

Chapter 16

Domestic and International Dimensions of Monetary Policy

16.1 The Demand for Money

- 1) What are the two features of money that distinguish it from all other goods in the economy?
- A) Money is government issued and it is redeemable for gold or silver.
 - B) Money is accepted as a medium of exchange and it is the common unit of account used to express prices.
 - C) Money is part of every barter transaction and it is divisible.
 - D) Money is a common unit of account and it is also can be traded for other currencies at a guaranteed exchange rate.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 2) Which of the following is a factor influencing the demand for money?
- A) Transactions demand
 - B) Precautionary demand
 - C) Asset demand
 - D) All of the above are correct

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Holding money to meet unplanned expenditures and emergencies is known as
- A) transactions demand.
 - B) precautionary demand.
 - C) asset demand.
 - D) aggregate demand.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Money is a _____ and a transaction is a _____.
- A) stock; stock
 - B) flow; flow
 - C) flow; stock
 - D) stock; flow

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: New

- 5) According to the text, the main reason for people to hold money is
- A) to enjoy looking at the pictures of past leaders.
 - B) to tell other people how rich they are.
 - C) because they are irrational.
 - D) to use it for different reasons.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: New

- 6) What is the most common reason people demand money?
- A) Each bill and coin is a reflection of important people and events in a nation's history.
 - B) People desire to use money as a medium of exchange when they buy goods and services.
 - C) Since very few of us engage in a flow of transactions, money is our financial safety net.
 - D) They demand money to ensure that the nation's government will not spend too much.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Revised

- 7) When households hold money for unplanned expenditures and emergencies, it is called
- A) the speculative demand for money.
 - B) the transactions demand for money.
 - C) the irrational demand for money.
 - D) the precautionary demand for money.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Revised

- 8) A person puts a \$100 bill in the glove compartment of his car in case of an emergency. This is an example of
- A) the precautionary demand for money.
 - B) the transaction demand for money.
 - C) the emergency investment demand for money.
 - D) the asset demand for money.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 9) The demand for money to cover unexpected expenditures and to meet emergencies is known as
- A) the transactions demand for money.
 - B) the precautionary demand for money.
 - C) the asset demand for money.
 - D) the terminal demand for money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

10) Precautionary demand for money will fall when

- A) the interest rate rises.
- B) the interest rate falls.
- C) the money supply increases.
- D) government spending falls.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

11) The precautionary demand for holding money arises because

- A) people want be able to make unexpected purchases or to meet emergencies.
- B) credit cards charge low interest rates, which makes money more attractive than credit.
- C) people would rather hold money in the form of time deposits than in the form of hard currency.
- D) expected transactions are completed more easily with debit cards than with credit cards.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

12) The transactions demand for money exists because households

- A) are insensitive to interest rate changes.
- B) must save for unexpected emergencies.
- C) do not like the fact that money is a liquid asset.
- D) do not receive their incomes at the same time they wish to make purchases.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

13) When people want to hold money to make regular planned expenditures, this is

- A) the transaction demand for money.
- B) the asset demand for money.
- C) the precautionary demand for money.
- D) the spending demand for money.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

14) As nominal Gross Domestic Product (GDP) rises, people will wish to

- A) hold less money for transactions.
- B) hold more money for transactions.
- C) spend less.
- D) invest only in stocks.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

15) The transactions demand for money

- A) varies negatively with nominal Gross Domestic Product (GDP).
- B) varies inversely with nominal Gross Domestic Product (GDP).
- C) varies directly with nominal Gross Domestic Product (GDP).
- D) is unrelated to nominal Gross Domestic Product (GDP).

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

16) When interest rates rise, the transactions demand for money usually

- A) decreases.
- B) increases.
- C) decreases initially and then increases to the original position.
- D) does not change.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

17) As nominal Gross Domestic Product (GDP) rises, the transactions demand for money

- A) increases, and the money demand curve shifts to the left.
- B) decreases, and the money demand curve shifts to the left.
- C) increases, and the money demand curve shifts to the right.
- D) remains constant, and the money demand curve remains the same.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

18) The transactions demand for money

- A) varies inversely with the precautionary demand for money.
- B) varies directly with the rate of interest.
- C) is a function of nominal Gross Domestic Product (GDP).
- D) is determined by the Federal Reserve System.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 19) The transactions demand for money will increase when
- A) the rate of interest increases.
 - B) the price level falls.
 - C) nominal Gross Domestic Product (GDP) increases.
 - D) nominal Gross Domestic Product (GDP) decreases.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The transactions demand for money
- A) varies directly with nominal Gross Domestic Product (GDP).
 - B) varies inversely with nominal Gross Domestic Product (GDP).
 - C) varies negatively with real nominal Gross Domestic Product (GDP).
 - D) has no relationship with nominal Gross Domestic Product (GDP).

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 21) The transactions demand for money refers to
- A) the desire for wealth.
 - B) the demand to hold money for use in planned purchases.
 - C) the desire for income.
 - D) the demand to hold money as a long-term store of value.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 22) The asset demand for money is related to which function of money?
- A) Medium of exchange
 - B) Unit of accounting
 - C) Store of value
 - D) Standard of deferred payment

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 23) When households choose to hold money as a store of value, rather than holding assets such as certificates of deposit, stocks, and bonds, _____ demand for money results.
- A) liquidity
 - B) transactions
 - C) precautionary
 - D) asset

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 24) Suppose the typical household holds \$1,000 when the interest rate is 5 percent. When the interest rate rises to 6 percent, the typical household would most likely hold
- A) more money because the opportunity cost of holding money is lower.
 - B) less money because the opportunity cost of holding money is lower.
 - C) more money because the opportunity cost of holding money is higher.
 - D) less money because the opportunity cost of holding money is higher.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 25) What is a primary determinant of the asset demand for money?

- I. the interest rate
 - II. the opportunity cost of holding money
 - III. the supply of money
- A) I only B) III only C) both I and II D) both II and III

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 26) One of the economic costs of holding currency is that

- A) it fulfills no precautionary role.
- B) it fulfills no transactions role.
- C) it earns no interest income.
- D) its real value always increases.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 27) The money demand function implies that money demand is

- A) positively related to interest rates.
- B) negatively related to bond prices.
- C) negatively related to interest rates.
- D) negatively related to transactions in the economy.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 28) Both the precautionary and asset demand for money are influenced by

- A) the U.S. Treasury.
- B) the interest rate.
- C) gold prices.
- D) none of the above.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

29) Using the interest rate as a measure of the opportunity cost of holding money, the demand for money curve

- A) slopes upward with respect to the rate of interest.
- B) is not affected by the price level.
- C) slopes downward with respect to the rate of interest.
- D) is vertical.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

30) When the rate of interest in the economy increases,

- A) the market price of existing bonds will fall.
- B) the transaction demand for money will increase.
- C) real Gross Domestic Product (GDP) will increase.
- D) the asset demand for money will increase.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

31) When the rate of interest in the economy falls, there will be

- A) an increase in the market price of existing bonds.
- B) a decrease in the transaction demand for money.
- C) less investment by businesses.
- D) an increase in nominal Gross Domestic Product (GDP).

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

32) The opportunity cost of holding money refers to

- A) the service fees associated with checking accounts.
- B) the service fees associated with checking accounts plus the costs undertaken to prevent theft.
- C) the interest that could have been earned if the money balances had been transferred to an interest-bearing asset.
- D) the pleasure that would have been received if the money balances had been used to buy a good or service.

Answer: C

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 33) The demand for money curve is drawn with
- A) the interest rate on the vertical axis and the curve sloping down.
 - B) the interest rate on the vertical axis and the curve sloping up.
 - C) nominal Gross Domestic Product (GDP) on the vertical axis and the curve sloping up.
 - D) nominal Gross Domestic Product (GDP) on the horizontal axis and the curve sloping down.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 34) Money's use in non-barter transactions relates to its role as a
- A) store of value.
 - B) medium of exchange.
 - C) unit of accounting.
 - D) standard of deferred payment.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 35) Asset demand for money is holding money
- A) to meet unplanned expenditures and emergencies.
 - B) as a medium of exchange to make payments.
 - C) as a store of value instead of other assets.
 - D) to speculate on the stock market and bonds.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 36) Something that affects the amount of money in existence will
- A) have no particular effect.
 - B) not affect the economy as a whole but may affect certain key markets such as the market for loans.
 - C) have an effect only if the change in money is large.
 - D) affect all markets.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

37) Which of the following is a true statement?

- A) To demand money is to demand wealth.
- B) To demand money is to demand a higher income.
- C) To use money, one must hold money.
- D) To get more money, one must earn interest on money.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

38) The demand for money refers to the desire to

- A) hold a good that yields utility when it is consumed.
- B) a high income.
- C) spend money because money is used in all transactions.
- D) hold money because money is used in all non-barter transactions.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

39) The main reason people hold money is that

- A) money provides a standard of value.
- B) money is used to buy goods and services.
- C) money is intrinsically valuable.
- D) money is power.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

40) Which of the following is NOT a reason why people are motivated to hold money?

- A) Asset demand.
- B) Precautionary demand.
- C) Liability demand.
- D) Transactions demand.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

41) People demand money for all of the following reasons EXCEPT

- A) it is a medium of exchange to make payments.
- B) it generates a rate of return.
- C) it can meet unplanned expenditures.
- D) it is a store of value.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

42) The transactions demand for money is the demand to hold money to

- A) make regular, expected purchases.
- B) meet unplanned expenditures.
- C) store one's wealth.
- D) purchase bonds when interest rates increase.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

43) When a person holds money, they give up

- A) the pleasure associated with spending money.
- B) the pleasure associated with saving money.
- C) the interest that could have been earned if the money had been changed into an interest-bearing asset.
- D) nothing, since the person can always use the money to buy goods or services or interest-bearing assets.

Answer: C

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

44) The transaction demand for money varies

- A) directly with the interest rate.
- B) directly with nominal GDP.
- C) inversely with nominal GDP and real GDP.
- D) inversely with nominal GDP only.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 45) As real GDP increases, people hold
- A) less money because they will want to increase the amount of savings.
 - B) less money because they will want to collect interest.
 - C) about the same amount of money since that has been enough in the past.
 - D) more money since they will increase their purchases.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 46) A major difference between the transactions demand for money and the precautionary demand is that the
- A) transactions demand means that people are foregoing interest but they are not foregoing interest in the precautionary demand.
 - B) transactions demand leads to the purchase of assets while the precautionary demand does not.
 - C) transactions demand involves expected expenditures while the precautionary demand involves unexpected expenditures.
 - D) transactions demand is for emergencies while the precautionary demand is for every day expenditures.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 47) Holding money as a medium of exchange to make payments is
- A) the transactions demand for money.
 - B) the capital demand for money.
 - C) the precautionary demand for money.
 - D) the asset demand for money.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 48) Alberto purchases ten cups of coffee a week. The amount of money that he holds to purchase ten cups of coffee is the
- A) precautionary demand for money.
 - B) transactions demand for money.
 - C) asset demand for money.
 - D) money balance demand for money.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

49) Holding money to meet unplanned expenditures is

- A) the transactions demand for money.
- B) the capital demand for money.
- C) the precautionary demand for money.
- D) the asset demand for money.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

50) When the interest rate increases, people will adjust their precautionary demand for money

- A) upward.
- B) downward.
- C) not at all.
- D) downward or upward depending upon the actual supply of money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

51) The precautionary demand for money is when people hold money

- A) for the interest it yields.
- B) as a store of value.
- C) as a medium of exchange.
- D) to meet unplanned expenditures.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

52) The relationship between the interest rate and the precautionary demand for money is

- A) positive.
- B) inverse.
- C) positive sometimes and inverse other times.
- D) nonexistent.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

53) A person is preparing for a long automobile trip and cashes in a certificate of deposit for cash in case of emergencies along the way. This is an example of the

- A) transactions demand for money.
- B) precautionary demand for money.
- C) wealth demand for money.
- D) asset demand for money.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

54) Holding money as a store of value instead of other assets is

- A) the transactions demand for money.
- B) the capital demand for money.
- C) the precautionary demand for money.
- D) the asset demand for money.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

55) The asset demand for money is related to the function of money called

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

Answer: C

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

56) People hold money as an asset rather than other assets because

- A) it is highly liquid.
- B) it holds its value.
- C) it grows in value.
- D) there is no cost to holding money as an asset.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

57) Javier has been thinking about purchasing a bond but is afraid that the bond will lose value. He has decided to hold money instead. This is known as the

- A) precautionary demand for money.
- B) transactions demand for money.
- C) asset demand for money.
- D) money balance demand for money.

Answer: C

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

58) People hold money because it is liquid and lacks risk under the

- A) money balance demand for money.
- B) asset demand for money.
- C) precautionary demand for money.
- D) transactions demand for money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

59) The relationship between the interest rate and the asset demand for money is

- A) positive.
- B) inverse.
- C) positive sometimes and inverse other times.
- D) nonexistent.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

60) John gets paid monthly and pays for everything with cash. When he cashes his check he keeps \$200 for food, \$100 for utilities, \$900 for rent, \$50 for transportation, \$100 for entertainment and \$300 for unexpected expenditures. Which of the following statements is true?

- A) The transactions demand for money is \$1,350, the precautionary demand is \$300 and the asset demand is \$0.
- B) The transactions demand for money is \$450, the precautionary demand is \$300 and the asset demand is \$900.
- C) The transactions demand for money is \$350, the precautionary demand is \$1,150 and the asset demand is \$150.
- D) The transactions demand for money is \$350, the precautionary demand is \$950 and the asset demand is \$0.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

61) George makes \$250 a week working as a student aid. When he cashes his check he takes \$100 to the cashiers office to pay part of his tuition. \$25 goes to paying off his books, \$75 goes for entertainment and \$50 he keeps for unexpected expenditures. Which of the following statements is true?

- A) The transactions demand for money is \$125, the precautionary demand is \$75 and the asset demand is \$50.
- B) The transactions demand for money is \$0, the precautionary demand is \$250 and the asset demand is \$0.
- C) The transactions demand for money is \$250, the precautionary demand is \$0 and the asset demand is \$0.
- D) The transactions demand for money is \$200, the precautionary demand is \$50 and the asset demand is \$0.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 62) Samia makes \$8,000 a month. Samia spends \$2,500 on rent and related household expenses, \$500 on food, \$200 on clothes, \$500 on entertainment and \$600 on transportation. She always keeps \$200 for things like the car breaking down. \$3,500 is invested in the stock market. Which of the following statements is true?
- A) The transactions demand for money is \$4,300, the precautionary demand is \$200 and the asset demand is \$3,500.
 - B) The transactions demand for money is \$4,300, the precautionary demand is \$3,500 and the asset demand is \$200.
 - C) The transactions demand for money is \$4,300, the precautionary demand is \$200 and the asset demand is \$0.
 - D) The transactions demand for money is \$3,500, the precautionary demand is \$200 and the asset demand is \$4,300.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 63) Suppose a family is holding \$1000 in its checking account for normal transactions, \$500 in cash for emergencies, and \$1500 as a store of value when the interest rate is 4 percent. If the interest rate rises to 10 percent, which of the following patterns of holding money would be most likely and why?
- A) Transactions demand—\$1000; Precautionary demand—\$350; Asset demand—\$500, because the opportunity cost of holding money has increased. The reduction money balances held as an asset is greatest because interest-bearing assets are much more attractive when interest rates are higher.
 - B) Transactions demand—\$500; Precautionary demand—\$500; Asset demand—\$1400, because the opportunity cost of holding money balances has risen. The reduction in money balances held for transaction purposes falls the most because people start using credit cards more when the opportunity cost of holding money increases.
 - C) Transactions demand—\$1000; Precautionary demand—\$500; Asset demand—\$500, because only the asset demand is responsive to changes in the interest rate.
 - D) Transactions demand—\$800; Precautionary demand—\$600; Asset demand—\$1500, because people can economize on their money balances for making transactions, but the possibility of an emergency increases with the interest rate. People will also expect rates to go higher, so they will hold money as an asset until the rates increase further.

Answer: A

Diff: 3

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 64) The demand for money curve is drawn
- A) holding several things constant, including GDP and interest rates.
 - B) holding several things constant, including the price level and interest rates.
 - C) with interest rates on the horizontal axis, and the curve sloping up since the "price" of holding money varies directly with the interest rate.
 - D) with interest rates on the vertical axis and the curve sloping down since lower interest rates mean the "price" of holding money has fallen.

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 65) When considering the demand for money curve, the interest rate
- A) will have a positive relationship with the quantity of money demanded.
 - B) varies negatively with the transactions demand for money.
 - C) is the price of holding money.
 - D) is independent of the opportunity cost of money.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 66) The opportunity cost of holding money is
- A) the interest income foregone.
 - B) the transactions demand for money.
 - C) contractionary monetary policy.
 - D) the monetary rule.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 67) The relationship between the quantity of money balances demanded and the interest rate is
- A) determined by open market operations.
 - B) negative.
 - C) contractionary monetary policy.
 - D) the reserve requirements.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

68) The demand for money curve

- A) shows the relationship between money demanded and open market operations.
- B) shows the relationship between the quantity of money balances demanded and the interest rate.
- C) is positively related to the interest rate.
- D) varies inversely with the supply of money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

69) The reason that people may not want to hold money is

- A) the precautionary demand for money and the risk of being robbed.
- B) the opportunity cost.
- C) the transactions demand makes it unnecessary.
- D) due to the direct relationship between money demand and the interest rate.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

70) The demand for money for which the purpose is making unexpected purchases or meeting emergencies is considered to be part of

- A) precautionary demand.
- B) transactions demand.
- C) asset demand.
- D) savings demand.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

71) In economics, the demand for money as basically a demand for

- A) bonds.
- B) status.
- C) liquidity.
- D) investment.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Revised

72) Holding money as a medium of exchange to purchase goods and services and make payments is known as the

- A) spending demand for money.
- B) transactions demand for money.
- C) precautionary demand for money.
- D) asset demand for money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

73) The demand for money curve depicts

- A) an inverse relationship between the quantity of money demanded and the quantity of bonds demanded.
- B) a direct relationship between the quantity of money demanded and the quantity of bonds demanded.
- C) an inverse relationship between the quantity of money demanded and the interest rate.
- D) a direct relationship between the quantity of money demanded and the interest rate.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

74) Which of the following will tend to occur when the interest rate increases?

- A) The demand for money curve shifts leftward.
- B) The demand for money curve shifts rightward.
- C) There is a rightward movement along the demand for money curve.
- D) There is a leftward movement along the demand for money curve.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

75) Which of the following will cause a reduction in the amount of money individuals wish to hold?

- A) an increase in the interest rate
- B) an increase in income
- C) an increase in the price level
- D) all of the above

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

76) The amount of money people wish to hold shows an inverse relationship to

- A) their planned near-term purchases.
- B) the money supply.
- C) the income tax rate.
- D) the interest rate.

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

77) The amount of money that people wish to hold to use in transactions varies directly with

- A) their planned near-term purchases.
- B) the money supply.
- C) the income tax rate.
- D) the interest rate.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 78) The downward slope of the demand for money curve reflects the fact that
- A) people hold more of their wealth in the form of money as the price level rises.
 - B) people hold more of their wealth in the form of money as the price level falls.
 - C) people hold more of their wealth in the form of money as the interest rate rises.
 - D) people hold more of their wealth in the form of money as the interest rate falls.

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 79) Which of the following is NOT a type of demand for holding money?
- A) transactions demand
 - B) precautionary demand
 - C) asset demand
 - D) qualitative demand

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 80) Which of the following represents the opportunity cost of holding money?
- A) liquidity
 - B) the interest rate
 - C) the rate of inflation
 - D) none of the above

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 81) The transactions demand for money is related to money functioning as a
- A) unit of accounting.
 - B) medium of exchange.
 - C) store of value.
 - D) medium of deferred payment.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 82) The demand for money is based on
- A) the transactions demand, asset demand, and precautionary demand.
 - B) the demand for cash, demand for securities, and the demand for real estate.
 - C) the demand for consumption, demand for investment, and demand by government.
 - D) a demand for liquidity and wealth.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 83) A person keeps \$500 in his home in order to be prepared for some unforeseen future event. This reflects his

A) speculative demand for money. B) asset demand for money.
C) precautionary demand for money. D) liquidity demand for money.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 84) Asset demand for money is related to money functioning as a

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

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 85) The interest rate is the opportunity cost

A) of investing in stocks. B) of investing in Treasury securities.
C) of using credit cards. D) of holding money.

Answer: D

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 86) If the interest rate increases, the

A) quantity of money demanded will remain unchanged.
B) money demand curve will shift to the right.
C) money demand curve will shift to the left.
D) quantity of money demanded will fall.

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 87) Warren always carries a one hundred dollar bill in case of emergencies. This is an example of the

A) precautionary demand for money. B) asset demand for money.
C) transactions demand for money. D) wealth demand for money.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 88) Travis always carries \$100 in his wallet to pay for groceries. This is an example of the
- A) precautionary demand for money.
 - B) asset demand for money.
 - C) transactions demand for money.
 - D) wealth demand for money.

Answer: C

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 89) Bertha holds some of her savings as currency and coins placed in her sewing basket. This is an example of
- A) precautionary demand for money.
 - B) asset demand for money.
 - C) transactions demand for money.
 - D) wealth demand for money.

Answer: B

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 90) The demand for money is downward sloping, because at higher interest rates,
- A) the opportunity cost of holding cash is lower.
 - B) the opportunity cost of holding money is higher.
 - C) the opportunity cost of holding money is decreasing.
 - D) the opportunity cost of holding money is constant.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 91) If the interest rate increases, there is a(n)
- A) increase in the demand for money.
 - B) decrease in the demand for money.
 - C) increase in the quantity of money demanded.
 - D) decrease in the quantity of money demanded.

Answer: D

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

- 92) Suppose Tim has \$1,000 in cash on hand to buy collectable baseball cards at a swap meet. Tim often sells these cards at a profit. This is an example of the
- A) asset demand for money.
 - B) transaction demand for money
 - C) precautionary demand for money.
 - D) wealth demand for money.

Answer: A

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

93) The asset demand for money is

- A) greater at high interest rates as investors can earn more on their investments.
- B) greater at low interest rates, because the opportunity cost of holding money is low.
- C) greater at low interest rates, because the opportunity cost of holding money is high.
- D) lower at low interest rates, because the opportunity cost of holding money is high.

Answer: B

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

94) As interest rates rise, the quantity of money demanded

- A) falls.
- B) rises.
- C) stays the same.
- D) does not react to interest rate changes.

Answer: A

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

95) What is meant by the demand for money?

Answer: Money is used to buy goods and services. So, if we want to purchase something, we must have some money. The demand for money is amount of desired money holdings, given factors such as income and the interest rate.

Diff: 1

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

96) "The demand for money is infinite since everyone wants more money." Do you agree or disagree with this statement? Why?

Answer: Disagree. The demand for money does not refer to the desire to have more wealth or income. It is a demand to hold money balances so that one can purchase goods and services. Therefore, the demand for money is not infinite, but is downward sloping with respect to the cost of holding money balances—the interest rate.

Diff: 3

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

97) What are three reasons people want to hold money balances?

Answer: There are three reasons people hold money balances. The transactions demand for money is the demand to hold money to make regular, expected expenditures. The precautionary demand is the money held to meet unplanned expenditures and emergencies. The asset demand for money is to hold money as an asset that is a store of value.

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

98) What does the demand curve for money look like? Why?

Answer: If the quantity of money is on the horizontal axis and the interest rate on the vertical axis, the demand curve for money is a downward sloping curve or line. People hold money because of money's role as a medium of exchange and a store of value. The lower the interest rate the lower the cost to hold money balances since the forgone interest is lower. People will hold more balances when the price of doing so is less, so the demand curve for money slopes down.

Diff: 2

Topic: 16.1 The Demand for Money

AACSB: Analytic skills

Question Status: Previous Edition

16.2 How the Fed Influences Interest Rates

1) Which of the following actions by the Fed would lead to an increase in the money supply?

- A) An increase in the required reserve ratio
- B) An increase in the differential between the discount rate and the federal funds rate
- C) An increase in tax rates
- D) The purchase of government securities

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

2) An increase in bond prices will most likely result in

- A) an increase in interest rates.
- B) a decrease in the quantity demanded of money.
- C) an increase in the quantity demanded of money.
- D) an increase in the opportunity cost of holding money.

Answer: C

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Revised

3) If a bond sells for \$2,000 and pays \$200 per year in interest, the interest rate on the bond is

- A) 20 percent.
- B) 10 percent.
- C) 5 percent.
- D) 100 percent.

Answer: B

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 4) If you initially pay \$1,000 for a bond with an annual interest rate of 5 percent, but then the market interest rate rises to 6 percent,
- A) the market price of the bond is still \$1,000.
 - B) the bond's annual interest payment remains equal to \$50.
 - C) the market price of the bond has increased.
 - D) the market price of the bond has decreased.

Answer: D

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 5) The price of bonds and the interest rate are
- A) inversely related.
 - B) positively related.
 - C) unrelated.
 - D) related, but we are not sure how.

Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 6) An excess quantity of money demanded will lead to a rise in
- A) the interest rate.
 - B) investment.
 - C) income.
 - D) bond prices.

Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Which of the following will lead to a decrease in the price of existing bonds?
- A) A decrease in the rate of interest
 - B) An inward shift in money demand
 - C) A decrease in planned investment spending
 - D) A reduction in the money supply

Answer: D

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 8) An increase in the money supply typically leads to
- A) a reduction in the rate of interest.
 - B) a decrease in the price level.
 - C) a reduction in the velocity of money.
 - D) an inward shift in money demand.

Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 9) If the Fed purchases U.S. government securities in the open market, all of the following would occur EXCEPT

- A) an expansion of the money supply.
- B) an increase in investment.
- C) a fall in bond prices.
- D) an increase in real Gross Domestic Product (GDP).

Answer: C

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 10) If the Fed sells bonds through its open market operations, then there is
- A) an increase in the demand for bonds and a rise in the price of existing bonds.
 - B) an increase in the supply of bonds and a fall in the price of existing bonds.
 - C) a decrease in interest rates because of the increase in the supply of bonds.
 - D) a decrease in interest rates because of the decrease in the demand for bonds.

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 11) If the Fed decides to buy bonds, the result will be
- A) lower bond prices and lower interest rates.
 - B) lower bond prices and higher interest rates.
 - C) higher bond prices and lower interest rates.
 - D) higher bond prices and higher interest rates.

Answer: C

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 12) The market prices of existing bonds are
- A) not related to the interest rate.
 - B) directly related to the interest rate.
 - C) inversely related to the interest rate.
 - D) stated in terms of the interest rate.

Answer: C

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

13) Interest rates typically rise when

- A) bond prices increase.
- B) bond prices decrease.
- C) the coupon payout on existing bonds increase.
- D) the maturity date on existing bonds extends farther into the future.

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

14) Which of the following is NOT a reason the Fed changes the rate of growth of the money supply?

- A) To influence aggregate demand
- B) To shift the demand for money curve
- C) To influence the amount of consumption
- D) To influence the amount of investment

Answer: B

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Revised

15) The market price of existing bonds is _____ to the rate of interest prevailing in the economy.

- A) inversely related
- B) directly related
- C) totally unrelated
- D) synonymous

Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

16) Open market operations by the Fed cause

- A) changes in the difference between the discount rate and the federal funds rate.
- B) aggregate supply to change.
- C) the prices of bonds to change.
- D) changes in the required reserve ratio.

Answer: C

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 17) When the Fed conducts open market operations, it
- A) purchases or sells government bonds issued by the U.S. Treasury.
 - B) is engaging in fiscal policy.
 - C) also raises taxes at the same time.
 - D) shifts the demand for money curve.

Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 18) A sale of bonds by the Fed generates
- A) an increase in the demand for money balances.
 - B) a decrease in the demand for money balances.
 - C) an increase in the demand for bonds and a rise in bond prices.
 - D) an increase in the supply of bonds and a fall in bond prices.

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 19) The purchase of government bonds by the Fed leads to a(n)
- A) increase in the supply of bonds and a decrease in bond prices.
 - B) decrease in the supply of bonds and an increase in bond prices.
 - C) increase in the demand of bonds and a decrease in the price of bonds.
 - D) decrease in the demand of bonds and an increase in the price of bonds.

Answer: B

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 20) An increase in the interest rate will
- A) decrease the price of bonds.
 - B) increase the price of bonds.
 - C) increase or decrease the price of bonds depending upon whether the money supply has increased or decreased.
 - D) leave the price of bonds unchanged.

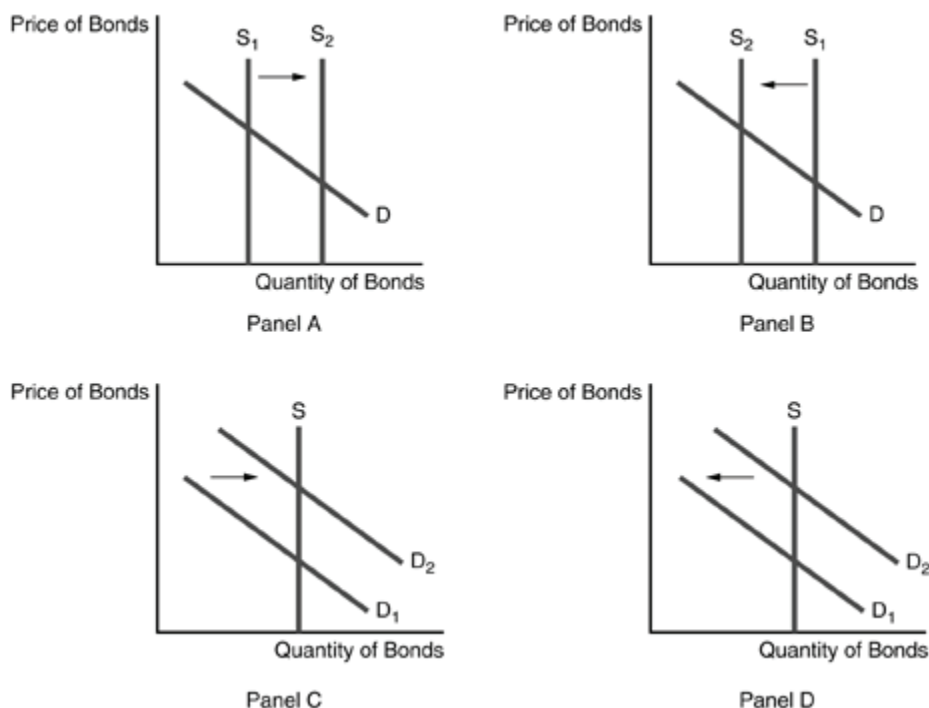
Answer: A

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition



- 21) Refer to the above figure. Which panel is consistent with the Fed selling bonds?
 A) Panel A B) Panel B C) Panel C D) Panel D

Answer: A

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 22) Refer to the above figure. Which panel is consistent with the Fed buying bonds?
 A) Panel A B) Panel B C) Panel C D) Panel D

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 23) Refer to the above figure. Which panels could represent the situation if the Fed had engaged in open market operations?
 A) Panels A and B B) Panels A and C
 C) Panels B and C D) Panels C and D

Answer: A

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 24) A bond that pays a yearly interest rate of \$100 is for sale. The interest rate was 10 percent and now is 5 percent. The price of the bond was
- A) \$1000 and now is \$500. B) \$1000 and now is \$2000.
C) \$500 and now is \$2000. D) \$2000 and now is \$1000.

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 25) A bond is selling for \$1000 and it pays \$150 in interest a year. If the interest rate changes to 20 percent, then
- A) the interest payment rises to \$200. B) the interest payment falls to \$75.
C) the price of the bond falls to \$750. D) the price of the bond rises to \$1500.

Answer: C

Diff: 3

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 26) Which of the following is a true statement about the relationship between the price of bonds and the interest rate?
- A) The prices of bonds are directly related to the interest rate.
 - B) The prices of bonds increase when the interest rates rise.
 - C) The prices of bonds are unrelated to the interest rate.
 - D) The prices of bonds are inversely related to the interest rate.

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Revised

- 27) The Fed engages in open market operations and sells government securities. The result is
- A) lower interest rates.
 - B) higher interest rates.
 - C) interest rates remain unchanged since there is no reason to think bond prices changed.
 - D) uncertain since more information is needed.

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 28) Which of the following is associated with a contractionary monetary policy?
- A) Lowering the differential between the discount rate and the federal funds rate
 - B) Selling bonds
 - C) Lowering the required reserve ratio
 - D) Raising bond prices

Answer: B

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 29) The Fed would be pursuing a contractionary monetary policy if it was
- A) lowering the differential between the discount rate and the federal funds rate.
 - B) lowering the reserve requirement.
 - C) selling dollars in foreign exchange markets.
 - D) selling bonds in the open market.

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 30) How does the Fed increase the level of reserves in the banking system?
- A) by lowering interest rates
 - B) by raising interest rates
 - C) by selling bonds
 - D) by buying bonds

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 31) When the Fed purchases federal government bonds in the open market,
- A) there is no change in the money supply.
 - B) the money supply expands.
 - C) the money supply contracts.
 - D) the demand for money expands.

Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 32) When interest rates in the bond market go up,
- A) there is no impact on the price of existing bonds.
 - B) the price of existing bonds goes up.
 - C) the price of stocks goes up.
 - D) the price of existing bonds goes down.

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

33) The prices of all fixed-income assets (bonds)

- A) vary directly with the interest rate.
- B) are independent of the interest rate.
- C) vary inversely with the interest rate.
- D) are determined by the U.S. Treasury.

Answer: C

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

34) The asset demand for money is

- A) greater at high interest rates as investors can earn more on their investments.
- B) greater at low interest rates, because the opportunity cost of holding money is low.
- C) greater at low interest rates, because the opportunity cost of holding money is high.
- D) lower at low interest rates, because the opportunity cost of holding money is high.

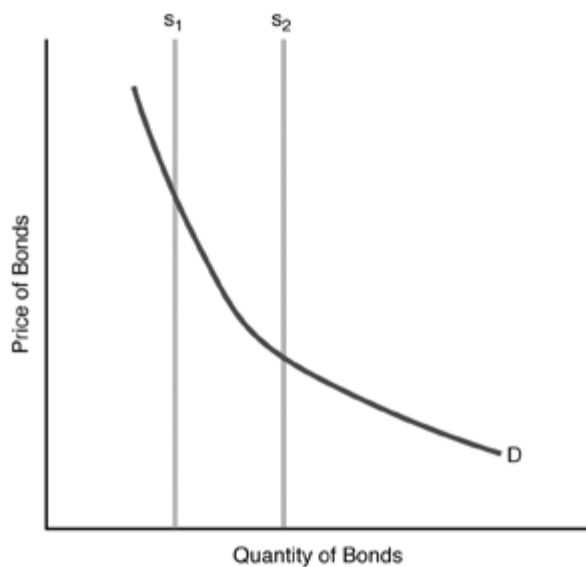
Answer: B

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition



35) In the above figure, if we begin at S_1 and the Fed sells bonds,

- A) the price of bonds falls, and the interest rate rises.
- B) the price of bonds falls, and so does the interest rate.
- C) the price of bonds rises, and so does the interest rate.
- D) the price of bonds rises, and the interest rate falls.

Answer: A

Diff: 3

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

36) In the above figure, if we begin at S_2 and the Fed buys bonds,

- A) the price of bonds falls, and the interest rate rises.
- B) the price of bonds falls, and so does the interest rate.
- C) the price of bonds rises, and so does the interest rate.
- D) the price of bonds rises, and the interest rate falls.

Answer: D

Diff: 3

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

37) Suppose the Fed conducts an open market sale of bonds. This monetary policy action will tend to cause

- A) the price of bonds to increase and the interest rate to increase.
- B) the price of bonds to increase and the interest rate to decrease.
- C) the price of bonds to decrease and the interest rate to increase.
- D) the price of bonds to decrease and the interest rate to decrease.

Answer: C

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

38) If the Fed sells U.S. government securities, the

- A) money supply increases, and the money supply curve shifts to the right.
- B) money supply increases, and the money supply curve shifts to the left.
- C) money supply decreases, and the money supply curve shifts to the right.
- D) money supply decreases, and the money supply curve shifts to the left.

Answer: D

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

39) Suppose the Fed conducts an open market purchase of bonds. This monetary policy action will tend to cause

- A) the price of bonds to increase, and the interest rate to increase.
- B) the price of bonds to increase, and the interest rate to decrease.
- C) the price of bonds to decrease, and the interest rate to increase.
- D) the price of bonds to decrease, and the interest rate to decrease.

Answer: B

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 40) The Federal Open Market Committee engages in contractionary monetary policy by
- A) lowering interest rates.
 - B) creating excess reserves.
 - C) selling bonds.
 - D) buying bonds.

Answer: C

Diff: 1

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 41) What happens to the price of bonds when the Fed is selling bonds? What happens to the interest rate? What happens to the money supply?

Answer: If the Fed sells bonds, the supply of bonds in the market increases, causing the price of bonds to fall. Since the price of bonds is inversely related to the interest rate, the interest rate increases. The Fed sells bonds to reduce the money supply.

Diff: 2

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

- 42) Describe and explain the relationship between the price of bonds and the interest rate.

Answer: There is an inverse relationship between the price of a bond and the interest rate. If a bond pays interest of \$100 a year and the price of the bond is \$1000, the interest rate is 10 percent. If the interest rate falls to 5 percent, then the price of a bond paying \$100 a year interest would rise to \$2000. The interest rate is the amount of interest paid per year divided by the price of the bond, so the interest rate and the price of the bond are inversely related.

Diff: 3

Topic: 16.2 How the Fed Influences Interest Rates

AACSB: Analytic skills

Question Status: Previous Edition

16.3 Effects of an Increase in the Money Supply

- 1) An increase in the supply of money, other things constant,
- A) stimulates an increase in demand for money.
 - B) reduces the purchasing power of money.
 - C) reduces the rate of growth of the price level.
 - D) generates significant changes in relative prices.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 2) The direct effect of an increase in the money supply is to
- A) raise interest rates as people increase their saving.
 - B) increase interest rates as people anticipate higher inflation in the future.
 - C) increase aggregate demand as people try to spend their excess money balances.
 - D) decrease aggregate demand as people anticipate future economic problems.

Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The short-run effect of an increase in the supply of money is
- A) an increase in both real Gross Domestic Product (GDP) and the price level.
 - B) an increase in the price level but not in real Gross Domestic Product (GDP).
 - C) an increase in real Gross Domestic Product (GDP) but not in the price level.
 - D) an increase in the price level, a decrease in real Gross Domestic Product (GDP), but an increase in nominal national income.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 4) The indirect effect of an increase in the money supply is to
- A) raise interest rates so people will save more.
 - B) lower interest rates, which stimulates both investment and consumption spending.
 - C) put more cash in people's pockets, thereby increasing aggregate demand.
 - D) pay off a portion of the public debt.

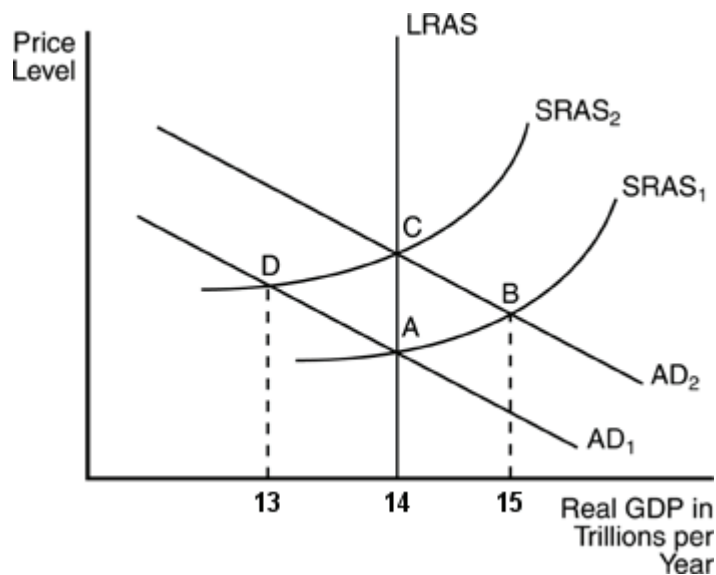
Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition



- 5) Look at the above figure. Suppose the economy was initially in equilibrium at point A. What point would represent the short-run equilibrium if the Fed makes an open market purchase of bonds?

A) A B) B C) C D) D

Answer: B

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 6) In the long run, the effect of a reduction in the money supply is to

A) decrease the price level only.
 B) decrease real Gross Domestic Product (GDP) only.
 C) decrease both the price level and real Gross Domestic Product (GDP).
 D) decrease the price level and increase real Gross Domestic Product (GDP).

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 7) To close a recessionary gap, the Fed would

A) decrease the money supply. B) increase interest rates.
 C) sell bonds. D) increase the money supply.

Answer: D

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 8) Expansionary monetary policy during periods of underutilized resources can cause
- A) real Gross Domestic Product (GDP) to increase without an increase in the price level.
 - B) real Gross Domestic Product (GDP) to increase with a decrease in the price level.
 - C) real Gross Domestic Product (GDP) to increase with an increase in the price level.
 - D) nominal Gross Domestic Product (GDP) to increase but cannot affect real Gross Domestic Product (GDP).

Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 9) If the economy is underutilizing its economic resources, the Fed should
- A) discourage investment spending.
 - B) expand the money supply to increase aggregate demand.
 - C) decrease aggregate supply.
 - D) contract the money supply to decrease aggregate demand.

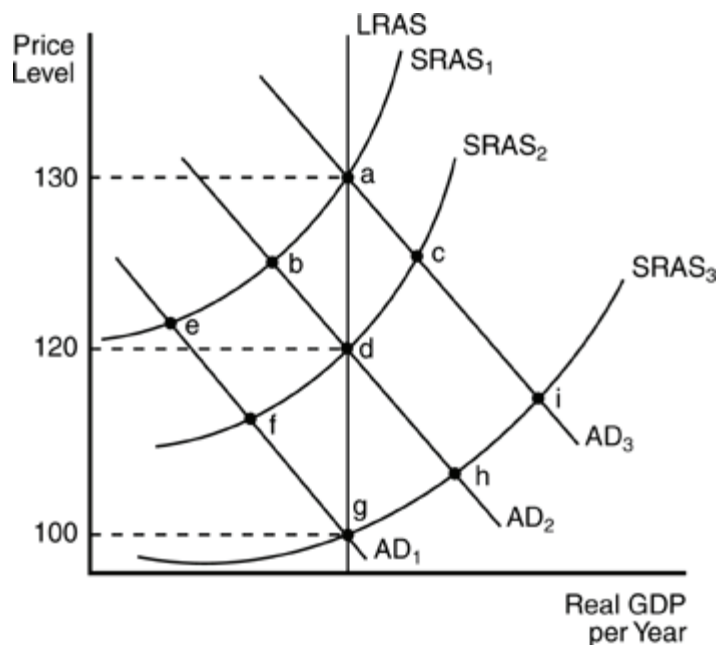
Answer: B

Diff: 3

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition



- 10) In the above figure, assume the economy starts out in equilibrium at point d. If the Fed increases the money supply so that the new aggregate demand curve is AD_3 , then the new short-run equilibrium will be at point

A) a. B) b. C) c. D) i.

Answer: C

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 11) In the above figure, assume the economy starts out in equilibrium at point d. If the Fed increases the money supply so that the new aggregate demand curve is AD_3 , then the long-run equilibrium will be at point

A) a. B) b. C) c. D) i.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 12) In the above figure, assume the aggregate demand of the economy is AD_2 and the Fed actions move aggregate demand to AD_1 . In this situation, the Fed has practiced

A) contractionary monetary policy. B) expansionary monetary policy.
C) irresponsible fiscal policy. D) Keynesian fiscal policy.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Revised

- 13) In the above figure, assume the economy is in equilibrium at point d. Then the Fed decreases the money supply so that the new aggregate demand curve is AD_1 . In the long run, the new price level will be

A) 100. B) 120. C) 130. D) 110.

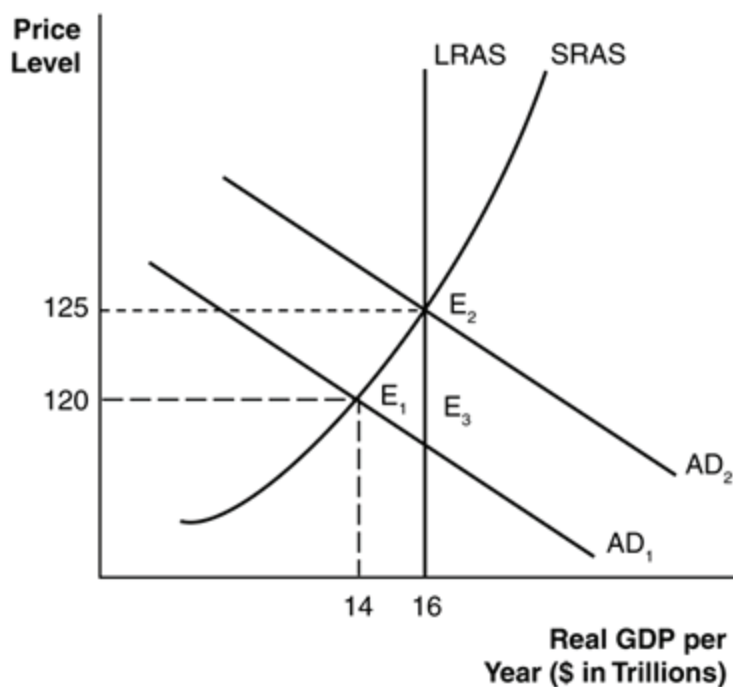
Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition



- 14) In the above figure, if the economy is in equilibrium at E_1 , then

A) the economy is producing below its potential long-run equilibrium at full employment.
 B) the economy is producing above its potential long-run equilibrium at full employment.
 C) there is an inflationary gap in the economy.
 D) the economy is in a period of high inflation.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Revised

- 15) In the above figure, if the economy is at equilibrium at E_1 , the Fed would most likely
- A) adopt a contractionary monetary policy.
 - B) adopt an expansionary monetary policy.
 - C) attempt to lower the aggregate demand in the economy.
 - D) attempt to lower the price level below 120.

Answer: B

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 16) In the long run, a decrease in the money supply will
- A) decrease real Gross Domestic Product (GDP).
 - B) increase real Gross Domestic Product (GDP).
 - C) increase the price level.
 - D) decrease the price level.

Answer: D

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 17) One result of a contractionary monetary policy would be
- A) a decline in the price level.
 - B) an increase in the money supply.
 - C) an increase in business investment.
 - D) lower interest rates.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 18) The "direct effect" of an increase in the money supply is to
- A) increase aggregate demand as people spend their excess money balances.
 - B) increase aggregate demand as interest rates fall and investment spending increases.
 - C) increase aggregate supply as producers anticipate higher future profits.
 - D) decrease the rate of inflation.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 19) The "indirect effect" of an increase in the money supply is to
- A) increase aggregate demand as people try to spend their excess money balances.
 - B) increase aggregate demand as interest rates fall and investment spending increases.
 - C) increase aggregate supply as firms anticipate future profits.
 - D) decrease the price level.

Answer: B

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 20) Which of the following will NOT occur in the short run when the money supply decreases?
- A) People will buy fewer goods and services.
 - B) The interest rate will increase.
 - C) Aggregate supply decreases.
 - D) The price level decreases.

Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 21) An increase in the money supply will
- A) increase aggregate supply.
 - B) decrease aggregate supply.
 - C) increase aggregate demand.
 - D) decrease aggregate demand.

Answer: C

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 22) The short-run effect of an increase in the money supply is to
- A) increase real GDP only.
 - B) increase the price level only.
 - C) increase both real GDP and the price level.
 - D) increase nominal GDP but decrease the price level.

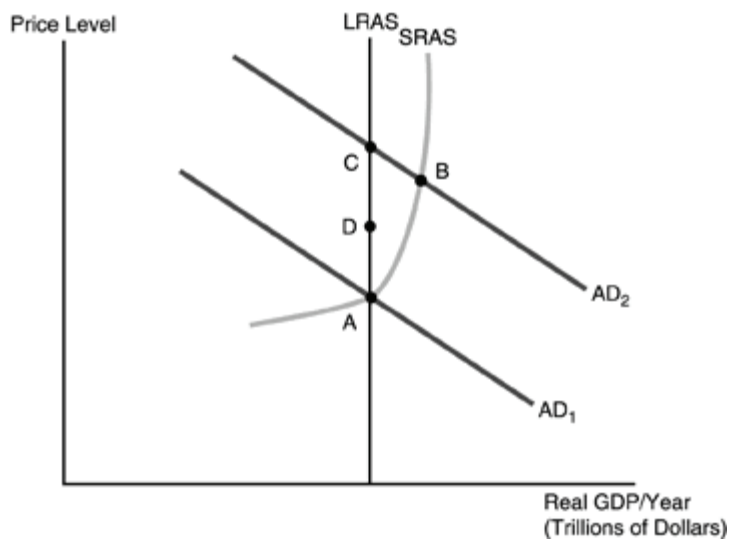
Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition



- 23) Refer to the above figure. Suppose point A is the original equilibrium. If there is an increase in the money supply, the new short-run equilibrium is given by point

A) A. B) B. C) C. D) D.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 24) Refer to the above figure. Suppose point A is the original equilibrium. If there is an increase in the money supply, the new long-run equilibrium is given by point

A) A. B) B. C) C. D) D.

Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 25) The long-run effect of an increase in the money supply when starting from full employment is to

A) increase real GDP only.
 B) increase the price level only.
 C) increase both real GDP and the price level.
 D) increase real GDP as the price level increases too.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 26) An expansionary monetary policy is one that
- A) stimulates aggregate supply.
 - B) reduces aggregate supply and aggregate demand.
 - C) stimulates aggregate demand.
 - D) reduces aggregate demand while stimulating aggregate supply.

Answer: C

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 27) Suppose the economy currently has a recessionary gap. The Fed engages in expansionary monetary policy. The impact of expansionary monetary policy will be to
- A) increase aggregate demand, increase prices and increase real GDP.
 - B) increase aggregate demand, increase prices and decrease real GDP.
 - C) increase short-run aggregate supply, decrease in prices and decrease in real GDP.
 - D) increase short-run aggregate supply, decrease prices and increase real GDP.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 28) Suppose the economy currently has an inflationary gap. The Fed engages in contractionary monetary policy. The impact of contractionary monetary policy will be to
- A) increase short-run aggregate supply, decrease in prices and decrease in real GDP.
 - B) increase short-run aggregate supply, decrease prices and increase real GDP.
 - C) decrease aggregate demand, decrease prices, and increase real GDP.
 - D) decrease aggregate demand, decrease prices, and decrease real GDP.

Answer: D

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 29) Suppose the economy is in long-run equilibrium. The Fed changes its policy and lowers the differential between the discount rate and the federal funds rate. In the long run we would expect to observe
- A) a lower price level.
 - B) a higher price level.
 - C) a lower real GDP.
 - D) a higher real GDP.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 30) If the economy is operating below its full employment level, the Fed can
- A) increase aggregate demand by increasing the rate of growth of the money supply.
 - B) increase aggregate demand by stimulating the demand for money.
 - C) increase aggregate demand by selling bonds and raising interest rates.
 - D) increase aggregate supply by raising the price level.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 31) Suppose the economy is operating below its full employment level. By using an expansionary monetary policy, the Fed can
- A) raise real GDP without increasing the price level.
 - B) raise real GDP and the price level.
 - C) raise real GDP and decrease the price level.
 - D) raise the price level alone, but cannot increase real GDP.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 32) Suppose the economy is operating below its full employment level. The Fed
- A) is powerless to affect either aggregate demand or aggregate supply. Fiscal policy is needed.
 - B) can move the economy toward the full employment level by expanding the money supply to increase aggregate supply.
 - C) can move the economy toward the full employment level by expanding the money supply to increase aggregate demand and to hold prices constant.
 - D) can move the economy toward the full employment level by expanding the money supply to increase aggregate demand through both its direct and its indirect effects.

Answer: D

Diff: 3

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 33) A recessionary gap currently exists. The Fed wants to bring the economy to a full employment level by using open market operations. The Fed should
- A) sell government securities.
 - B) buy government securities.
 - C) increase the differential between the discount rate and the federal funds rate.
 - D) decrease the differential between the discount rate and the federal funds rate.

Answer: B

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 34) An inflationary gap currently exists. The Fed wants to bring the economy to a full employment level by using open market operations. The Fed should
- A) sell government securities.
 - B) buy government securities.
 - C) increase the differential between the discount rate and the federal funds rate.
 - D) decrease the differential between the discount rate and the federal funds rate.

Answer: A

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 35) During a period of contractionary monetary policy,
- A) the price level is increased, which leads to an increase in the money supply.
 - B) the price level is decreased, which leads to a decrease in the money supply.
 - C) the rate of growth of the money supply is increased, leading to an increase in the price level.
 - D) the rate of growth of the money supply is reduced, leading to a decrease in the price level.

Answer: D

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 36) During a period of expansionary monetary policy,
- A) the price level is increased, which leads to an increase in the money supply.
 - B) the price level is decreased, which leads to a decrease in the money supply.
 - C) the rate of growth of the money supply is increased, leading to an increase in the price level.
 - D) the rate of growth of the money supply is reduced, leading to a decrease in the price level.

Answer: C

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 37) As a result of an increase in the money supply, some banks may end up with excess reserves. What is the likely result?
- A) Banks will make more loans, thereby contributing to an increase in aggregate demand.
 - B) Banks will make more loans, thereby contributing to a decrease in aggregate demand.
 - C) Banks will raise interest rates.
 - D) Banks will spend the excess reserves by paying their employees more.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

38) How is the effect of expansionary monetary policy depicted in an aggregate supply –aggregate demand graph?

- A) The aggregate supply curve shifts leftward.
- B) The aggregate supply curve shifts rightward.
- C) The aggregate demand curve shifts rightward.
- D) The equilibrium level of income increases, but neither curve shifts.

Answer: C

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

39) In the real world, contractionary monetary policy would be used to

- A) combat a recession.
- B) reduce the rate of inflation.
- C) increase nominal GDP.
- D) increase long-run aggregate supply.

Answer: B

Diff: 3

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

40) How would expansionary monetary policy affect the AD curve?

- A) It would shift to the right.
- B) It would shift to the left.
- C) It would become more static.
- D) It would fall.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

41) The appropriate monetary policy in the event of a recessionary gap would be to

- A) increase the difference between the discount rate and the federal funds rate.
- B) engage in an open market purchase of U.S. government securities.
- C) increase the difference between the federal funds rate and the required reserve ratio.
- D) raise the required reserve ratio.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 42) The direct effect of an increase in the money supply is
- A) people will spend the extra money, causing the aggregate demand curve to shift to the right and prices to rise, and causing the economy to go into recession.
 - B) people will save the money, causing an increase in bank deposits, causing interest rates to fall, and loans to expand.
 - C) people will save more money, causing a decrease in economic activity and a fall in prices.
 - D) people will spend the extra money, causing the aggregate demand curve to shift to the right, creating an increase in economic activity.

Answer: D

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 43) An indirect effect of monetary policy is that as the money supply
- A) increases, interest rates fall, and borrowing and spending increase.
 - B) increases, interest rates rise, and borrowing and spending decrease.
 - C) decreases, interest rates fall, and borrowing and spending increase.
 - D) decreases, interest rates rise, and borrowing and spending increase.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 44) Suppose the Fed increases the money supply. As a result of this, people go out and spend more money on consumer goods, increasing aggregate spending. This is known as a(n)
- A) direct effect of monetary policy.
 - B) indirect effect of monetary policy.
 - C) direct effect of fiscal policy.
 - D) indirect effect of fiscal policy.

Answer: A

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 45) Suppose the Fed increases the money supply. As a result of this, people deposit excess funds into their bank accounts, causing banks to have excess reserves. As a result, the banks lower the interest rates that they charge on loans, and investment rises, causing an increase in aggregate spending. This is known as a(n)
- A) direct effect of monetary policy.
 - B) indirect effect of monetary policy.
 - C) direct effect of fiscal policy.
 - D) indirect effect of fiscal policy.

Answer: B

Diff: 2

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

46) What are the direct and indirect effects of an increase in the money supply?

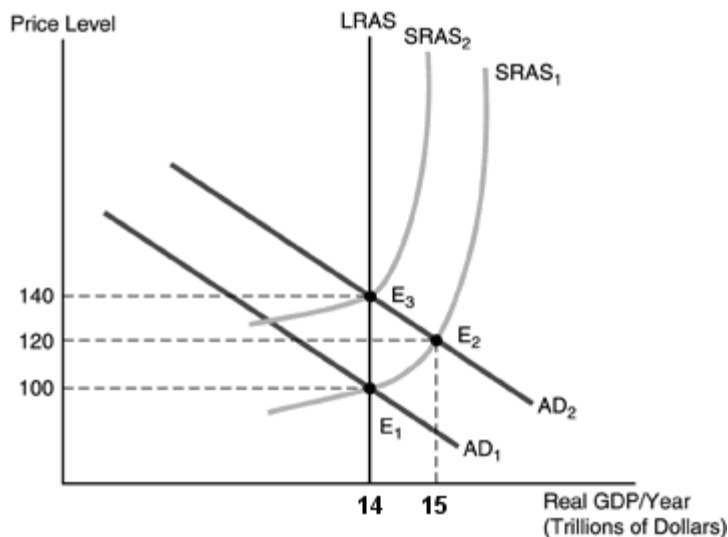
Answer: The direct effect of more money in the economy is to induce people to buy more goods and services, causing consumption expenditures to increase and aggregate demand to increase. The indirect effect is to increase reserves as people put some of the extra funds into transactions accounts. Banks want to make more loans, causing interest rates to fall. Consumer expenditures and business investment spending increase indirectly as the rise in reserves raises the money supply and pushes down the interest rate. Either way, the aggregate demand curve would shift out.

Diff: 1

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition



47) Using a graph above, show the short-run and long-run effects of an expansionary monetary policy.

Answer: In the above figure, E₁ is the original equilibrium. The increase in the money supply causes the aggregate demand to increase due to the direct and indirect effects. Real GDP increases in the short run to \$15 trillion and the price level increases to 120. Once input owners revise their expectations about prices, the short-run aggregate supply curve shifts to SRAS₂, real GDP returns to \$14 trillion, and the price level increases to 140. The long-run effect of the expansionary monetary policy is to increase the price level.

Diff: 3

Topic: 16.3 Effects of an Increase in the Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

16.4 Open Economy Transmission of Monetary Policy

- 1) An expansionary monetary policy results in lower interest rates, which in turn
 - A) increases foreign demand for U.S. financial instruments, raising the international price of the dollar and reducing net exports.
 - B) increases the foreign demand for U.S. financial instruments, lowering the international price of the dollar and decreasing net exports.
 - C) reduces the international price of the dollar and increases net exports.
 - D) reduces the foreign demand for U.S. financial instruments and reduce net exports.

Answer: C

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 2) An appreciation of the U.S. dollar is most likely a result that
 - A) the Fed has pursued an expansionary monetary policy.
 - B) U.S. interest rates have increased.
 - C) U.S. bond prices have increased.
 - D) more dollars are required to obtain foreign currencies.

Answer: B

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 3) As the world economy becomes more integrated through globalization,
 - A) the Fed will find it easier to conduct monetary policy.
 - B) the Fed will have a more difficult time reaching its money supply growth rate targets.
 - C) the Fed will rely less on open market operations and more on changing the required reserve ratio when conducting monetary policy.
 - D) U.S. interest rates will determine world interest rates.

Answer: B

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 4) A contractionary monetary policy causes
- A) higher interest rates, which increases the international price of the dollar and decreases net exports.
 - B) higher interest rates, which decreases the foreign demand for U.S. financial instruments, raising the international price of the dollar and increasing net exports.
 - C) lower interest rates, which decreases the foreign demand for U.S. financial instruments, raising the international price of the dollar and increasing net exports.
 - D) higher interest rates, which increases the foreign demand for U.S. financial instruments, which causes interest rates to decrease. There is no effect on net exports.

Answer: A

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 5) It has been observed that a change in monetary policy in the United States
- A) impacts net exports.
 - B) has little or no effect on foreign markets.
 - C) leads to corresponding changes in other countries.
 - D) has only short run influences.

Answer: A

Diff: 1

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 6) An appreciation of the U.S. dollar occurs when
- A) the international price of the dollar falls.
 - B) the international price of the dollar rises.
 - C) the U.S. demand for foreign currencies increases.
 - D) the supply of dollars in international markets increases.

Answer: B

Diff: 1

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 7) When the U.S. dollar appreciates,
- A) foreign residents demand more of U.S. goods, and U.S. residents desire to purchase more foreign goods.
 - B) foreign residents demand more of U.S. goods, and U.S. residents desire to purchase fewer foreign goods.
 - C) foreign residents demand fewer of U.S. goods, and U.S. residents desire to purchase more foreign goods.
 - D) foreign residents demand fewer of U.S. goods, and U.S. residents desire to purchase fewer foreign goods.

Answer: C

Diff: 1

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 8) An appreciation of the U.S. dollar
- A) makes our exports more expensive in terms of foreign currency and imports cheaper in terms of the dollar, increasing net exports.
 - B) makes our exports less expensive in terms of foreign currency and imports cheaper in terms of the dollar, increasing net exports.
 - C) makes our exports less expensive in terms of foreign currency and imports cheaper in terms of the dollar, decreasing net exports.
 - D) makes our exports more expensive in terms of foreign currency and imports cheaper in terms of the dollar, decreasing net exports.

Answer: D

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 9) A depreciation of the U.S. dollar
- A) makes U.S. exports more expensive in terms of foreign currency and imports less expensive in terms of the dollar, increasing net exports.
 - B) makes U.S. exports less expensive in terms of foreign currency and imports more expensive in terms of the dollar, increasing net exports.
 - C) makes U.S. exports less expensive in terms of foreign currency and imports more expensive in terms of the dollar, decreasing net exports.
 - D) makes U.S. exports more expensive in terms of foreign currency and imports less expensive in terms of the dollar, decreasing net exports.

Answer: B

Diff: 1

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Revised

- 10) As a result of contractionary monetary policy,
- A) interest rates fall, the dollar depreciates, and domestic goods become cheaper, thereby reducing net exports.
 - B) interest rates rise, the dollar appreciates, and domestic goods become more expensive, thereby reducing net exports.
 - C) interest rates rise, the dollar appreciates, and domestic goods become cheaper, thereby reducing net exports.
 - D) interest rates rise, the dollar appreciates, and domestic goods become cheaper, thereby increasing net exports.

Answer: B

Diff: 1

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 11) The net-export effect of contractionary monetary policy is
- A) the depreciation of the value of the dollar and a resulting increase of U.S. net exports.
 - B) the depreciation of the value of the dollar and a resulting decrease of U.S. net exports.
 - C) the appreciation of the value of the dollar and a resulting increase of U.S. net exports.
 - D) the appreciation of the value of the dollar and a resulting decrease of U.S. net exports.

Answer: D

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 12) What effect does a contractionary monetary policy in the U.S. have on the foreign trade sector?
- A) The lower value of the dollar will decrease exports and increase imports.
 - B) The lower value of the dollar will decrease imports and increase exports.
 - C) The higher value of the dollar will decrease exports and increase imports.
 - D) The higher value of the dollar will decrease imports and increase exports.

Answer: C

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 13) What effect does an expansionary monetary policy in the U.S. have on the foreign trade sector?
- A) The lower value of the dollar will decrease exports and increase imports.
 - B) The lower value of the dollar will decrease imports and increase exports.
 - C) The higher value of the dollar will decrease exports and increase imports.
 - D) The higher value of the dollar will decrease imports and increase exports.

Answer: B

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

14) Which of the following would NOT be a result of a contractionary monetary policy?

- A) Interest rates would rise.
- B) Foreign goods would become more expensive to U.S. residents.
- C) Net exports would decline.
- D) Imports would rise.

Answer: B

Diff: 3

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

15) The net-export effect of expansionary monetary policy is a(n)

- A) depreciation of the value of the dollar and the increase of U.S. net exports.
- B) depreciation of the value of the dollar and the decrease of U.S. net exports.
- C) appreciation of the value of the dollar and the increase of U.S. net exports.
- D) appreciation of the value of the dollar and the decrease of U.S. net exports.

Answer: A

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

16) The net-export effect of contractionary monetary policy is a(n)

- A) depreciation of the value of the dollar and the increase of U.S. net exports.
- B) depreciation of the value of the dollar and the decrease of U.S. net exports.
- C) appreciation of the value of the dollar and the increase of U.S. net exports.
- D) appreciation of the value of the dollar and the decrease of U.S. net exports.

Answer: D

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

17) As global financial markets become more intertwined, the Fed has

- A) less control over monetary policy.
- B) more control over monetary policy.
- C) more control over fiscal policy.
- D) more control over fiscal policy.

Answer: A

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 18) Why is it more difficult for the Fed to control the money supply today than it was fifty years ago?

Answer: The international financial markets are more global today. If the Fed decides to reduce the money supply, people can obtain dollars in international markets, offsetting the actions of the Fed. People can borrow in other currencies if they want more liquidity. The globalization of international money markets makes it more difficult for the Fed to control the rate of growth of the money supply in the United States.

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

- 19) What effects does an expansionary monetary policy have on the trade balance? Why?

Answer: An expansionary monetary policy may cause interest rates to fall, which would lead to outflows of financial capital and a depreciation of the dollar. This would cause net exports to increase, so the net export effect is in the same direction as the monetary policy effect.

Diff: 2

Topic: 16.4 Open Economy Transmission of Monetary Policy

AACSB: Dynamics of the global economy

Question Status: Previous Edition

16.5 Monetary Policy and Inflation

- 1) According to the equation of exchange, if $M = \$400$, $P = 8$, and $Y = \$200$, then

- A) net domestic product is \$800. B) V is 4.
C) the price level must fall. D) V cannot be determined.

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 2) Which of the following best represents the equation of exchange?

- A) $M * P = V * Y$ B) $M * V = P * Y$ C) $M * Y = P * V$ D) $M * Y * V = P$

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The hypothesis that changes in the money supply lead to an equiproportional change in the price level is called

- A) the quantity theory of money. B) the classical theory of money.
C) the Keynesian theory of money. D) the fractional theory of money.

Answer: A

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 4) According to the quantity theory of money, the price level decreases in equal proportion to
- A) an increase in the income velocity of money.
 - B) a decrease in the nominal interest rate.
 - C) an increase in the real interest rate.
 - D) a decrease in the money supply.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 5) Other things being equal, the quantity theory of money suggests that any increase in the money supply
- A) causes a reduction in the demand for money.
 - B) results in a decrease in the aggregate price level.
 - C) causes the aggregate level of nominal Gross Domestic Product (GDP) to fall.
 - D) results in a proportionate increase in the price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 6) According to the quantity theory of money, increases in the money supply lead to
- A) decreases in nominal Gross Domestic Product (GDP).
 - B) increases in the price level.
 - C) decreases in the price level.
 - D) increases in taxes.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 7) According to the quantity theory of money,
- A) a change in the money supply can lead only to a proportionate change in the price level.
 - B) the velocity of money is the least stable factor in monetary analysis.
 - C) the rate of inflation is not related to changes in the money supply.
 - D) price level changes can best be explained by Keynesian analysis.

Answer: A

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

8) The formula of the equation of exchange is

- A) $M_S = Y$. B) $M_S = VPY$. C) $M_S V = PY$. D) $M_S/P = Y$.

Answer: C

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Revised

9) According to both the equation of exchange and the quantity theory of money,

- A) an increase in the money supply will increase real Gross Domestic Product (GDP).
B) an increase in the money supply will decrease real Gross Domestic Product (GDP).
C) a decrease in the money supply will decrease the velocity of money.
D) a decrease in the money supply will decrease the price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

10) The velocity of money

- A) is, according to the equation of exchange, equal to P/M .
B) indicates the number of times per year a dollar is spent on final goods and services.
C) is, according to the equation of exchange, equal to M/Y .
D) indicates the speed with which the U.S. Treasury can mint new coins.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

11) According to the equation of exchange, if $V = 5$, $P = 3$, and $Y = \$50$, then the money supply equals

- A) \$10. B) \$30. C) \$150. D) \$300.

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

12) According to the quantity theory of money, an excess quantity of money supplied will lead to

- A) a reduction in spending and higher interest rates.
B) a reduced level of real Gross Domestic Product (GDP).
C) a higher level of employment.
D) a higher price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 13) A decrease in the supply of money will, according to the quantity theory of money, lead to
- A) a higher price level.
 - B) a higher nominal Gross Domestic Product (GDP).
 - C) a lower real Gross Domestic Product (GDP).
 - D) a lower price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 14) The income velocity of money is
- A) the time it takes to produce money.
 - B) the time lag from when the Fed decides to increase the money supply until the effect takes place.
 - C) the number of times per year a dollar is spent on final goods and services.
 - D) the time it takes for monetary policy to have an effect on world financial markets.

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: Previous Edition

- 15) According to the equation of exchange, if real Gross Domestic Product (GDP), in base year dollars, is \$25 billion, the money supply is \$1 billion, and the price index equals 2, then the income velocity of money is
- A) 5. B) 10. C) 25. D) 50.

Answer: D

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 16) The equation of exchange is
- A) an assumption that is not always true.
 - B) true in the short run but not always in the long run.
 - C) an accounting identity and therefore is always true.
 - D) a theory developed at the Federal Reserve.

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Revised

- 17) An assumption used in the quantity theory of money is that
- A) the price level is constant.
 - B) velocity is constant.
 - C) nominal Gross Domestic Product (GDP) is constant.
 - D) the money supply is constant.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: Previous Edition

- 18) According to the quantity theory of money,
- A) real Gross Domestic Product (GDP) is directly related to changes in the money supply in the long run.
 - B) velocity varies indirectly with the rate of growth of the money supply.
 - C) a proportionate increase in the money supply leads to a less than proportionate increase in real Gross Domestic Product (GDP), at least in the long run.
 - D) a given proportionate increase in the money supply leads to an equal proportionate increase in the price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 19) An increase in the money supply, other things being constant,
- A) causes interest rates to rise.
 - B) generates an increase in the demand for money.
 - C) causes the price level to increase.
 - D) causes the purchasing power of money to increase.

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The income velocity of money is the absolute number of times, on average, that
- A) people purchase goods and services during a year.
 - B) each monetary unit is spent on final goods and services.
 - C) each unit of real GDP is produced by business firms.
 - D) each one-unit increase in the price level occurs.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 25) The identity stating that the total amount spent on final output equals the amount received for final output is known as the
- A) fundamental law of economics.
 - B) circular flow identity.
 - C) equation of exchange.
 - D) identity equation.

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 26) In words, the equation of exchange says that
- A) the total amount spent on final output equals the amount received for final output.
 - B) the amount of money in circulation equals the velocity of the price level.
 - C) changes in the money supply will have no impact on the amount spent on final output.
 - D) when velocity equals 1, nominal GDP equals the price level.

Answer: A

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 27) If the total money supply is \$3 trillion, real GDP is \$8 trillion and the price level is 1.5, then the equation of exchange tells us that velocity equals
- A) 0.25
 - B) 3
 - C) 4
 - D) 16

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 28) If velocity is equal to 4, this means that
- A) the rate of growth of the money supply is 4.
 - B) each dollar of the money supply is spent on the average 4 times per year.
 - C) for every 4 dollars of the money supply, nominal GDP will increase by 4.
 - D) an increase in the money supply will lead to an increase in aggregate supply of 4.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 29) If nominal GDP is \$5 trillion and velocity is 20, then
- A) actual money balances held by the nonbanking public are \$250 billion.
 - B) actual money balances held by the nonbanking public are \$100 trillion.
 - C) real GDP equals \$100 trillion.
 - D) real GDP equals \$400 trillion.

Answer: A

Diff: 3

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

30) The equation of exchange is an _____ while the quantity theory of money is a theory that _____.

- A) accounting identity; assumes the money supply is constant
- B) accounting identity; assumes velocity is held constant
- C) accounting theory; assumes the price level is constant
- D) accounting theory; economists use to explain changes in real GDP

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

31) The quantity theory of money is based on the formula that

- A) $V = PYM_S$.
- B) $Y = PV/M_S$.
- C) $M_S = PV/Y$.
- D) $P = M_S V/Y$.

Answer: D

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Revised

32) The quantity theory of money and prices assumes

- A) velocity is constant.
- B) real output is constant.
- C) the price level is constant.
- D) the price level is increasing at a constant rate.

Answer: A

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: Revised

33) The quantity theory of money and prices

- A) is derived from the equation of exchange assuming that prices remain constant.
- B) shows how a change in the price level leads to a change in the money supply.
- C) shows how the demand for money is inversely related to the price level.
- D) is the hypothesis that changes in the money supply leads to proportional changes in the price level.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 34) According to the quantity theory of money and prices, a 10 percent increase in the money supply ultimately leads to
- A) a 10 percent increase in real GDP.
 - B) a 10 percent increase in real national output.
 - C) a 10 percent increase in the price level.
 - D) a 10 percent increase in velocity.

Answer: C

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 35) An increase in the price level means that
- A) long-run aggregate supply has increased.
 - B) monetary policy has been contractionary.
 - C) the value of the dollar has increased.
 - D) the purchasing power of money has fallen.

Answer: D

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 36) Which of the following is a variable in the equation of exchange?
- A) the price level.
 - B) the money supply.
 - C) the velocity of money.
 - D) real GDP.
 - E) all of the above.

Answer: E

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 37) The equation of exchange can be written as
- A) $M_S P = VY$.
 - B) $M_S V = PY$.
 - C) $M_S Y = VP$.
 - D) None of the above are correct.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Revised

38) The "V" in the equation of exchange $M_S V = PY$ refers to

- A) a variable.
- B) income velocity of money.
- C) the velocity of inflation.
- D) a vector that links P to Y.

Answer: B

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: New

39) If V is constant and Y is fixed, any change in M

- A) leads to a smaller change in P.
- B) leads to a larger change in P.
- C) leads to a proportionate change in P.
- D) does not lead to change in P.

Answer: C

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

40) By saying that the equation of exchange is an accounting identity, we mean that

- A) it is useful for accountants, but not for economists.
- B) it identifies the key national income accounts.
- C) it is always true.
- D) it explains the effect of questionable accounting practices on macroeconomic performance.

Answer: C

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

41) The quantity theory of money and prices asserts that

- A) increases in the money supply lead to inflation.
- B) increases in the money supply lead to an increase in the velocity of money.
- C) increases in the money supply lead to a decrease in the velocity of money.
- D) increases in the money supply will increase real GDP.

Answer: A

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

42) The quantity theory of money and prices rests on the assumption that

- A) the velocity of money is constant.
- B) the minimum wage is constant.
- C) the nominal interest rate is constant.
- D) the foreign exchange rate is constant.

Answer: A

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: Previous Edition

- 43) The number of times per year that a dollar is spent on final goods and services defines
- A) the money supply.
 - B) the income velocity of money.
 - C) the price index.
 - D) GDP.

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB:

Question Status: Previous Edition

- 44) Which of the following best describes the income velocity of money?
- A) $V = PM_S$
 - B) $V = Y$
 - C) $V = PY/M_S$
 - D) $V = M_S/PY$

Answer: C

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 45) According to the simple quantity theory of money, which of the following variables are considered either constant or relatively stable?
- A) V and Y
 - B) Y and M_S
 - C) P and M_S
 - D) P and Y

Answer: A

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 46) The hypothesis that changes in the money supply lead to proportional changes in the price level is called
- A) the equation of exchange.
 - B) the Keynesian multiplier.
 - C) the theory of empirical relativity.
 - D) the quantity theory of money and prices.

Answer: D

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 47) The equation of exchange specifies that
- A) $M_S V = PY$.
 - B) velocity and money supply are directly related.
 - C) $M_S P = VY$.
 - D) $M_S = PVY$.

Answer: A

Diff: 1

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 48) In an economy that is at full employment, an increase in money supply will result in inflation, unless
- A) velocity increases.
 - B) velocity decreases.
 - C) real GDP falls.
 - D) tax reduction is proportional to increases in the money supply.

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 49) In the equation of exchange, if the money supply is \$6 trillion, the price level is 1.5, and the real GDP is \$12 trillion, the velocity is
- A) 3.0.
 - B) 9.3.
 - C) 6.0.
 - D) 2.0.

Answer: A

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 50) If we assume that velocity is constant, and if the money supply increases by 6 percent, we would expect, *ceteris paribus*, that the price level would
- A) increase by 3 percent.
 - B) increase by 6 percent.
 - C) decrease by 3 percent.
 - D) decrease by 6 percent.

Answer: B

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 51) If both nominal and real GDP are increasing when the money supply is constant, then we can conclude that
- A) velocity has increased.
 - B) velocity has decreased.
 - C) interest rate has fallen.
 - D) interest rate has increased.

Answer: A

Diff: 3

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 52) If a nation's nominal GDP is \$40 billion, its money supply is \$8 billion, and its price level is 1.25, then the velocity of money is
- A) 0.2.
 - B) 2.0.
 - C) 5.0.
 - D) 6.25.

Answer: D

Diff: 2

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

- 53) What is the equation of exchange? How can the equation of exchange be converted into the quantity theory of money?

Answer: The equation of exchange is $M_S V = PY$, where M_S is the money supply, V is the velocity of money, and PY is the nominal GDP. It is an accounting identity, so is not a theory. The equation of exchange becomes the quantity theory of money and prices by assuming that velocity is constant and that real GDP (Y) is stable. Then we have $P = (M_S)V/Y$ or that a change in the money supply will lead only to a proportionate change in the price level.

Diff: 3

Topic: 16.5 Monetary Policy and Inflation

AACSB: Analytic skills

Question Status: Previous Edition

16.6 Monetary Policy in Action: The Transmission Mechanism

- 1) In the interest–rate–based transmission mechanism, a decrease in the money supply will
- A) increase the price level.
 - B) reduce the rate of interest and the level of investment.
 - C) reduce investment, shift the aggregate demand function inward, and lower real Gross Domestic Product (GDP).
 - D) shift the aggregate supply function inward and increase real Gross Domestic Product (GDP).

Answer: C

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 2) The monetary transmission mechanism that assumes that money supply growth stimulates the economy primarily by encouraging investment is
- A) the interest–rate–based transmission mechanism.
 - B) the classical transmission mechanism.
 - C) the post–Keynesian transmission mechanism.
 - D) pre–Keynesian transmission mechanism.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 3) The linkages of the interest-rate-based transmission mechanism of monetary policy are summarized as follows:
- A) change in the money supply → change in speculative balances → change in transactions balances → change in planned investment → change in aggregate demand.
 - B) change in the money supply → change in planned investment → change in government spending → change in aggregate demand.
 - C) change in the money supply → change in interest rates → change in planned investment → change in aggregate demand.
 - D) change in the money supply → change in interest rates → change in transactions balances → change in government spending → change in aggregate demand.

Answer: C

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Assume (other things constant) that the Fed increases the money supply. The mechanism through which aggregate demand increases is, according to interest-rate-based transmission mechanism, summarized as follows:
- A) the money supply increases → there is a drop in money balances held → interest rates increase → planned investment spending decreases → aggregate demand increases.
 - B) increase in money supply → increase in money balances held → decrease in interest rates → decrease in planned investment spending → increase in aggregate demand.
 - C) increase in money supply → decrease in money balances held → decrease in interest rates → increase in planned investment spending → increase in aggregate demand.
 - D) increase in money supply → decrease in interest rates → increase in planned investment spending → increase in aggregate demand.

Answer: D

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 5) According to the interest-rate-based monetary policy transmission mechanism,
- A) an increase in money supply will increase interest rates.
 - B) an increase in money supply will decrease interest rates.
 - C) a decrease in money supply will decrease interest rates.
 - D) a decrease in money supply will not change interest rates.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 6) According to the interest-rate-based monetary policy transmission mechanism,
- A) an increase in the required reserve ratio will lower interest rates.
 - B) a decrease in the required reserve ratio will lower interest rates.
 - C) a decrease in the required reserve ratio will not affect interest rates.
 - D) an increase in the required reserve ratio will not affect interest rates.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 7) The interest-rate-based transmission mechanism assumes that the Fed can stimulate investment by
- A) selling bonds.
 - B) buying bonds.
 - C) raising the discount rate relative to the federal funds rate.
 - D) raising the required reserve ratio.

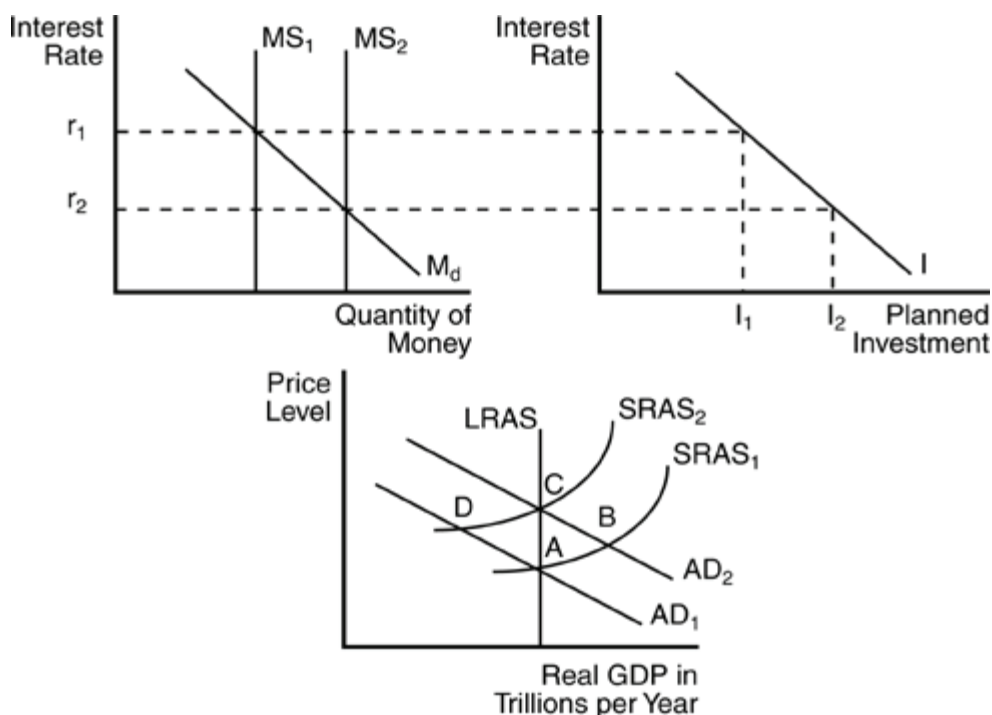
Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition



- 8) In the above figure, suppose the economy is in short-run equilibrium at point D. Which of the following is the best policy option for the Fed?
- A) Increase the required reserve ratio
 - B) Increase government spending
 - C) Increase taxes
 - D) Open market purchase of government securities

Answer: D

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Revised

- 9) In the above figure, suppose the economy is at a short-run equilibrium at point B and the interest rate is r_2 . Which of the following policy options for the Fed will help solve the short-run situation?
- A) Lowering the differential between the discount rate and the federal funds rate
 - B) Open market purchase of government securities
 - C) Lowering the required reserve ratio
 - D) Open market sale of government securities

Answer: D

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Revised

- 10) In the above figure, if the economy is initially at an equilibrium output at point A and the interest rate is r_1 , then an open market purchase of bonds by the Fed will
- A) cause interest rates to increase and output to decline.
 - B) cause interest rates to decline to r_2 , investment to increase to I_2 , and the AD curve to shift upward to the right.
 - C) cause interest rates to decline to r_2 , investment to decline, and aggregate demand to shift inward to the left.
 - D) not have any impact on short- or long-run equilibrium real Gross Domestic Product (GDP).

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 11) According to proponents of the interest-rate-based monetary policy transmission mechanism, any increase in the money supply
- A) is effective in increasing Gross Domestic Product (GDP) only if it causes an outward shift of the aggregate supply curve.
 - B) will increase Gross Domestic Product (GDP) only if interest rates fall and investment is sensitive to decreasing interest rates.
 - C) causes velocity to increase, and so in the short run nominal Gross Domestic Product (GDP) must increase.
 - D) will move the economy from the "liquidity trap" during times of recession if interest rates fall enough to stimulate private investment.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 12) Proponents of the interest-rate-based monetary policy transmission mechanism argue that when the Federal Reserve buys bonds, there will be
- A) an increase in investment spending.
 - B) a decrease in the money supply.
 - C) a decrease in nominal Gross Domestic Product (GDP), but not in real income.
 - D) a decrease in the price of outstanding bonds.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 13) The interest-rate-based monetary policy transmission mechanism argues that an increase in the money supply
- A) has no effect on aggregate demand but reduces long-run aggregate supply.
 - B) has no effect on aggregate demand but increases short-run aggregate supply.
 - C) causes interest rates to fall, which causes an increase in planned investment, and an increase in aggregate demand.
 - D) causes the inflation rate to decline, which causes an increase in household consumption spending and an increase in aggregate demand.

Answer: C

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 14) The interest-rate-based monetary policy transmission mechanism emphasizes the
- A) indirect effect of a change in the money supply that operates via a change in total planned expenditures generated by a change in the interest rate.
 - B) direct effect of a change in the money supply that operates via a change in total planned production generated by a change in the price level.
 - C) direct effect of a change in the money supply that operates via a change in total planned expenditures generated by a change in the interest rate.
 - D) indirect effect of a change in the money supply that operates via a change in total planned production generated by a change in the price level.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 15) Which of the following statements is FALSE?
- A) Both monetary and interest rate targets cannot be pursued simultaneously.
 - B) A reduction in the required reserve ratio increases the money supply and pushes down the equilibrium interest rate.
 - C) An open market purchase reduces the money supply and pushes down the equilibrium interest rate.
 - D) an open market sale decreases the money supply and pushes up the equilibrium interest rate.

Answer: C

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

16) A key causal link in the interest-rate-based transmission mechanism for monetary policy is from

- A) investment to the interest rate.
- B) the money supply to excess reserves.
- C) a monetary policy action to excess reserves.
- D) real GDP to investment.

Answer: C

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

17) If the source of economic instability is generally variations in spending, then the Fed should

- A) set money supply targets.
- B) print more money.
- C) buy gold.
- D) raise taxes.

Answer: A

Diff: 3

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

18) According to the interest-rate-based monetary policy transmission mechanism, an increase in the money supply generates

- A) lower interest rates, which causes an increase in planned real investment spending and an increase in aggregate demand.
- B) increased spending on consumer goods and services directly, which causes an increase in aggregate demand.
- C) an increase in nominal GDP and a change in the price level, but no change in real GDP.
- D) an increase in aggregate supply since the supply of money is part of aggregate supply.

Answer: A

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Revised

19) Which of the following is NOT a reason the Fed alters the rate of growth of the money supply?

- A) To influence aggregate demand
- B) To shift the demand for money curve
- C) To influence the amount of consumption
- D) To influence the amount of investment

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 20) The interest-rate-based approach to the monetary policy transmission mechanism says that a change in the money supply influences aggregate demand by
- A) a change in interest rates, which changes investment.
 - B) a change in interest rates, which changes the money supply.
 - C) changing consumer consumption behavior as they adjust to a change in the number of dollars available.
 - D) leading to shifts of the short-run aggregate supply curve.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 21) According to the interest-rate-based monetary policy transmission mechanism, an increase in the money supply will
- A) lead to a decrease in investment spending and an increase in real GDP that is equal to the decrease in investment spending.
 - B) lead to a decrease in investment spending and an increase in real GDP which is greater than the decrease in investment spending.
 - C) lead to an increase in investment spending and a decrease in real GDP that is equal to the increase in investment spending.
 - D) lead to an increase in investment spending and an increase in real GDP which is greater than the increase in investment spending.

Answer: D

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 22) According to the interest-rate-based transmission mechanism, a decrease in the money supply will
- A) lead to a decrease in investment spending and an increase in real GDP that is equal to the decrease in investment spending.
 - B) lead to a decrease in investment spending and a decrease in real GDP which is greater than the decrease in investment spending.
 - C) lead to an increase in investment spending and a decrease in real GDP that is equal to the increase in investment spending.
 - D) lead to an increase in investment spending and a decrease in real GDP which is greater than the increase in investment spending.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 23) If the Fed wants to target interest rates, it must
- A) control the money supply.
 - B) control the value for velocity.
 - C) give up trying to control the money supply.
 - D) coordinate its activities with the largest private banks in the United States.

Answer: C

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 24) Suppose that there is instability in the economy due to an unstable demand for money. The Fed should
- A) target both the money supply and interest rates.
 - B) target interest rates.
 - C) target the money supply.
 - D) wait for the demand for money to become more stable before engaging in monetary policy.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 25) An increase in the money supply will affect aggregate demand
- A) only if the increase in the money supply causes interest rates to rise.
 - B) only if the increase in the money supply causes people to buy less goods and services.
 - C) only if the increase in the money supply causes people to increase their saving.
 - D) if the increase in the money supply causes interest rates to fall and/or causes people to buy more goods and services.

Answer: D

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 26) According to the interest–rate–based perspective on the monetary policy transmission mechanism,
- A) key channels of monetary policy indirectly ultimately relate money supply changes to total planned spending through indirect effects on planned investment.
 - B) changes in the money supply have little influence on macroeconomic variables.
 - C) monetary policy leads to increases in the price level but will have no effect on the rate of output.
 - D) inflation is always caused by excessive monetary growth and changes in the money supply offset aggregate demand only directly.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 27) If the Fed wants to target interest rates, it must
- A) control the money supply.
 - B) control the value for velocity.
 - C) give up trying to control the money supply.
 - D) coordinate its activities with the largest private banks in the United States.

Answer: C

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 28)) Suppose that there is instability in the economy due to an unstable demand for money. The Fed should
- A) target both the money supply and interest rates.
 - B) target interest rates.
 - C) target the money supply.
 - D) wait for the demand for money to become more stable before engaging in monetary policy.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 29) The interest-rate-based approach to monetary policy says that a change in the money supply influences aggregate demand by
- A) a change in interest rates which changes investment.
 - B) following the monetary rule.
 - C) changing consumer consumption behavior as they adjust to a change in the number of dollars available.
 - D) leading to shifts of the short-run aggregate supply curve.

Answer: A

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 30) According to the interest-rate-based monetary policy transmission mechanism, an increase in the money supply will
- A) lead to a decrease in investment spending and an increase in real GDP that is equal to the decrease in investment spending.
 - B) lead to a decrease in investment spending and an increase in real GDP which is greater than the decrease in investment spending.
 - C) lead to an increase in investment spending and a decrease in real GDP that is equal to the increase in investment spending.
 - D) lead to an increase in investment spending and an increase in real GDP which is greater than the increase in investment spending.

Answer: D

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 31) According to the interest-rate-based monetary policy transmission mechanism, a decrease in the money supply will
- A) lead to a decrease in investment spending and an increase in real GDP that is equal to the decrease in investment spending.
 - B) lead to a decrease in investment spending and a decrease in real GDP which is greater than the decrease in investment spending.
 - C) lead to an increase in investment spending and a decrease in real GDP that is equal to the increase in investment spending.
 - D) lead to an increase in investment spending and a decrease in real GDP which is greater than the increase in investment spending.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 32) If the Fed has announced that it plans on lowering the interest rate it will
- A) engage in expansionary open market operations, thereby decreasing the money supply.
 - B) engage in expansionary open market operations, thereby increasing the money supply.
 - C) engage in contractionary open market operations, thereby decreasing the money supply.
 - D) engage in contractionary open market operations, thereby increasing the money supply.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 33) If the Fed has announced that it plans on increasing the interest rate it will
- A) engage in expansionary open market operations, thereby decreasing the money supply.
 - B) engage in expansionary open market operations, thereby increasing the money supply.
 - C) engage in contractionary open market operations, thereby decreasing the money supply.
 - D) engage in contractionary open market operations, thereby increasing the money supply.

Answer: C

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 34) According to the interest-rate-based transmission mechanism for monetary policy, an increase in the money supply will cause the
- A) interest rate to fall, causing planned real investment spending to rise and leading to a decrease in aggregate demand.
 - B) interest rate to rise, causing planned real investment spending to rise and leading to a decrease in aggregate demand.
 - C) interest rate to fall, causing planned real investment spending to rise and leading to an increase in aggregate demand.
 - D) interest rate to fall, causing planned real investment spending to fall and leading to an increase in aggregate demand.

Answer: C

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 35) According to the interest-rate-based transmission mechanism for monetary policy, a decrease in the money supply will cause the
- A) interest rate to fall, causing planned real investment spending to rise and leading to a decrease in aggregate demand.
 - B) interest rate to rise, causing planned real investment spending to rise and leading to a decrease in aggregate demand.
 - C) interest rate to fall, causing planned real investment spending to rise and leading to an increase in aggregate demand.
 - D) interest rate to rise, causing planned real investment spending to fall and leading to a decrease in aggregate demand.

Answer: D

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 36) The interest-rate-based transmission mechanism for monetary policy in the Keynesian system indicates that
- A) increases in the money supply lead to decreases in the interest rate, which decreases investment, which decreases the level of real GDP.
 - B) decreases in the money supply lead to increases in the interest rate, which increases investment, which increases the level of real GDP.
 - C) increases in the money supply cause people to spend more, leading to increases in real GDP.
 - D) increases in the money supply lead to decreases in the interest rate, which increases investment, which increases the level of real GDP.

Answer: D

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 37) According to the interest-rate-based monetary policy transmission mechanism, which of the following monetary policies would result in an increase in the level of planned real investment spending?
- A) contractionary
 - B) expansionary
 - C) reactionary
 - D) Monetary policy has no effect on investment.

Answer: B

Diff: 1

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 38) The interest-rate-based monetary policy transmission mechanism suggests that the changes in the money supply affect aggregate spending
- A) indirectly through interest rates and planned investment spending.
 - B) directly through interest rates and planned consumption spending.
 - C) indirectly through tax rates and planned consumption spending.
 - D) directly through interest rates and planned government spending.

Answer: A

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 39) If the Fed chooses to keep the money supply at a target level, then it must allow
- A) all the interest rate to fluctuate.
 - B) abandon open market operations.
 - C) vary the spread between the federal funds rate and the discount rate.
 - D) eliminate reserve requirements.

Answer: A

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 40) If the Fed chooses to keep the market interest rate at a target level, then it must
- A) keep bank reserves at a constant level.
 - B) abandon open market operations.
 - C) allow the money supply to fluctuate.
 - D) ask its member banks to charge this target rate on all loans.

Answer: C

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 41) If the Fed wants to target a rate of growth of the money supply larger than the current money growth rate, it should
- A) raise the interest rate.
 - B) reduce the interest rate.
 - C) reduce bond prices.
 - D) create price deflation.

Answer: B

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Revised

- 42) Suppose the economy is initially in long-run and short-run equilibrium. If the Fed decides to pursue a contractionary monetary policy, we will see
- A) bond prices fall, interest rates fall, aggregate demand remains unchanged as consumption spending decreases, but investment spending increases. GDP remains constant in both the short run and the long run, but the price level falls in both.
 - B) bond prices fall, interest rates rise, aggregate demand falls as investment and consumption spending decrease, and real GDP and the price level decreasing in the short-run, but only the price level decreasing in the long run.
 - C) bond prices fall, interest rates rise, aggregate demand falls as investment spending decreases and consumption spending remains unchanged, and real GDP and the price level decrease in the short run, but only the price level falls in the short run.
 - D) interest rates rise but no change in bond prices. Aggregate demand falls as consumption spending and investment spending decrease, and the price level and real GDP fall in both the short run and the long run.

Answer: B

Diff: 3

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 43) Suppose there is an increase in the money supply, but that people's demand for money balances increases by a greater amount at the same time. The net effect would be
- A) a lower price level in the long run.
 - B) no change in aggregate demand or aggregate supply.
 - C) an increase in aggregate demand due to the increase in the money supply, but a decrease in aggregate supply due to the increase in the demand for money.
 - D) lower interest rates, greater real GDP, and a higher price level as aggregate demand increases because of the indirect effect of the increase in the money supply.

Answer: A

Diff: 3

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

- 44) "The Fed should pursue simultaneous money supply and interest rate targets." Do you agree or disagree? Explain.

Answer: Disagree. The Fed cannot pursue simultaneous money supply and interest rate targets.

Diff: 2

Topic: 16.6 Monetary Policy in Action: The Transmission Mechanism

AACSB: Analytic skills

Question Status: Previous Edition

16.7 The Way Fed Policy Is Currently Implemented

- 1) The interest rate that the Fed charges banks to borrow funds from the Fed is the
- A) discount rate.
 - B) federal funds rate.
 - C) money market rate.
 - D) nominal interest rate.

Answer: A

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

- 2) One of the tools of monetary policy is to change the discount rate. Since 2003
- A) the Fed has not changed the discount rate.
 - B) the Fed has pegged the discount rate to the reserve requirement.
 - C) the Fed has kept the discount rate a fixed amount above the federal funds rate.
 - D) the Fed has kept the federal funds rate one percentage point above the discount rate.

Answer: C

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

- 3) The tools of monetary policy are
- A) open market operations, differential between the discount rate and the federal funds rate, and tax rates.
 - B) open market operations, government spending, and the required reserve ratio.
 - C) open market operations, differential between the discount rate and the federal funds rate, and the required reserve ratio.
 - D) government spending, tax rates, and the required reserve ratio.

Answer: C

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

- 4) To change the rate of growth of the money supply, the Fed can do all but which one of the following?
- A) Engage in open market operations
 - B) Change the discount rate
 - C) Shift the demand for money curve by changing the interest rate
 - D) Change the required reserve ratio.

Answer: C

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Revised

- 5) Typically, increasing the difference between the discount and federal funds rates causes
- A) an increase in market interest rates.
 - B) no change in interest rates.
 - C) a boom in the economy.
 - D) high corporate profits.

Answer: A

Diff: 3

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 6) Changes in which of the following will cause changes in the equilibrium federal funds rate?
- A) the demand for excess reserves by banks
 - B) the demand for required reserves by banks
 - C) the supply of reserves created through past open market operations
 - D) all of the above

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 7) A open market purchase of government securities by the Fed will cause which of the following?
- A) a reduction in the federal funds rate
 - B) an increase in the amount of excess reserves that banks will wish to hold
 - C) an increase in the equilibrium quantity of reserves
 - D) all of the above

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 8) In the market for bank reserves, the supply of reserves is
- A) an upward sloping curve.
 - B) a downward sloping curve.
 - C) a horizontal curve.
 - D) none of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 9) If the Fed raises the interest rate paid on excess reserves while holding the federal funds rate unchanged, then banks will
- A) lend more reserves in the federal funds market and keep more excess reserves.
 - B) lend fewer reserves in the federal funds market and keep more excess reserves.
 - C) not keep excess reserves or lend reserves in the federal funds market.
 - D) not react to it.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: New

- 10) Other things being equal, if the Fed raises the interest rate paid on excess reserves,
- A) the supply of reserves in the federal funds market will increase.
 - B) the supply of reserves in the federal funds market will decrease.
 - C) both the demand for reserves and the supply of reserves in the federal funds market will increase.
 - D) both the demand for reserves and the supply of reserves in the federal funds market will decrease.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: New

- 11) Since October 2008, Congress has granted the Fed an authority to
- A) charge banks interest on both required reserves and excess reserves.
 - B) pay banks interest on both required reserves and excess reserves.
 - C) charge banks interest on required reserves but pay them interest on excess reserves.
 - D) charge banks interest on excess reserves but pay them interest on required reserves.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: New

- 12) In the market for bank reserves, a reduction in the required reserve ratio will cause
- A) a reduction in the federal funds rate.
 - B) an increase in the equilibrium quantity of reserves.
 - C) a reduction in the demand for reserves.
 - D) all of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 13) The opportunity cost of holding excess reserves is equal to
- A) the discount rate.
 - B) the federal funds rate.
 - C) the federal funds rate minus the discount rate.
 - D) none of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 14) An open market sale of government securities by the Fed will cause which of the following?
- A) an increase in the federal funds rate
 - B) an increase in the equilibrium quantity of reserves
 - C) all of the above
 - D) none of the above

Answer: A

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 15) An open market sale of government securities by the Fed will cause which of the following?
- A) an excess quantity of reserves supplied and an increase in the federal funds rate
 - B) an excess quantity of reserves supplied and a reduction in the federal funds rate
 - C) an excess quantity of reserves demanded and an increase in the federal funds rate
 - D) an excess quantity of reserves demanded and a reduction in the federal funds rate

Answer: C

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 16) An open market purchase of government securities by the Fed will cause which of the following?
- A) an excess quantity of reserves supplied and an increase in the federal funds rate
 - B) an excess quantity of reserves supplied and a reduction in the federal funds rate
 - C) an excess quantity of reserves demanded and an increase in the federal funds rate
 - D) an excess quantity of reserves demanded and a reduction in the federal funds rate

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 17) The rate at which banks can borrow excess reserves from other banks is equal to
- A) the discount rate.
 - B) the required reserve ratio.
 - C) the interest rate paid on reserves held with the Fed.
 - D) none of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 18) In the market for bank reserves, the supply of reserves is
- A) an upward sloping curve.
 - B) a downward sloping curve.
 - C) a vertical curve.
 - D) none of the above.

Answer: C

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 19) In the market for bank reserves, an increase in the required reserve ratio will cause
- A) an increase in the federal funds rate.
 - B) an increase in the quantity of reserves.
 - C) a reduction in the demand for reserves.
 - D) all of the above.

Answer: A

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

20) What happens when the Fed aims to change interest rates?

- A) It asks Congress to legislate new interest rates.
- B) It buys or sells government bonds on the open market to achieve the desired rate.
- C) It buys or sells dollars on the foreign exchange market to achieve the desired rate.
- D) It announces a new discount interest rate.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

21) The federal funds rate is

- A) the interest rate paid on reserves held with the Fed.
- B) the interest rate at which banks can borrow excess reserves from other banks.
- C) the interest rate on bonds issued by the federal government.
- D) none of the above.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

22) The incentive of holding excess reserves is equal to

- A) the discount rate.
- B) the federal funds rate.
- C) the interest rate earned on excess reserves.
- D) none of the above.

Answer: C

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

23) The rate at which banks can borrow excess reserves from other banks is equal to

- A) the discount rate.
- B) the federal funds rate.
- C) the interest rate paid on reserves held with the Fed.
- D) the treasury bill rate.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

- 24) The interest rate that the Fed charges banks to borrow funds from the Fed is the
- A) discount rate.
 - B) federal funds rate.
 - C) money market rate.
 - D) nominal interest rate.

Answer: A

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

- 25) In the market for bank reserves, the supply of reserves is
- A) an upward sloping curve.
 - B) a downward sloping curve.
 - C) a vertical curve.
 - D) a horizontal curve.

Answer: C

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 26) In the market for bank reserves, an open market purchase by the Fed will cause
- A) a reduction in the federal funds rate.
 - B) an increase in the quantity of reserves.
 - C) an increase in the supply of reserves.
 - D) all of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 27) In the market for bank reserves, an open market sale by the Fed will cause
- A) an increase in the federal funds rate.
 - B) a reduction in the quantity of reserves.
 - C) a reduction in the supply of reserves.
 - D) all of the above.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 28) Which of the following is NOT part of the FOMC directive?
- A) It lays out the FOMC's general economic objectives.
 - B) It establishes short-term federal funds rate objectives.
 - C) It specifies target ranges for money supply growth.
 - D) It specifies who the chair of the Fed is.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

29) What is the maximum number of voting members of the FOMC?

- A) 4 B) 7 C) 11 D) 12

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

30) The Trading Desk's open market operations

- A) are confined within a one-hour interval each weekday morning.
B) are confined within a six-hour interval each weekday morning.
C) occur throughout each day.
D) occur once a week.

Answer: A

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

31) The official Federal Reserve strategy for implementing its monetary policy objectives is spelled out in the

- A) Federal Reserve Board (FRB) Decree.
B) Federal Reserve Bank Cooperative (FRBC) Proposal.
C) Federal Advisory Committee (FAC) Statement.
D) Federal Open Market Committee (FOMC) Directive.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Revised

32) The office of the Federal Reserve Bank of New York charged with implementing Federal Reserve open market policy actions is known as the

- A) Open Market Coordination Office. B) Open Market Cooperation Office.
C) Response Desk. D) Trading Desk.

Answer: D

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Previous Edition

33) Which of the following institutions within the Federal Reserve System determines how many government securities the Fed should buy or sell on a given day?

- A) the Board of Governors.
- B) Federal Advisory Committee.
- C) the Federal Reserve Bank of Chicago's Board of Trade.
- D) the Federal Reserve Bank of New York's Trading Desk.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Revised

34) Which of the following policy tools is directly controlled by the Trading Desk at the Federal Reserve Bank of New York?

- A) the spread between the discount rate and the federal funds rate
- B) the spread between the federal funds rate and the interest rate on banks' required reserves
- C) the required reserve ratio
- D) open market sales and purchases

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Revised

35) Under the Fed's current interest-rate-targeting approach to monetary policy, if the demand for federal funds by depository institutions increases today, then, other things being equal,

- A) the market federal funds rate decreases, and the Fed's Trading Desk responds by selling bonds.
- B) the market federal funds rate increases, and the Fed's Trading Desk responds by buying bonds.
- C) the market federal funds rate decreases, and the Fed's Trading Desk responds by buying bonds.
- D) the market federal funds rate increases, and the Fed's Trading Desk responds by selling bonds.

Answer: B

Diff: 3

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 36) It is the responsibility of the Trading Desk at the Federal Reserve Bank of New York to implement policies in the form of
- A) changes in the spread between the federal funds rate and the discount rate that are consistent with rules established by the twelve Federal Reserve bank presidents.
 - B) variations in reserve requirements that are consistent with the announcements by the Chair of the Fed's Board of Governors.
 - C) changes in foreign exchange rates that are consistent with policies established by the Secretary of the Treasury.
 - D) buying or selling government securities that are consistent with the FOMC Directive.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Revised

- 37) Operations of the Trading Desk of the Federal Reserve Bank of New York are typically conducted
- A) no more often than once per month.
 - B) once a year.
 - C) no more often than once per week.
 - D) within a one-hour period during each day.

Answer: D

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB:

Question Status: Revised

- 38) In addition to open market operations and the required reserve ratio, another tool of monetary policy available to the Fed is
- A) fiscal policy.
 - B) tax rates and the progressivity of the income-tax system.
 - C) government spending and various transfer-payment programs.
 - D) the difference between the discount rate and the federal funds rate.

Answer: D

Diff: 1

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 39) If the Fed thought the economy was experiencing a recessionary gap, and it wanted to correct this gap, it would
- A) sell bonds.
 - B) lower the differential between the discount rate and the federal funds rate.
 - C) raise the reserve requirement.
 - D) increase aggregate supply.

Answer: B

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

- 40) Suppose the economy is in long-run and short-run equilibrium. The Fed changes its policy by raising the difference between the discount rate and the federal funds rate. In the long run we would expect to observe
- A) a lower price level.
B) a higher price level.
C) a lower real national income.
D) a higher real national income.

Answer: A

Diff: 2

Topic: 16.7 The Way Fed Policy Is Currently Implemented

AACSB: Analytic skills

Question Status: Previous Edition

16.8 Selecting the Federal Funds Rate Target

- 1) The neutral federal funds rate is
- A) the federal funds rate that will result in the growth rate of GDP being equal to its potential rate of growth.
 - B) the nominal federal funds rate minus inflation.
 - C) the real federal funds rate plus inflation.
 - D) the federal funds rate consistent with zero inflation.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 2) Suppose the actual federal funds rate is greater than the neutral federal funds rate. Given this information, we would expect that
- A) the rate of growth of real GDP will be less than its potential rate of growth.
 - B) the rate of growth of real GDP will be greater than its potential rate of growth.
 - C) the rate of growth of real GDP will be equal to its potential rate of growth.
 - D) the rate of growth of real GDP may be above or below its potential rate of growth.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 3) Suppose the neutral federal funds rate is equal to 5%. If the actual federal funds rate is 3.5%, we would expect that
- A) the rate of growth of real GDP will be less than its potential rate of growth.
 - B) the rate of growth of real GDP will be greater than its potential rate of growth.
 - C) the rate of growth of real GDP will be equal to its potential rate of growth.
 - D) the rate of growth of real GDP may be above or below its potential rate of growth.

Answer: B

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 4) Which of the following is NOT a basis for the Taylor–rule guideline for how the Federal Reserve should set its target value for the federal funds rate?
- A) an estimated long–run real interest rate
 - B) the current deviation of the actual inflation rate from the Fed's inflation objective
 - C) the present deviation of the actual unemployment rate from the Fed's unemployment objective
 - D) the gap between actual real GDP and a measure of potential real GDP

Answer: C

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 5) Suppose that the Fed has decided to utilize the Taylor rule to implement monetary policy. If the actual federal funds rate target is presently below the level specified by the Taylor rule and has been lower than this level for several weeks, then this would be a signal that
- A) monetary policy is very expansionary.
 - B) monetary policy is very contractionary.
 - C) the Fed should halt efforts to target the money supply.
 - D) the Fed should switch to targeting the money supply instead of the federal funds rate.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 6) Suppose the actual equilibrium federal funds rate is less than the neutral federal funds rate. Given this information, we would expect that
- A) real GDP will grow at a rate greater than the potential real GDP growth rate.
 - B) real GDP will grow at a rate less than the potential real GDP growth rate.
 - C) real GDP will grow at a rate equal to the potential real GDP growth rate.
 - D) the inflation rate will tend to fall.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 7) Suppose the actual equilibrium federal funds rate is above the rate implied by a particular inflation goal. In this situation, the Taylor rule implies that
- A) fiscal policy is contractionary.
 - B) fiscal policy is expansionary.
 - C) monetary policy is expansionary.
 - D) monetary policy is contractionary.

Answer: D

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

8) For the United States, the neutral federal funds rate has

- A) varied over time.
- B) been roughly constant over time.
- C) increased over time.
- D) decreased over time.

Answer: A

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

9) If the actual federal funds rate is less than the neutral federal funds rate, we would expect that

- A) the rate of growth of real GDP will be less than its potential rate of growth.
- B) the rate of growth of real GDP will be greater than its potential rate of growth.
- C) the rate of growth of real GDP will be equal to its potential rate of growth.
- D) the rate of growth of real GDP may be above or below its potential rate of growth.

Answer: B

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

10) Suppose the actual equilibrium federal funds rate is greater than the neutral federal funds rate.

Given this information, we would expect that

- A) real GDP will grow at a rate greater than the potential real GDP growth rate.
- B) real GDP will grow at a rate less than the potential real GDP growth rate.
- C) real GDP will grow at a rate equal to the potential real GDP growth rate.
- D) the inflation rate will tend to increase.

Answer: B

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

11) A reduction in the rate of growth of potential real GDP will

- A) cause the neutral federal funds rate to decrease.
- B) cause the neutral federal funds rate to increase.
- C) have no effect on the neutral federal funds rate.
- D) have an ambiguous effect on the neutral federal funds rate.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 12) According to the Taylor rule, the Fed will set the federal funds rate target based on which of the following?

A) an estimated long-run real interest rate
B) the current deviation of the actual inflation rate from the Fed's inflation objective
C) the proportionate gap between actual real GDP and a measure of potential real GDP
D) all of the above

Answer: D

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 13) Which Federal Reserve Bank now regularly tracks target levels for the federal funds rate predicted by a basic Taylor-rule equation?

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

Answer: D

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 14) Suppose the actual equilibrium federal funds rate is below the rate implied by a particular inflation goal. In this situation, the Taylor rule implies that

A) fiscal policy is contractionary. B) fiscal policy is expansionary.
C) monetary policy is expansionary. D) monetary policy is contractionary.

Answer: C

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 15) Between 2003 and 2008, the actual federal funds rate

A) tended to be lower than the rates predicted by the Taylor rule.
B) tended to higher than the rates predicted by the Taylor rule.
C) followed closely the rates predicted by the Taylor rule.
D) moved in directions opposite to the rates predicted by the Taylor rule.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB:

Question Status: New

- 16) Suppose the actual federal funds rate is below the rate implied by a particular inflation goal. In this situation, the Taylor rule implies that
- A) monetary policy is expansionary.
 - B) monetary policy is contractionary.
 - C) monetary policy is neither expansionary or contractionary.
 - D) fiscal policy is contractionary.

Answer: A

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 17) Suppose the actual federal funds rate is above the rate implied by a particular inflation goal. In this situation, the Taylor rule implies that
- A) monetary policy is expansionary.
 - B) monetary policy is contractionary.
 - C) monetary policy is neither expansionary or contractionary.
 - D) fiscal policy is expansionary.

Answer: B

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 18) Suppose the actual federal funds rate is equal to the rate implied by a particular inflation goal. In this situation, the Taylor rule implies that
- A) monetary policy will tend to produce that inflation rate.
 - B) monetary policy is contractionary.
 - C) monetary policy is expansionary.
 - D) fiscal policy will result in a balanced budget.

Answer: A

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 19) The Taylor rule implies that the Fed should set the federal funds target based on which of the following?
- A) an estimated long-run real interest rate
 - B) the current deviation of the actual inflation rate from the Fed's inflation objective
 - C) the proportionate gap between actual real GDP and a measure of potential real GDP
 - D) all of the above

Answer: D

Diff: 2

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 20) Changes in which of the following would most likely NOT affect the neutral federal funds rate?
- A) the money supply
 - B) potential real GDP
 - C) technology
 - D) aggregate supply shocks

Answer: A

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 21) The value of the neutral federal funds rate in the United States
- A) has consistently risen over time.
 - B) has consistently decreased over time.
 - C) is determined by the Federal Reserve.
 - D) depends on the speed at which the economy's long-run aggregate supply increases over time.

Answer: D

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

- 22) An increase in the rate of growth of potential real GDP will
- A) cause the neutral federal funds rate to decrease.
 - B) cause the neutral federal funds rate to increase.
 - C) have no effect on the neutral federal funds rate.
 - D) have an ambiguous effect on the neutral federal funds rate.

Answer: B

Diff: 1

Topic: 16.8 Selecting the Federal Funds Rate Target

AACSB: Analytic skills

Question Status: Previous Edition

16.9 Appendix E: Increasing the Money Supply

- 1) According to Keynes, the impact of an **increase** in the money supply is
- A) a lower interest rate and a larger growth in real GDP.
 - B) a lower interest rate and a smaller growth in real GDP.
 - C) a higher interest rate and a larger growth in real GDP.
 - D) a higher interest rate and a smaller growth in real GDP.

Answer: A

Diff: 2

Topic: 16.9 Appendix E: Increasing Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 2) According to Keynes, the effect on planned real investment spending resulting from the interest-rate impact of an **increase** in the money supply
- A) impacts the economy through the multiplier.
 - B) impacts the economy by increasing the value of the U.S. dollar.
 - C) impacts the economy by reducing the deficit.
 - D) does not impact the economy.

Answer: A

Diff: 1

Topic: 16.9 Appendix E: Increasing Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

16.10 Appendix E: Decreasing the Money Supply

- 1) According to Keynes, the impact of a **decrease** in the money supply is a
- A) lower interest rate and larger growth in real GDP.
 - B) lower interest rate and smaller growth in real GDP.
 - C) higher interest rate and larger growth in real GDP.
 - D) higher interest rate and smaller growth in real GDP.

Answer: D

Diff: 2

Topic: 16.10 Appendix E: Decreasing Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 2) According to Keynes, contractionary monetary policy
- A) impacts the economy by an amount smaller than the change in investment.
 - B) impacts the economy by an amount larger than the change in investment.
 - C) will have no impact on the equilibrium nominal GDP.
 - D) will have no impact on the equilibrium real GDP.

Answer: B

Diff: 2

Topic: 16.10 Appendix E: Decreasing Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

- 3) According to Keynes, the effect on planned real investment spending resulting from the interest-rate impact of a **decrease** in the money supply
- A) impacts the economy through the multiplier.
 - B) impacts the economy by reducing the value of the U.S. dollar.
 - C) impacts the economy by increasing the deficit.
 - D) does not impact the economy.

Answer: A

Diff: 2

Topic: 16.10 Appendix E: Decreasing Money Supply

AACSB: Analytic skills

Question Status: Previous Edition

16.11 Appendix E: Arguments Against Monetary Policy

- 1) According to traditional Keynesians, monetary policy is ineffective in affecting the economy during a recession because
- A) an increase in the money supply will have little impact on interest rates.
 - B) an increase in the money supply will only lead to higher interest rates.
 - C) an increase in the money supply will only lead to lower investment spending.
 - D) an increase in the money supply will raise the amount of government debt.

Answer: A

Diff: 2

Topic: 16.11 Appendix E: Arguments Against Monetary Policy

AACSB: Analytic skills

Question Status: New

- 2) According to traditional Keynesians, when the central bank increases the money supply during a recession
- A) people will spend all of the money on goods and services.
 - B) people will borrow more from banks.
 - C) people will keep most of it in their bank accounts.
 - D) people will refuse to use the money.

Answer: C

Diff: 2

Topic: 16.11 Appendix E: Arguments Against Monetary Policy

AACSB: Analytic skills

Question Status: New

- 3) According to traditional Keynesians, monetary policy as a tool to fight a recession
- A) has an uncertain effect on the economy, depending on the direction of fiscal policy.
 - B) is very effective because interest rates will fall immediately.
 - C) is ineffective because interest rates will not fall.
 - D) cannot be determined because traditional Keynesians do not consider monetary policy at all.

Answer: C

Diff: 2

Topic: 16.11 Appendix E: Arguments Against Monetary Policy

AACSB: Analytic skills

Question Status: New