Chapter 11

1) Fill in the blanks. Firms and the government borrow funds by issuing ____________, and pay interest to firms and households that ____________ their debt.

a) loans; sell
b) loans; purchase
c) bonds; sell
d) bonds; purchase

2) If a $1,000 bond pays $100 per year, the interest rate on the bond is calculated as follows:

a) $1,000 / $100 = $10
b) $1,000 * $100 = $10,0000
c) $100
d) $100 / $1,000 = 10%

3) The amount of money you wish to hold, or your demand for money, depends on:

a) How much wealth you would like.
b) How much of your financial assets you wish to hold in the form of money.
c) How much income you would like to have.
d) All of the above.

4) Which of the following motives for holding money emphasizes the usefulness of money for buying things?

a) The transactions motive.
b) The precautionary motive.
c) The speculative motive.
d) The inflationary expectations motive.

5) In our analysis of the demand for money and the optimal balance, we assume that:

a) Money arrives once a month.
b) Spending is spread out over time, and occurs at a completely uniform rate.
c) Only two kinds of assets available to households: bonds and money.
d) All of the above.

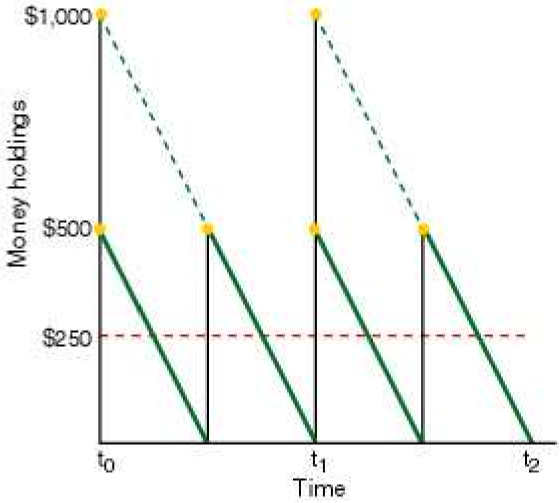
6) The mismatch between the timing of money inflow and the timing of money outflow is called:

a) The transaction motive.
b) The non-synchronization of income and spending.
c) The cycle of money balances.
d) Disequilibrium in the optimal money balance.

7) Jim receives $1,200 per month (30 days) and spends $40 each day. What is his average money balance?

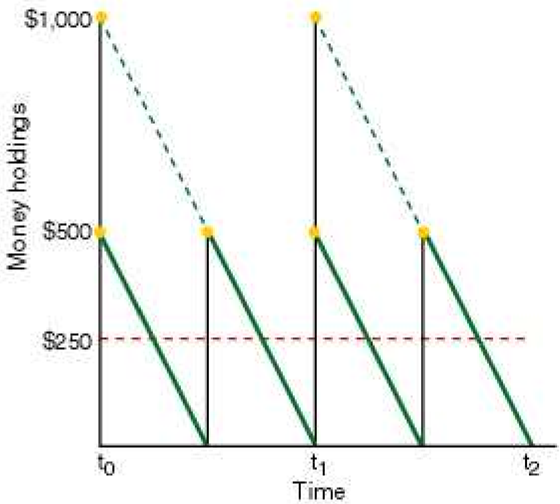
a) $40.
b) $30.
c) $1,200.
d) $600.

8) Refer to the graph below. How does this person manage his money balances?



a) This person earns $1,000, spends $500, and buys two $250 bonds, one at the beginning of the month and one halfway through the month.
b) This person earns $1,000, spends $500 throughout the month, and buys a $250 bond.
c) This person earns $1,000, spends $1,000 throughout the month, buys a $500 bond at the beginning of the month, and sells the bond halfway through the month.
d) This person earns $1,000, spends $500 throughout the month, and saves the rest (or buys a $500 bond).

9) Refer to the graph below. What is the impact of an increase in the market rate of interest on this graph, all else the same?



a) The amount of total income ($1,000) would decrease.
b) The horizontal, dashed line shifts upward.
c) The solid diagonal lines would stretch higher.
d) The horizontal, dashed line shifts downward.

10) Which of the following is a better measure of the opportunity cost of holding money balances?

a) The transactions motive.
b) The optimal money balance.
c) The interest rate.
d) The demand for money curve.

11) Assume that there are no management costs associated with buying and selling bonds. What is the impact of an increase in the interest rate on money holdings and interest revenue?

a) Both money holdings and interest revenue would rise.
b) Money holdings would decline, and interest revenue would rise.
c) Both money holdings and interest revenue would decline.
d) Money holdings would rise and interest revenue would decline.

12) Which of the following describes the inverse relationship between the interest rate and the quantity of money demanded?

a) The speculative motive.
b) The precautionary motive.
c) The transactions motive.
d) The inflationary expectations motive.

13) The price that a buyer is willing to pay for an existing bond:

a) Is not affected by the interest rate.
b) Is higher when interest rates are low and expected to rise.
c) Is higher than its face value when the buyer is willing to accept a lower interest rate than before.
d) Is never lower than the face value of the bond.

14) When market interest rates fall, bond values will:

a) Rise.
b) Fall.
c) Remain the same.
d) Disappear.

15) When interest rates are high today and expected to fall:

a) Demand for bonds today is low and money demand is high.
b) Both demand for bonds and money demand today are low.
c) Demand for bonds today is high and money demand is low.
d) Both demand for bonds and money demand today are high.

16) The demand for money increases when:

a) The dollar volume of transactions increases and the average transaction amount decreases.
b) Both the dollar volume of transactions and the average transaction amount decrease.
c) The dollar volume of transactions decreases and the average transaction amount increases.
d) Both the dollar volume of transactions and the average transaction amount increase.

17) Fill in the blanks. A good indicator of the total number of transactions in the economy is ______________, while the average amount of each transaction depends more directly on ______________.

a) income; the interest rate
b) income; the price level
c) output; income
d) the interest rate; income

18) An increase in the interest rate causes:

a) A shift of the money demand curve to the right.
b) A shift of the money demand curve, sometimes to the left, and sometimes to the right.
c) A shift of the money demand curve to the left.
d) No shift in the money demand curve.

19) The demand for money curve shifts to the left with:

a) A decrease in the interest rate.
b) None of the above.
c) An increase in the price level.
d) A decrease in the level of output (income).

20) Fill in the blanks. The demand for goods and services is a _______________ and the demand for money is a _______________.

a) flow variable; stock variable
b) flow variable; flow variable
c) stock variable; flow variable
d) stock variable; stock variable

21) When the interest rate is above the equilibrium interest rate:

a) There is more money in circulation than households and firms want to hold.
b) The quantity of money demanded is greater than the quantity of money supplied.
c) The quantity of money demanded is too high to achieve equilibrium.
d) People will move out of bonds and into money—hold larger cash balances.

22) An increase in the money supply, without a change in the demand for money will:

a) Result in an excess demand for money.
b) Increase the equilibrium interest rate.
c) Decrease the equilibrium interest rate.
d) Decrease the quantity of money demanded.

23) If the Fed wants to maintain the interest rate constant, it will have to:

a) Leave the money supply unchanged regardless of changes in the demand for money.
b) Decrease the reserve requirement when the demand for money shifts to the left.
c) Increase the money supply when the demand for money increases.
d) Increase the money supply when the demand for money decreases.

24) If the Fed wanted to drive the interest rate up, it would:
   a) Decrease the reserve requirement.
   b) Sell U.S. government securities in the open market.
   c) Expand the money supply.
   d) Lower the discount rate.

25) An increase in the level of aggregate output (income) causes:
   a) An increase in the demand for money and a lower equilibrium interest rate.
   b) An increase in the demand for money and a higher equilibrium interest rate.
   c) A decrease in the demand for money and a higher equilibrium interest rate.
   d) A decrease in the demand for money and a lower equilibrium interest rate.

26) An increase in the price level causes:
   a) A decrease in the demand for money and a lower equilibrium interest rate.
   b) An increase in the demand for money and a higher equilibrium interest rate.
   c) An increase in the demand for money and a lower equilibrium interest rate.
   d) A decrease in the demand for money and a higher equilibrium interest rate.

27) Why would the Fed want to lower the interest rate?
   a) To stimulate spending, particularly investment.
   b) To reduce spending and income.
   c) To influence events in the money market while leaving the goods market unchanged.
   d) To stimulate spending while leaving income unchanged.

28) Which of the following refers to tight monetary policy?
   a) Polices that expand the money supply without changing interest rates.
   b) Fed policies that contract the money supply in an effort to restrain the economy.
   c) Fed policies that contract the money market without having an effect on the goods market.
   d) Fed policies that expand the money supply in an effort to stimulate the economy.

29) Easy monetary policy refers to:
   a) Fed polices that affect the money market without the changing conditions in the goods market.
   b) Fed policies that stimulate economic activity without changing interest rates.
   c) Fed policies that expand the money supply in an effort to stimulate the economy.
   d) Very small and gradual changes in interest rates by the Fed.

30) Tight monetary policies contribute to:
   a) Economic expansions.
   b) Both expansions and recessions.
   c) Economic recessions.
   d) None of the above. The Fed does not trigger economic expansions or recessions.

31) Interest is a fee that a lender pays to a borrower for the use of funds.
   a) True
   b) False

32) The higher the interest rate, the higher the opportunity cost of holding money; thus, the higher the demand for money.

a) True
b) False

33) A reasonable measure of the number of transactions in the economy is aggregate output.

a) True
b) False

34) Increases in the price level cause an increase in the demand for money.

a) True
b) False

35) An excess supply of money will cause households and firms to buy more bonds, driving interest rates down.

a) True
b) False

36) If the Fed wants to create upward pressure on the interest rate, it can buy government securities in the open market.

a) True
b) False

37) An increase in the price level is like an increase in output. Both events cause an increase in money demand.

a) True
b) False

38) Easy monetary policy refers to the Fed policies that expand the money supply.

a) True
b) False

39) If the Fed wants to stimulate economic activity, it will increase the money supply.

a) True
b) False

40) The main goal of the Fed is to try to stimulate economic activity continuously, by expanding the money supply when the demand for money increases.

a) True
b) False

41) Suppose that the Fed holds the growth rate of the money supply constant while government expenditures are having an expansionary impact on the economy. Explain and predict the impact of this scenario on interest rates and private spending.

Write a paragraph about the issue above.

42) How can the Fed use its tools of monetary policy to try to bring the economy out of a recession? Write a paragraph about the issue above.

43) Suppose that an unemployment report shows lower than anticipated unemployment and upward pressure on wages. If the goal of the Fed is to prevent inflation, what will be the anticipated impact of this report on the money supply, interest rates, and bond prices?
Write a paragraph about the issue above.

Chapter 12

1) Which of the following statements describes the relationship between the goods market and the money market?

a) The goods and money markets operate independently of each other.
b) Income is determined in the goods market and has no influence on the money market.
c) The interest rate is determined in the money market and has no influence on the goods market.
d) None of the above.

2) An increase in output, all else the same, leads to:

a) A decrease in the interest rate.
b) An increase in money demand.
c) An increase in money supply.
d) An increase in both the supply and the demand for money.

3) Which of the following is a link between the goods market and the money market?

a) Income has considerable influence on the demand for money in the money market.
b) The interest rate has significant effects on planned investment in the goods market.
c) Both a and b above.
d) None of the above. The goods market and the money market are not linked in the ways described above.

4) Reducing the interest rate, ceteris paribus, is likely to:

a) Shift the demand for money curve to the right.
b) Shift the supply of money curve to the right.
c) Increase the level of planned investment spending.
d) Decrease the level of planned investment.

5)Fill in the blanks. A higher interest rate ___________ planned investment and causes planned aggregate expenditure to shifts ____________.

a) decreases; downward
b) decreases; upward
c) increases; downward
d) increases; upward

6) When the interest rate rises, planned investment falls, and equilibrium output (income):

a) Falls by even more than the fall in planned investment.
b) Rises by exactly the same amount as the fall in planned investment.
c) Falls by exactly the same amount as the fall in planned investment.
d) Rises by even more than the fall in planned investment.

7) For every possible level of the interest rate there is:

a) Always equilibrium in both the goods and money markets.
b) Only one equilibrium level of Y.
c) A possible equilibrium in the money market but never simultaneous with equilibrium in the money market.
d) A different equilibrium level of Y.

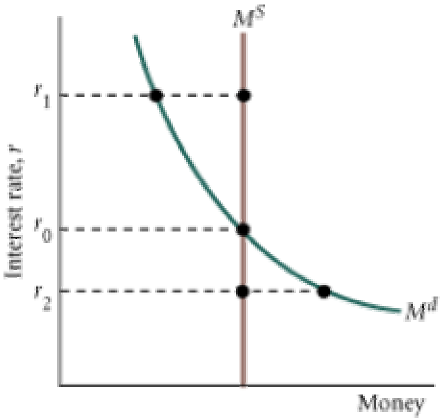
8) The impact of an increase in income on the money market is as follows:

a) The demand of money curve shifts to the left.
b) The supply of money curve shifts to the left.
c) The demand for money curve shifts to the right.
d) The supply of money curve shifts to the right.

9) If the amount of money demanded by households and firms is less than the amount in circulation as determined by the Fed,

a) There is an excess demand for money in the money market.
b) The interest rate will rise.
c) The interest rate will fall.
d) The interest rate will remain unchanged.

10) Refer to the graph below. At which level of the interest rate is the amount of money demanded by households and firms less than the amount of money in circulation?



a) At r2.
b) At r0.

c) At r1.
d) None of the above. Those two quantities are always the same.

11) Which of the following would be considered expansionary fiscal policy?
a) An increase in government spending.
b) An increase in the money supply.
c) An increase in net taxes.
d) All of the above.

12) Which of the following policy changes would be considered expansionary monetary policy?
a) An increase in the money supply.
b) An increase in government spending.
c) An increase in net taxes.
d) All of the above.

13) Which multiplier effect is smaller?
a) The multiplier of a decrease in net taxes.
b) Any multiplier of autonomous expenditures other than the multiplier of G or T.
c) Neither multiplier above is smaller. The magnitude of a change in equilibrium GDP from either the multiplier of government spending or the multiplier of net taxes is identical.
d) The multiplier of an increase in government spending.

14 Which of the following is a likely impact of an increase in government purchases (G)?
a) An increase in equilibrium output (income) (Y).
b) An increase in the equilibrium interest rate (r).
c) Disequilibrium in the money market with the quantity of money demanded being greater than the quantity of money supplied.
d) All of the above.

15) An increase in government spending (G),

a) Increases planned aggregate expenditure, increases aggregate output, but may also cause a decrease in planned investment, which reduces both planned aggregate expenditure and aggregate output.
b) Increases planned aggregate expenditure, increases aggregate output, and spurs even more planned investment, which further increases aggregate output.
c) Decreases aggregate expenditure, planned investment, and aggregate output.
d) All of the cases above have equal chance of occurring.

16) Due to the crowding-out effect of increases in government spending, the government spending multiplier is:

a) Reduced to zero.
b) Smaller than it would be without the crowding-out effect.
c) Always equal to one.
d) Larger than it would be without the crowding-out effect.

17) Fed accommodation of an increase in government spending causes the multiplier of government spending to be:

a) Smaller.
b) Larger.
c) Infinity.
d) Reduced to zero.

18) If planned investment does not fall when the interest rate rises, then:

a) The crowding-out still exists, but it would be weaker.
b) The crowding-out effect is stronger.
c) There is no crowding-out effect.
d) Fed accommodation would be essential to eliminate the crowding out effect.

19) A decrease in net taxes results in:

a) An increase in Y, a decrease in r, and an increase in I.
b) A decrease in Y, an increase in r, and a decrease in I.
c) An increase in Y, an increase in r, and a decrease in I.
d) A decrease in Y, a decrease in r, and an increase in I.

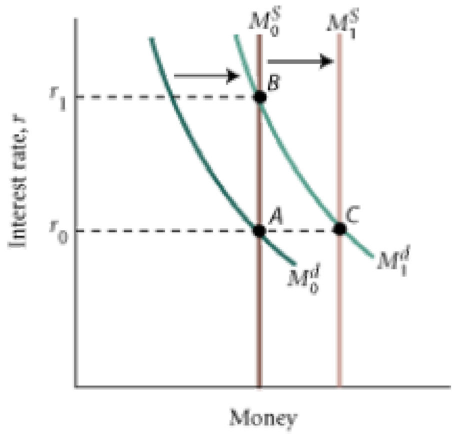
21) An increase in the money supply results in:

a) A decrease in Y, a decrease in r, and an increase in I.
b) An increase in Y, an increase in r, and a decrease in I.
c) A decrease in Y, an increase in r, and a decrease in I.
d) An increase in Y, a decrease in r, and an increase in I.

22) If the slope of the investment function is steep, or nearly vertical,

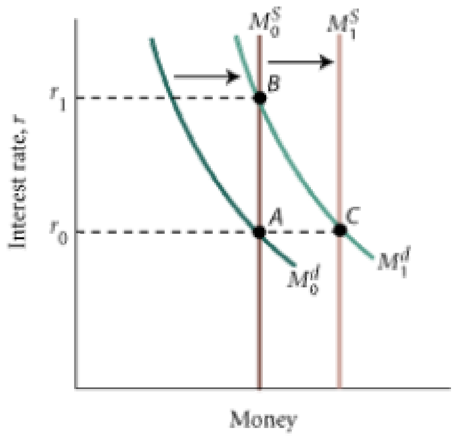
a) Monetary policy is highly effective.
b) Monetary policy is ineffective.
c) The slope of the money supply curve is zero.
d) The effects of monetary policy are reversed.

23) Refer to the figure below. Which of the following is best described by the figure?



a) Fiscal accommodation of a contractionary monetary policy.
b) Fiscal accommodation of an expansionary monetary policy.
c) Fed accommodation of an expansionary fiscal policy.
d) Fed accommodation of a contractionary fiscal policy.

24) Refer to the figure below. In response to the increase in money demand, which of the following would be considered expansionary monetary policy?



a) The move from A to C.
b) The move from A to B.
c) Both moves are considered expansionary monetary policy.
d) Neither move. Both moves represent contractionary monetary policy.

25) Which policy mix favors investment spending over government spending?

a) Both expansionary fiscal policy and expansionary monetary policy.
b) An increase in the money supply and a fall in government purchases.
c) Expansionary fiscal policy and contractionary monetary policy.
d) None of the above. No policy mix favors investment over government spending.

26) The demand for investment shifts to the right when:

a) Labor is less expensive relative to capital.
b) The interest rate decreases.
c) Entrepreneurs are optimistic about future sales.
d) Capital utilization rates are low.

27) The goods market and the money market operate independently.

a) True
b) False

28) The level of output is determined in the goods market, and the interest rate is determined in the money market.

a) True
b) False

29) An increase in the volume of transactions usually causes an increase in the supply of money, but no change in the demand for money.

a) True
b) False

30) There is a negative relationship between planned investment spending and the interest rate.

a) True
b) False

31) For every value of the interest rate, there is a different level of planned investment and a different level of output.

a) True
b) False

32) A reduction in net taxes is considered contractionary fiscal policy.

a) True
b) False

33) If the Fed does not change the money supply, increased government spending results in the crowding out of investment spending.

a) True
b) False

34) To bring the economy out of a recession, the Fed can adopt contractionary monetary policy.

a) True
b) False

35) Contractionary policies are used to fight inflation.

a) True
b) False

36) A mix of expansionary fiscal policy and contractionary monetary policy tends to favor investment spending over government spending.

a) True
b) False

37) Explain the precise links between the goods market and the money market.

Write a paragraph about the issue above

38) Explain the crowding-out effect and the type of monetary policy that could prevent it.

Write a paragraph about the issue above

39) What combination of fiscal and monetary policies could be used to bring the economy out of a recession? What is the ideal mix of these policies if policymakers favor an expansion of the private sector over the public sector?

Write a paragraph about the issue above