7.1 What is Money?

1) A disadvantage of the barter system is that
   A) no trade occurs.
   B) people must produce all their own food, clothing, and shelter.
   C) the opportunity to specialize is greatly reduced.
   D) gold is the only unit of account.
   Answer: C
   Diff: 1
   Topic: Section 7.1
   Question Status: Previous Edition

4) Money’s primary role in the economy comes from the benefits of lowering transactions costs and allowing specialization. This function of money is called
   A) store of value.
   B) medium of exchange.
   C) standard of deferred payment.
   D) unit of account.
   Answer: B
   Diff: 1
   Topic: Section 7.1
   Question Status: Previous Edition

6) In some countries, prices in stores are listed in terms of U.S. dollars, rather than in units of the local currency. That’s most likely because
   A) the country’s political system is unstable.
   B) interest rates are higher using U.S. dollars than using the local currency.
   C) there is no other store of value.
   D) the country has experienced high rates of inflation.
   Answer: D
   Diff: 1
   Topic: Section 7.1
   Question Status: Previous Edition

7) The number of units of one good that trade for one unit of alternative goods can be determined most easily when
   A) there is one unit of account.
   B) the goods all weigh about the same.
   C) the goods are all new.
   D) the goods are actively traded through barter.
   Answer: A
   Diff: 1
   Topic: Section 7.1
   Question Status: New

13) M1 does not include
    A) MMMFs.
B) travelers’ checks.
C) currency.
D) demand deposits.
Answer: A
Diff: 1
Topic: Section 7.1
Question Status: Previous Edition

15) Which of the following statements about M1 and M2 is true?
   A) Demand deposits are not part of M1.
   B) M2 is more liquid than M1.
   C) M1 is larger than M2.
   D) Savings deposits are part of M2.
Answer: D
Diff: 1
Topic: Section 7.1
Question Status: Previous Edition

16) M2 includes
   A) large-denomination time deposits.
   B) institutional MMMFs.
   C) commercial paper.
   D) M1.
Answer: D
Diff: 1
Topic: Section 7.1
Question Status: Previous Edition

21) What’s the most common way for a central bank to reduce the money supply?
   A) Collect higher taxes
   B) Sell bonds to the public
   C) Buy bonds from the government
   D) Buy bonds from the public
Answer: B
Diff: 1
Topic: Section 7.1
Question Status: Previous Edition

22) A developing country does not have enough taxes to cover its expenditures and is unable to borrow. This
government would be most likely to cover its deficit by
   A) purchasing government bonds from the public.
   B) selling government bonds to the public.
   C) selling newly issued government bonds directly to the central bank.
   D) buying newly issued government bonds directly from the central bank.
Answer: C
Diff: 2
Topic: Section 7.1
Question Status: Previous Edition

7.2 Portfolio Allocation and the Demand for Assets

5) Time to maturity refers to the amount of time until
A) an asset repays the principal to an investor.
B) an asset pays interest for the first time.
C) a bond can be sold on the secondary market.
D) the yield curve shows an upward slope.
Answer: A
Diff: 1
Topic: Section 7.2
Question Status: New

6) AAA Company stock has a higher expected rate of return than ZZZ Company stock. All else being equal, you would expect that relative to ZZZ, AAA company stock provides
A) less risk and less liquidity.
B) less risk and more liquidity.
C) more risk and less liquidity.
D) more risk and more liquidity.
Answer: C
Diff: 1
Topic: Section 7.2
Question Status: Previous Edition

7) A one-year bond has an interest rate of 5% today. Investors expect that in one year, a one year bond will have an interest rate equal to 7%. According to the expectations theory of the term structure of interest rates, in equilibrium, a two-year bond today will have an interest rate equal to
A) 3.0%.
B) 5.0%.
C) 5.5%.
D) 6.0%.
Answer: D
Diff: 1
Topic: Section 7.2
Question Status: New

9) The interest rate on long-term bonds is somewhat higher than suggested by the expectations theory because
A) the expectations theory doesn’t account for taxes.
B) a risk premium exists.
C) an inflation premium must be added to long-term bonds.
D) the Fed can only control short-term interest rates.
Answer: B
Diff: 1
Topic: Section 7.2
Question Status: New

10) By spreading her investments out over many different assets, an investor achieves
A) a higher expected return.
B) increased risk.
C) diversification.
D) greater liquidity.
Answer: C
Diff: 1
Topic: Section 7.2
Question Status: New
7.3 The Demand for Money

1) A 10% decrease in real income usually leads to ________ in money demand.
   A) an increase
   B) no change
   C) a decrease of less than 10%
   D) a decrease of 10%
   Answer: C
   Diff: 1
   Topic: Section 7.3
   Question Status: Previous Edition

2) Which of the following is most likely to lead to a decrease of 10% in the nominal demand for money?
   A) An increase in real income of 5%
   B) A decrease in real income of 5%
   C) A decline of 10% in the price level
   D) An increase of 10% in the price level
   Answer: C
   Diff: 2
   Topic: Section 7.3
   Question Status: Previous Edition

3) Which of the following is most likely to lead to an increase of 1% in the nominal demand for money?
   A) An increase in real income of 0.5%
   B) A decrease in real income of 0.5%
   C) A decline of 1% in the price level
   D) An increase of 1% in the price level
   Answer: D
   Diff: 2
   Topic: Section 7.3
   Question Status: New

5) An increase in the real interest rate would cause an increase in the real demand for money
   A) no matter what the change in expected inflation.
   B) if expected inflation fell by less than the rise in the real interest rate.
   C) if expected inflation fell by the same amount as the rise in the real interest rate.
   D) if expected inflation fell by more than the rise in the real interest rate.
   Answer: D
   Diff: 2
   Topic: Section 7.3
   Question Status: Previous Edition

6) An increase in expected inflation is likely to cause
   A) a decline in the demand for real balances.
   B) an increase in the demand for real balances.
   C) no change in the demand for real balances.
   D) no change in the demand for real balances only if the income elasticity of real money demand is zero.
   Answer: A
   Diff: 1
   Topic: Section 7.3
   Question Status: Previous Edition
7) Mr. Pierpont has wealth of $200,000. He wants to keep at least $80,000 in bonds at all times, and will shift $10,000 into bonds from his checking account for each percentage point that the interest rate on bonds exceeds the interest rate on his checking account. If the interest rate on checking accounts is 4% and the interest rate on bonds is 9%, how much does Mr. Pierpont keep in his checking account?
   A) $50,000
   B) $70,000
   C) $130,000
   D) $150,000
   Answer: B
   Diff: 1
   Topic: Section 7.3
   Question Status: New

9) Money demand is given by
   \[ M_d/P = 1000 + 0.2Y - 1000i. \]
   Given that \( P = 200, Y = 2000, \) and \( i = 0.10 \), real money demand is equal to
   A) 1,300.
   B) 1,500.
   C) 260,000.
   D) 300,000.
   Answer: A
   Diff: 2
   Topic: Section 7.3
   Question Status: Previous Edition

11) If there is a financial panic and increased uncertainty about the returns in the stock market and bond market, what is the likely effect on money demand?
   A) Money demand declines first, then rises when inflation increases.
   B) Money demand rises.
   C) The overall effect is ambiguous.
   D) Money demand declines.
   Answer: B
   Diff: 2
   Topic: Section 7.3
   Question Status: Previous Edition

12) Suppose a new law imposes a tax on all trades of bonds and stock. What is the likely effect on money demand?
   A) Money demand declines first, then rises when inflation increases.
   B) Money demand rises.
   C) The overall effect is ambiguous.
   D) Money demand declines.
   Answer: B
   Diff: 2
   Topic: Section 7.3
   Question Status: Previous Edition

16) Which of the following is the most likely explanation for the causes behind the “case of the missing money”?
   A) Higher prices in the 1970s reduced the demand for money.
   B) Government deficits increased the demand for money, draining it out of the private sector.
   C) Financial innovations, such as money market mutual funds, changed the demand for narrow
definitions of money such as M1.

D) Increases in Eurodollar deposits drew money out of the American banking system.

Answer: C

Diff: 2

Topic: Section 7.3
Question Status: Previous Edition

17) Velocity is defined as

A) nominal money stock/nominal GDP.
B) nominal GDP/nominal money stock.
C) real money stock/real GDP.
D) \( mc^2 \).

Answer: B

Diff: 1

Topic: Section 7.3
Question Status: Previous Edition

18) If real GDP is $4 billion, the price level is 1.25, and the nominal money stock is $500 million, then velocity is

A) 0.1.
B) 1.
C) 10.
D) 100.

Answer: C

Diff: 2

Topic: Section 7.3
Question Status: Previous Edition

19) Money demand is given by

\[ \frac{M^d}{P} = 1000 + .2Y - 1000i \]

Given that \( P = 200, Y = 2000, \) and \( i = .10, \) velocity is equal to

A) 0.65.
B) 0.75.
C) 1.33.
D) 1.54.

Answer: D

Diff: 2

Topic: Section 7.3
Question Status: Previous Edition

20) Suppose velocity is 3, real output is 9000, and the price level is 1.5. What is the level of real money demand in this economy?

A) 2000
B) 3000
C) 6000
D) 30,000

Answer: B

Diff: 2

Topic: Section 7.3
Question Status: Previous Edition

7.4 Asset Market Equilibrium
1) Under a situation of asset market equilibrium,
   A) the quantity of money supplied equals the quantity of money demanded.
   B) the quantity of money supplied equals the quantity of nonmonetary assets demanded.
   C) the quantity of nonmonetary assets supplied equals the quantity of monetary assets demanded.
   D) the quantity of money supplied equals the quantity of nonmonetary assets supplied.
   Answer: A
   Diff: 1
   Topic: Section 7.4
   Question Status: Previous Edition

2) When the real quantity of money supplied equals the real quantity of money demanded, there is said to be
   A) goods market equilibrium.
   B) asset market equilibrium.
   C) monetary neutrality.
   D) money illusion.
   Answer: B
   Diff: 1
   Topic: Section 7.4
   Question Status: New

3) If the quantity of money demanded exceeds the quantity of money supplied, then
   A) the quantity of nonmonetary assets demanded exceeds the quantity supplied.
   B) the quantity of nonmonetary assets supplied exceeds the quantity demanded.
   C) the quantity of nonmonetary assets demanded will still equal the quantity supplied, all else being equal.
   D) you can make no conclusions about the relative supply and demand of nonmonetary assets.
   Answer: B
   Diff: 2
   Topic: Section 7.4
   Question Status: Previous Edition

4) Suppose the real money demand function is
   \[ \frac{M^d}{P} = 2400 + 0.2 Y - 10,000 (r + \pi_e). \]
   Assume \( M = 4000, P = 2.0, \pi_e = .03, \) and \( Y = 5000. \) The real interest rate that clears the asset market is
   A) 3%.
   B) 6%.
   C) 11%.
   D) 14%.
   Answer: A
   Diff: 3
   Topic: Section 7.4
   Question Status: Previous Edition

6) Suppose the real money demand function is
   \[ \frac{M^d}{P} = 2400 + 0.2 Y - 10,000 (r + \pi_e). \]
   Assume \( M = 5000, P = 2.0, \) and \( \pi_e = .03. \) If \( Y \) were to increase from 4000 to 5000, then the real interest rate would increase by how many percentage points?
   A) 2
   B) 4
   C) 5
   D) 7
   Answer: A
   Diff: 3
   Topic: Section 7.4
   Question Status: Previous Edition

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