2 percent.
    c. 5 percent and a real interest rate of 3.5 percent
    d. 5 percent and a real interest rate of 2 percent
29. The Fisher effect says that
    a. the nominal interest rate adjusts one for one with the inflation rate.
    b. the growth rate of the money supply is negatively related to the velocity of money.
    c. real variables are heavily influenced by the monetary system.
    d. All of the above are correct.
30. Suppose that monetary neutrality and the Fisher effect both hold. An increase in the money supply growth rate increases
    a. the inflation rate and nominal interest rates.
    b. the inflation rate, but not nominal interest rates.
    c. nominal interest rates, but not the inflation rate.
    d. neither the inflation rate nor nominal interest rates.