Unit 4 Chapters 25, 26, 27, and 32 Review

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

Chapter 25

1) Which of the following formulas is correct? 1) ________
   A) Net investment = gross investment + depreciation
   B) Net investment = gross investment - wealth
   C) Net investment = gross investment + capital
   D) Net investment = gross investment - depreciation
   E) Net investment = gross investment - saving

2) A bond's price is $80 and the bond pays $8 in interest every year. The bond's interest rate is ________. 2) ________
   A) 10 percent
   B) 80 percent
   C) 8 percent
   D) 4 percent
   E) None of the above are correct.

3) On January 1, Rick's Photo owned $50,000 of equipment. During the year, the value of the equipment fell by $10,000, plus Rick bought $25,000 in new equipment. Rick's company experienced 3) ________
   A) $10,000 of depreciation.
   B) an increase of new capital by $10,000.
   C) an increase of net investment of $35,000.
   D) a change in total financial capital of $15,000.
   E) $40,000 of depreciation.

4) In the loanable funds market, demanders of funds are ________ and suppliers of funds are ________. 4) ________
   A) households and the government if it has a budget surplus; firms and the government if it has a budget deficit
   B) firms and the government if it has a budget deficit; households and the government if it has a budget surplus
   C) households and firms; the government if it has a budget deficit
   D) firms and the government if it has a budget surplus; households and the government if it has a budget deficit
   E) households and the government if it has a budget deficit; firms and the government if it has a budget surplus

5) Other things remaining the same, the ________ the real interest rate, the ________. 5) ________
   A) higher; greater the quantity of loanable funds demanded
   B) lower; greater the quantity of loanable funds supplied
   C) lower; greater the demand for loanable funds
   D) lower; greater the quantity of loanable funds demanded
   E) higher; greater the demand for loanable funds

6) As the economy enters a strong expansion, then firms' demand for loanable funds 6) ________
   A) increases due to increases in the real interest rate.
   B) increases because profit expectations will increase.
   C) decreases due to lower profit expectations.
   D) increases due to increases in the nominal interest rate.
   E) decreases due to decreases in the nominal interest rate.

7) The demand for loanable funds increases if 7) ________
A) firms fear a recession.
B) wealth increases.
C) technological growth slows.
D) expected profit increases.
E) population growth slows.

8) The demand for loanable funds curve shows the 8) ________
A) positive relationship between the demand for loanable funds curve and the supply of loanable funds curve.
B) positive relationship between the interest rate and the quantity of loanable funds demanded.
C) negative relationship between the demand for loanable funds curve and the supply of loanable funds curve.
D) negative relationship between the interest rate and the quantity of loanable funds demanded.
E) U-shaped relationship between the interest rate and the quantity of loanable funds demanded.

9) The supply of loanable funds is from 9) ________
A) households and firms.
B) households and the government if it has a budget surplus.
C) households and the government if it has a budget deficit.
D) firms and the government if it has a budget deficit.
E) firms and the government if it has a budget surplus.

10) If the real interest rate decreases, people decide to ________ because the opportunity cost of ________. 10) ________
A) decrease their consumption expenditure; consumption has decreased.
B) increase their consumption expenditure; saving has decreased.
C) save more; saving has decreased.
D) increase their consumption expenditure; consumption has decreased.
E) None of the above answers are correct.

11) As the economy enters an expansion there will be 11) ________
A) an increase in the supply of loanable funds.
B) a leftward shift in the supply of loanable funds curve.
C) a leftward shift in the demand for loanable funds curve.
D) a decrease in the nominal interest rate.
E) None of the above answers are correct.

12) If the disposable income decreases, then 12) ________
A) the supply of loanable funds increases.
B) the supply of loanable funds decreases.
C) the quantity of loanable funds supplied decreases.
D) the demand for loanable funds increases.
E) the quantity of loanable funds demanded increases.

13) Which of the following factors changes saving supply and hence shifts the supply of loanable funds curve? 13) ________
i. disposable income
ii. wealth
iii. expected profit
A) iii only B) i, ii, and iii C) ii only D) i and ii E) i only

14) If wealth ________, then saving increases, which is shown by a ________. 14) ________
A) decreases; rightward shift of the supply of loanable funds curve
B) increases; leftward shift of the supply of loanable funds curve
C) decreases; a movement downward along the supply of loanable funds curve
D) increases; rightward shift of the supply of loanable funds curve
E) increases; movement upward along the supply of loanable funds curve

15) If the real interest rate falls, other things being the same, the quantity of loanable funds demanded ________ and the quantity of loanable funds supplied ________. 15) ________

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

16) If a government has a budget deficit, it must 16) ________

A) decrease taxes.
B) lower the real interest rate.
C) decrease its expenditures.
D) borrow in the loanable funds market.
E) increase taxes.

17) The tendency for higher government budget deficits to decrease investment is called the 17) ________

A) Ricardo-Barro effect.
B) deficit effect.
C) inflation effect.
D) wealth effect.
E) crowding-out effect.

18) If saving supply decreases, the equilibrium real interest rate ________ and the equilibrium quantity of investment ________. 18) ________

A) rises; decreases
B) rises; increases
C) falls; increases
D) falls; decreases
E) does not change; does not change

19) Crowding out can occur when a government budget ________ raises the real interest rate and the equilibrium quantity of investment ________. 19) ________

A) surplus; increases
B) deficit; decreases
C) deficit; increases
D) surplus; decreases
E) surplus; does not change

Chapter 26

20) Money is any commodity or token that is 20) ________

A) issued by the government.
B) generally accepted as a means of measurement.
C) generally accepted as a means of payment.
D) backed by gold.
E) a store of value.

21) When we use money to purchase goods and services, we are using money as a 21) ________

A) unit of account.
B) reserve of wealth.
C) store of value.
D) medium of exchange.
E) bartering tool.

22) When we put a price tag on goods and services, we are using money as a 22) ________
A) medium of exchange.
B) means of payment.
C) store of value.
D) barter token.
E) unit of account.

23) The store of value function is defined as the 23) ________
A) holding of money from one transaction to be used later in another transaction.
B) use of money as a medium of exchange.
C) pricing of goods and services in one measure.
D) exchange of goods and services directly for other goods and services.
E) double coincidence of wants that is used in the debate over barter versus money.

24) Which statement most accurately captures the state of money today? 24) ________
A) Money today includes checks and credit cards.
B) Money today includes currency, bank deposits and checks.
C) Money today includes bank deposits and checks but not currency.
D) Money today includes currency and checks but not bank deposits.
E) Money today includes bank deposits and currency but not checks.

25) The objects we use as money today include 25) ________
A) currency outside the banks and bank deposits.
B) only deposits inside the banks.
C) credit cards and debit cards.
D) only currency outside the banks.
E) currency inside banks and bank deposits.

26) Checkable deposits are money because 26) ________
A) they are protected by the Federal Reserve.
B) they can be converted into currency on demand and are used directly as a means of payment.
C) they are guaranteed by banks.
D) only banks and other financial institutions can offer them.
E) checks bounce when there are not enough funds to cash them.

27) Checks are not money because they 27) ________
A) can bounce when there are not enough funds to cash them.
B) are not guaranteed by banks.
C) are not issued by the government.
D) are just instruments to transfer money between banks.
E) are not always accepted when trying to purchase goods or services.

28) M1 is composed of 28) ________
A) currency held by individuals and businesses, traveler's checks, and the credit line on credit cards.
B) currency inside of banks, traveler's checks, and government-issued checks.
C) traveler's checks, credit cards, and e-cash.
D) currency held by individuals and businesses, traveler's checks, and checkable deposits owned by individuals and businesses.
E) checkable deposits owned by individuals and businesses, saving deposits, and certificates of deposit.

29) If Joe withdraws a $100 bill from his checking account and Jack deposits another $100 bill in his savings account, by how will M1 and M2 change? 29) ________

A) M1 will decrease, but M2 will remain the same.
B) Both M1 and M2 will remain the same.
C) M1 will remain the same, and M2 will increase.
D) M1 will increase, and M2 will increase.
E) M2 will decrease by $100.

30) Which of the following are assets of commercial banks? 30) ________

i. reserves.
ii. loans.
iii. deposits.

A) i and ii B) i, ii, and iii C) ii only D) i only E) ii and iii

31) When a commercial bank receives a deposit, it must keep part of the deposit as cash reserves to satisfy its 31) ________

A) interbank loans.
B) required reserves.
C) loan requirements.
D) excess reserves.
E) securities and loans.

32) A bank has checkable deposits of $1,000,000, loans of $600,000, and government securities of $400,000. If the required reserve ratio is 5 percent, the amount of required reserves is 32) ________

A) $30,000. B) $500,000. C) $1,00,000. D) $20,000. E) $30,000.

33) A bank has $250 in checking deposits, $1,000 in savings deposits, $1,200 in time deposits, $1,000 in loans to businesses, $400 in outstanding credit card balances, $800 in government securities, $25 in currency in its vault, and $25 in deposits at the Fed.The bank's reserves are equal to 33) ________

A) $2,225 B) $275. C) $350. D) $25. E) $50.

	Amount (dollars)
Checking deposits	600
Savings deposits	1000
Time deposits	1,500
Loans	1,200
Government securities	2,000
Outstanding credit card balances	400
Currency in vault	10
Deposits in reserve account at the Fed	20

34) The above table gives assets and deposits for a (small) bank. The bank's reserves are equal to 34) ________

A) $30. B) $630. C) $620. D) $20. E) $600.

35) What is the central bank of the United States? 35) ________

A) Each state has its own central bank, which, when all taken together, constitute the central bank of the United States.
B) The Federal Reserve System.
C) The Department of Treasury.
D) There is no central bank in the United States.
E) The U.S. Mint.

36) Which of the following is a policy tool of the Fed? 36) ________
i. setting the required reserve ratios
ii. conducting open market operations
iii. quantitative easing
A) i, ii, and iii
B) Both i and ii
C) iii only
D) i only
E) ii only

37) Which of the following is a tool the Fed uses to adjust the quantity of money? 37) ________
i. The Fed can change the interest rate on loans to bank customers.
ii. The Fed can change the discount rate on loans to banks.
iii. The Fed can buy or sell government securities.
A) i and iii B) ii and iii C) i only D) iii only E) ii only

38) The discount rate is the 38) ________
A) interest rate at which the Fed will loan reserves to commercial banks.
B) banks' real interest rate.
C) interest rate banks charge the Fed when the Fed borrows from the banks.
D) name of the interest rate banks charge their most credit-worthy borrowers.
E) the interest rate paid on U.S. government securities.

39) Open market operations are the 39) ________
A) purchase or sale of gold by the Fed.
B) lending of reserves to the banking system by the Fed.
C) purchase or sale of government securities by the Fed.
D) borrowing of reserves by the Fed from the banking system.
E) minimum percentage of loans that banks must retain as reserves in the open market.

Chapter 27

40) Suppose you can earn 5 percent on your savings account if you deposit $500 in it. The opportunity cost of holding the $500 is 40) ________
A) $125. B) $25. C) $100. D) $525. E) $495.

41) If the inflation rate is 2.5 percent and the nominal interest rate is 10 percent, then the real interest rate is 41) ________
A) -7.5 percent.
B) 2.5 percent.
C) -2.5 percent.
D) 12.5 percent.
E) 7.5 percent.

42) The demand for money curve slopes downward because a rise in the nominal interest rate ________ the opportunity cost of holding money and therefore ________ the quantity of money demanded. 42) ________
A) increases; increases
B) increases; decreases
C) decreases; decreases
D) increases; does not change
E) decreases; increases

43) The ________ the price level, the ________. 43) ________
A) higher; greater the demand for money
B) higher; smaller the demand for money
C) higher; greater the supply of money
D) higher; smaller the supply of money
E) lower; greater the demand for money

44) All else the same, when real GDP increases the 44) ________
A) supply of money decreases.
B) supply of money does not change and the demand for money does not change.
C) demand for money increases.
D) supply of money increases.
E) demand for money decreases.

45) When the Fed changes the quantity of money, there is an immediate effect on 45) ________
A) the inflation rate but not the price level.
B) the price level and the inflation rate.
C) real GDP.
D) the price level but not the inflation rate.
E) the nominal interest rate.

46) If the Fed is worried about inflation and wants to raise the interest rate, in the short run it can 46) ________
A) decrease the demand for money.
B) increase the demand for money.
C) decrease the quantity of money.
D) increase the quantity of money.
E) directly raise the interest rate without affecting either the demand for money or the supply of money.

47) Using the quantity theory of money, in the long run a 3 percent increase in the quantity of money leads to a 3 percent 47) ________
A) increase in real GDP.
B) decrease in the price level.
C) decrease in the real interest rate.
D) increase in the price level.
E) increase in the real interest rate.

48) If the quantity of money is $6 billion and nominal GDP is $9 billion, the velocity of circulation is 48) ________
A) 3. B) 0.67. C) 54. D) 1.5. E) 36.

49) High inflation 49) ________
A) lowers the price level.
B) leads to a more correct allocation of resources.
C) decreases uncertainty.
D) makes it easier to use money as a standard of account.
E) makes money function less well as a store of value.

50) One effect of inflation is that it is a tax that redistributes goods and services from 50) ________
A) government to households.
B) households and businesses to the government.
C) government to businesses.
D) investors to savers.
E) businesses to households.

51) Inflation is a tax because as the government ________ the quantity of money, the price level ________, and the purchasing power of households' money ________. 51) ________
A) decreases; rises; decreases
B) decreases; falls; decreases
C) increases; rises; decreases
D) increases; rises; increases
E) does not change; rises; increases

52) Which of the following is <u>NOT</u> a cost of inflation? 52) ________

A) tax cost
B) confusion cost
C) unemployment cost
D) uncertainty cost
E) shoe-leather cost

53) If the inflation rate is zero, the nominal interest rate is 53) ________

A) less than the real interest rate.
B) positive and the real interest rate is negative.
C) greater than the real interest rate.
D) equal to the real interest rate.
E) equal to the inflation rate.

54) During the 1990s, Canada had an average inflation rate of 1.5 percent while Columbia had an average inflation rate of 21.5 percent. You would expect that nominal interest rates in Canada are 54) ________

A) greater than nominal interest rates in Columbia.
B) not comparable to nominal interest rates in Columbia.
C) less than nominal interest rates in Columbia.
D) equal to nominal interest rates in Columbia.
E) unpredictably different from nominal interest rates in Columbia.

Chapter 32

55) Which of the following is NOT a monetary policy goal? 55) ________

A) keeping long-term interest rates moderate
B) maintaining stable prices
C) keeping a high exchange rate for the dollar
D) promoting maximum employment
E) All of the above are monetary policy goals.

56) The output gap is the 56) ________

A) difference between actual inflation and core inflation.
B) difference in graduation levels between high school and college.
C) percentage increase in the growth rate of real GDP.
D) percentage increase in the growth rate of real GDP minus the unemployment rate.
E) percentage deviation of real GDP from potential GDP.

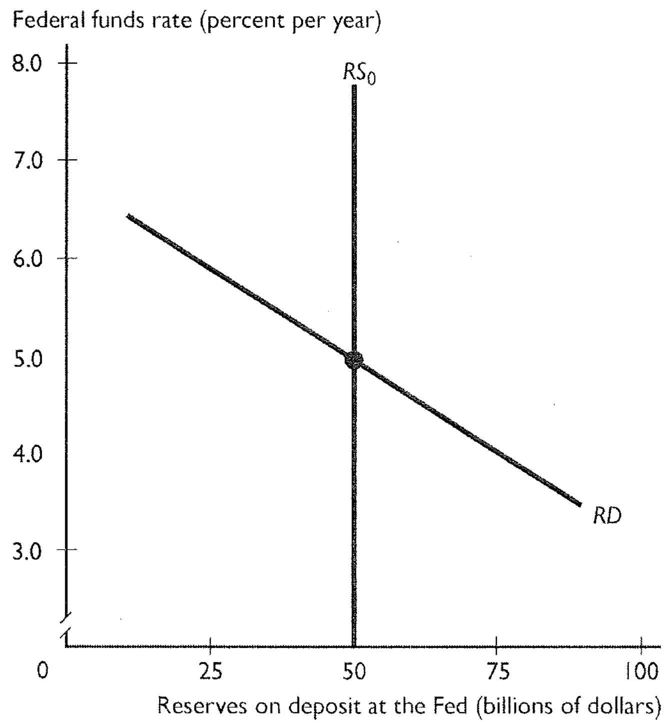
57) When real GDP is greater than potential GDP, there is ________ which leads the inflation rate to ________. 57) ________

A) an inflationary gap; rise
B) an inflationary gap; fall
C) a recessionary gap; remain stable
D) a recessionary gap; fall
E) a recessionary gap; rise

58) The interest rate banks charge each other on overnight loans is called the 58) ________

A) required reserve rate.
B) coupon rate.
C) discount rate.
D) federal funds rate.
E) real interest rate.

59) The steps in the transmission of monetary policy are 59) ________
A) Congress increases the budget deficit, which increases the money supply, which increases aggregate supply.
B) the Federal Reserve increases government expenditures on goods and services, leading to an increase in aggregate demand.
C) the Federal Reserve lowers the federal funds rate, which lowers the real interest rate, and leads to an increase in aggregate demand.
D) Congress increases government expenditures on goods and services, leading to an increase in aggregate demand.
E) Congress increases the money supply, which lowers the interest rate, and leads to an increase in aggregate demand.

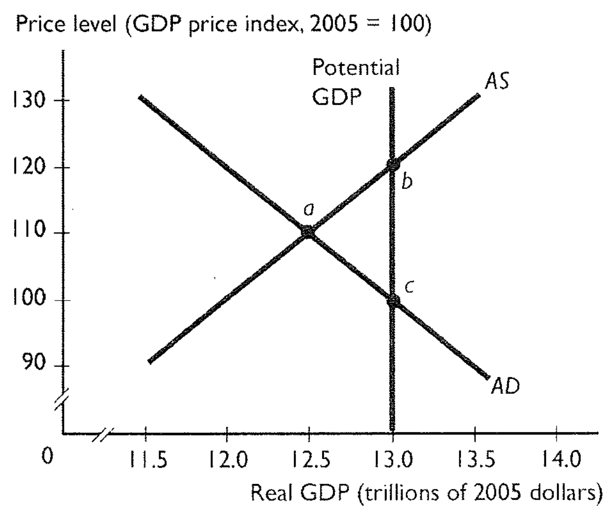


60) The figure above shows the market for bank reserves in Futureland. If the Bank of Futureland lowers the target federal funds rate by 1 percentage point, the central bank will conduct an open market ________ of government securities of ________ to ________ the supply of reserves. 60) ________
A) sale; $25 billion; increase
B) purchase; $25 billion; decrease
C) sale; $75 billion; decrease
D) purchase; $75 billion; increase
E) purchase; $25 billion; increase

61) Suppose the Federal Reserve lowers the federal funds rate. Put the following changes in order in which they occur, starting with the changes that take place almost immediately and ending with the changes that may occur up to a year afterwards: 61) ________
i. quantity of money increases
ii. quantity of reserves increases
iii. aggregate demand increases
iv. the long-term real interest rate falls

A) i–ii–iii–iv B) i–ii–iv–iii C) iii–iv–i–ii D) ii–i–iii–iv E) ii–i–iv–iii

62) A decrease in the federal funds rate 62) ________
A) decreases the supply of loanable funds, raises the real interest rate, and decreases aggregate demand.
B) lowers other sort-term interest rate, raises the real interest rate, and increases aggregate demand.
C) increases other short-term interest rates, decreases investment, and decreases aggregate demand.
D) decreases the demand for loanable funds, lowers the real interest rate, and decreases aggregate demand.
E) lowers the exchange rate, increases the supply of loanable funds, and increases aggregate demand.



63) The economy is at the equilibrium shown at point *a* in the above figure. If the Fed 63) ________
A) sells government securities, the economy moves to an equilibrium at point *c*.
B) buys government securities, the economy moves to an equilibrium at point *b*.
C) buys government securities, the economy moves to an equilibrium at point *c*.
D) sells government securities, the economy moves to an equilibrium at point *b*.
E) None of the above are correct because the economy will remain at point *a* if the Fed buys or if the Fed sells government securities.

64) The Fed raises the interest rate when it 64) ________
A) wants to increase the quantity of money.
B) wants to encourage bank lending.
C) cannot change the quantity of money.
D) fears recession.
E) fears inflation.

65) Raising the federal funds rate shifts the aggregate demand curve ________ so that real GDP ________ and the price level ________. 65) ________
A) leftward; decreases; falls
B) rightward; increases; falls
C) leftward; decreases; rises
D) rightward; increases; rises
E) leftward; increases; rises

66) If the Fed bases its monetary policy on judgments of its policymakers about the current needs of the economy, it is following a 66) ________
A) a money targeting rule.
B) an inflation targeting rule.
C) a monetary base instrument rule.
D) wait-and-see policy.
E) discretionary policy.

67) Of the following, which is <u>NOT</u> a monetary policy rule the Fed could follow? 67) ________

A) a *k*-percent rule
B) a money targeting rule
C) a gold price targeting rule
D) an inflation targeting rule
E) an unemployment rate targeting rule

68) Discretionary monetary policy has the drawback that it 68) ________

A) is currently illegal in the United States.
B) must lead to very high inflation.
C) cannot be implemented using changes in the federal funds rate.
D) makes inflation expectations harder to manage.
E) None of the above answers are correct.

69) The Fed increases the quantity of money to counteract 69) ________

A) a federal budget surplus.
B) inflation.
C) a recessionary gap.
D) negative net exports.
E) an inflationary gap.

70) In late 2007, the Fed began a series of cuts in the federal funds rate. Because the core inflation rate was about two percent, the most likely reason for these interest rate cuts was 70) ________

A) to avoid a recession.
B) to raise the price of the dollar in the foreign exchange market.
C) to increase the real interest rate.
D) to reduce the natural unemployment rate.
E) to encourage households to save more money.

Answer Key
Testname:

1) D
2) A
3) A
4) B
5) D
6) B
7) D
8) D
9) B
10) D
11) A
12) B
13) D
14) A
15) C
16) D
17) E
18) A
19) B
20) C
21) D
22) E
23) A
24) E
25) A
26) B
27) D
28) D
29) A
30) A
31) B
32) B
33) E
34) A
35) B
36) A
37) B
38) A
39) C
40) B
41) E
42) B
43) A
44) C
45) E
46) C
47) D
48) D
49) E
50) B
51) C
52) C
53) D
54) C
55) C
56) E

57) A
58) D
59) C
60) E
61) E
62) E
63) B
64) E
65) A
66) E
67) E
68) D
69) C
70) A