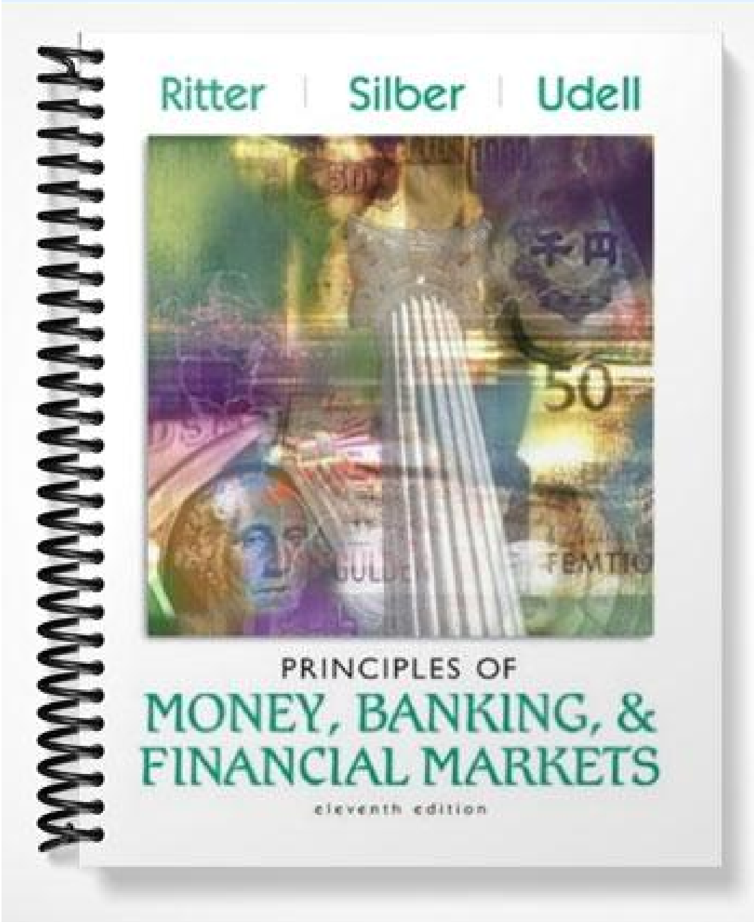
TEST BANK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PRINCIPLES OF
MONEY, BANKING, &
FINANCIAL MARKETS
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Chapter 2

The Role of Money in the Macroeconomy

D2 Interpretive

1. The most prominent role for money is to serve as a
   A) form of credit.
   B) source of income.
   C) means of payment.
   D) standard of value.
   Answer: C

D1 Applied

2. You just bought a new car. In this transaction, you used money as a
   A) form of credit.
   B) source of income.
   C) means of payment.
   D) standard of value.
   Answer: C

D1 Factual

3. The M1 definition of money includes
   A) currency outside banks plus checkable deposits and Eurodollars.
   B) currency outside banks plus checkable deposits plus retail money market deposit accounts.
   C) currency outside banks plus checkable deposits plus traveler's checks.
   D) currency outside banks plus checkable deposits plus small-denomination time deposits.
   Answer: C

D1 Interpretive

4. Money functions as a standard of value when people
   A) compare prices.
   B) buy financial assets.
   C) purchase goods and services.
   D) save.
   Answer: A

D1 Factual

5. A highly liquid asset is one that
   A) loses its value.
   B) appreciates over time.
   C) can be quickly turned into the medium of exchange without loss.
   D) cannot be used in financial transactions.
   Answer: C

D1 Factual

6. An asset that can be quickly turned into the medium of exchange without taking a loss is said to be very
   A) accountable.
   B) liquid.
   C) divisible.
   D) profitable.
   Answer: B

D2 Applied

7. Which of the following lists of assets is in the correct order from most liquid to least liquid?
   A) A car, a small denomination time deposit, a dollar bill
   B) Government bonds, checking accounts, parcel of land
   C) Government bonds, apartment building, money market deposit account
   D) A dollar bill, government bonds, a house
   Answer: D

D2 Applied

8. Which of the following is the least liquid?
   A) A checking account
   B) A government bond
   C) A traveler's check
   D) A money market deposit account
   Answer: B

D2 Applied

9. Which of the following is the most liquid?
   A) A Eurodollar deposit
   B) Currency
   C) A checking account
   D) A small-denomination time deposit
   Answer: B

D2 Factual

10. The M1 definition of money does not include

A) demand deposits.
B) negotiable order of withdrawal accounts.
C) money market deposit accounts.
D) checking accounts with savings and loan associations.
Answer: C

D3 Factual

11. The M1 definition of the money supply includes

A) Eurodollars.
B) travelers' checks.
C) large-denomination certificates of deposit.
D) small-denomination certificates of deposit.
Answer: B

D2 Factual

12. The difference between M1 and M2 definitions of the money supply is that M2 includes

A) demand deposits at banks.
B) large denomination time deposits.
C) retail money market mutual funds shares.
D) NOW accounts.
Answer: C

D2 Factual

13. A difference between M2 and M3 measures of the money supply is that M3 includes

A) bank repurchase agreements.
B) retail money market mutual fund shares.
C) demand deposits at banks.
D) NOW accounts.
Answer: A

D3 Factual

14. Which of the following is not included in M3?

A) Institutional money market mutual fund shares
B) Large-denomination time deposits
C) Small-denomination time deposits
D) All of the above are included in M3
Answer: D

D3 Factual

15. Which of the following is not included in M2?

A) Bank repurchase agreements
B) Savings deposits
C) Travelers' checks
D) Small-denomination time deposits
Answer: A

D2 Interpretive

16. The __________________ measure of money is the only definition of money that is generally accepted as a means for payment.

A) M1
B) M2
C) M3
D) M4
Answer: A

D1 Factual

17. __________________ is the narrowest and most traditional definition of money.

A) M1
B) M2
C) M3
D) M4
Answer: A

D1 Applied

18. The central bank in most countries is responsible for

A) monetary policy.
B) fiscal policy.
C) fiscal and monetary policy.
D) printing and currency only; most central banks have no policy role.
Answer: A

D1 Factual

19. In the United States, the money supply is determined by the

A) Federal Reserve.
B) U.S. Congress.
C) U.S. Treasury.
D) Federal Deposit Insurance Corporation.
Answer: A

D2 Applied

20. The proportion of the money supply that is held in the form of currency is ultimately determined by

A) the Federal Reserve.
B) the public.
C) the U.S. Congress.
D) commercial banks.
Answer: B

D2 Interpretive

21. The Federal Reserve controls the money supply by
    A) printing currency.
    B) setting commercial bank profit margins.
    C) maintaining constant fractions of various forms of money.
    D) wholesaling coins and paper currency to local banks.
    Answer: D

D1 Factual

22. Which of the following is not an important advantage of the use of money over barter?
    A) It is not necessary to remember a large number of exchange ratios of goods for other goods.
    B) Uncertainty in trading is reduced to a minimum.
    C) Inflation is a problem in a barter economy but not in one that uses money.
    D) The use of money reduces the amount of time people spend making transactions.
    Answer: C

D2 Interpretive

23. Which of the following characteristics is required of a good medium of exchange?
    A) High intrinsic value
    B) Low uncertainty over value in trade
    C) Deteriorating exchange value over time
    D) A high rate of return
    Answer: B

D1 Factual

24. An effective medium of exchange must
    A) be a good store of value.
    B) be a unit of account.
    C) exhibit low uncertainty over its value in trade.
    D) All of the above
    Answer: D

D1 Interpretive

25. If people lost confidence in the medium of exchange, the likely result would be
    A) inflation.
    B) increased barter activity.
    C) increased financial intermediation.
    D) no more transactions taking place.
    Answer: B

D2 Interpretive

26. The value of money ___________________ the price level.
    A) is the same as
    B) varies positively with
    C) varies inversely with
    D) none of the above
    Answer: C

D2 Interpretive

27. A rising price level causes
    A) reduced barter activity.
    B) consumers to shift from checking accounts to currency.
    C) a decrease in the money supply.
    D) a decrease in the value of money.
    Answer: D

D1 Interpretive

28. Money increases economic growth by facilitating transfers from
    A) savers to borrowers.
    B) the government to investors.
    C) investors to savers.
    D) investors to borrowers.
    Answer: A

D2 Interpretive

29. In a barter economy, the only way people can invest is if
    A) consumption is positive.
    B) there is inflation.
    C) they save by acquiring goods directly.
    D) money is introduced.
    Answer: C

D2 Interpretive

30. Financial markets increase the volume of saving and investment by
    A) storing large quantities of cash.
    B) reducing the velocity of money.
    C) providing savers a variety of ways to lend to borrowers.
    D) maintaining low interest rates.
    Answer: C

D1 Factual

31. Which of the following is not a financial institution?
    A) A mutual fund
    B) An insurance company
    C) A pension fund
    D) A mining company
    Answer: D

D2 Interpretive

32. The primary role of financial institutions is to
    A) regulate the money supply.
    B) transfer funds from investors to borrowers.
    C) package savings for transfer to borrowers.
    D) lend money to consumers.
    Answer: C

D1 Interpretive

33. When hyperinflation occurs,
    A) GDP falls to zero.
    B) interest rates fall.
    C) savings rates rise.
    D) money is a less effective medium of exchange.
    Answer: D

D2 Interpretive

34. When hyperinflation occurs, money becomes a less efficient medium of exchange because money ceases to be a reliable
    A) store of value.
    B) unit of account.
    C) investment.
    D) source of income.
    Answer: A

D1 Factual

35. Rising prices at a fast and furious pace is referred to as
    A) inflation.
    B) hyperinflation.
    C) deflation.
    D) a recession.
    Answer: B

D1 Factual

36. In the United States, currency is
    A) backed by gold.
    B) backed by silver.
    C) backed by nothing tangible.
    D) a liability on the books of commercial banks.
    Answer: C

D1 Factual

37. In the United States, money is backed by
    A) gold.
    B) gold and silver.
    C) gold, silver, and Federal Reserve notes.
    D) social convention and the legal system.
    Answer: D

D1 Factual

38. On a commercial bank's balance sheet, a checking account appears as
    A) a security.
    B) a liability.
    C) an asset.
    D) capital.
    Answer: B

D1 Interpretive

39. When commercial banks make loans, they
    A) increase bank capital.
    B) increase bank reserves.
    C) create checking account money.
    D) create new currency.
    Answer: C

D2 Factual

40. For a commercial bank, a new loan is
    A) a reserve.
    B) capital.
    C) a liability.
    D) an asset.
    Answer: D

D1 Factual

41. Bank ___________________ are in the form of vault cash and deposits with the central bank.
    A) assets
    B) liabilities
    C) capital
    D) reserves
    Answer: D

D1 Factual

42. A bank's excess reserves are equal to

A) total reserves minus required reserves.
B) demand deposits minus loans.
C) cash plus deposits at the central bank.
D) net worth.
Answer: A

D2 Factual

43. In the United States, the reserve requirement on demand deposits is approximately

A) 10 percent.
B) 20 percent.
C) 50 percent.
D) 90 percent.
Answer: A

D1 Interpretive

44. A bank can make new loans as long as it has

A) excess reserves.
B) required reserves.
C) reserves.
D) capital.
Answer: A

D2 Interpretive

45. A bank is fully loaned up when it has no

A) capital.
B) reserves.
C) excess reserves.
D) vault cash.
Answer: C

D2 Interpretive

46. A bank can create new money only when

A) its reserves fall below the amount required by the Federal Reserve.
B) it has excess reserves.
C) its has vault cash.
D) it is loaned up.
Answer: B

D2 Applied

47. Banks destroy money when they

A) lend securities.
B) sell securities.
C) buy securities.
D) purchase government bonds.
Answer: B

D2 Applied

48. Parker bank is fully loaned up. Which of the following is not an option Parker has to obtain additional reserves?

A) Call in loans
B) Buy securities
C) Sell securities
D) Borrow through the federal funds market
Answer: B

D1 Factual

49. The interest rate charged on overnight loans between banks is the

A) discount rate.
B) federal funds rate.
C) Treasury bill rate.
D) prime rate.
Answer: B

D2 Factual

50. Which of the following best describes the ideal quantity of money?

A) It equals the amount of spending.
B) It equals the level of GDP.
C) It equals the price level.
D) It stabilizes the price level while allowing full employment.
Answer: D

D2 Interpretive

51. Changes in the money supply have an immediate effect on an economy's

A) liquidity.
B) GDP.
C) price level.
D) employment.
Answer: A

D2 Interpretive

52. By altering people’s liquidity, an increase in the money supply relative to the demand for liquidity should lead to

A) more spending on real assets but not financial assets.
B) more spending on either real assets or financial assets.
C) more spending on financial assets but not on real assets.
D) no change in spending on either real or financial assets.
Answer: B

D2 Applied

53. If an increase in the money supply causes people to buy more financial assets,
    - A) securities prices go up, interest rates will fall, and spending on plant and equipment falls.
    - B) securities prices go up, interest rates will rise, and spending on plant and equipment falls.
    - C) securities prices go up, interest rates will fall, and spending on plant and equipment rises.
    - D) securities prices go up, interest rates will rise, and spending on plant and equipment rises.

    Answer: C

D2 Factual

54. The rate at which money turns over is the definition of
    - A) velocity.
    - B) liquidity.
    - C) GDP.
    - D) aggregate demand.

    Answer: A

D2 Interpretive

55. The velocity of money can be computed by
    - A) multiplying real GDP by the price level.
    - B) multiplying the price level by the money supply.
    - C) dividing GDP by the price level.
    - D) dividing GDP by the money supply.

    Answer: D

D2 Interpretive

56. Velocity is the relationship between a change in the money supply and the change in
    - A) the price level.
    - B) money demand.
    - C) real GDP.
    - D) GDP.

    Answer: D

D2 Interpretive

57. If a 5 percent increase in the money supply always leads to a 5 percent increase in nominal GDP, this indicates that
    - A) the price level is constant.
    - B) the economy is at full employment.
    - C) velocity is constant.
    - D) real GDP is constant.

    Answer: C

D2 Applied

58. Assume that nominal GDP is $2 trillion and the money supply is $400 billion. The velocity of money is __________________.
    A) $2.4 trillion
    B) $1.6 trillion
    C) 0.2
    D) 5.0
    Answer: D

D2 Applied

59. If the money supply is $1 trillion and the velocity of money is 5.0, nominal GDP is __________________.
    A) $200 billion
    B) $5 trillion
    C) $500 billion
    D) Cannot be determined from the information given
    Answer: B

D1 Interpretive

60. The velocity of money is determined by the
    A) Federal Reserve.
    B) banking system.
    C) U.S. Treasury.
    D) public.
    Answer: D

D2 Interpretive

61. The Federal Reserve cannot always control the level of total spending in the economy using monetary policy because it cannot control
    A) the money supply.
    B) velocity.
    C) total reserves.
    D) total bank lending.
    Answer: B

D3 Interpretive

62. Which of the following statements is incorrect?
    A) The flow of spending depends on the supply of money and the velocity of money.
    B) A higher level of GDP can be caused by higher prices or by increased production.
    C) The determinants of the velocity of money are well-known and can be easily influenced by the Fed.
    D) The Fed's main job is to regulate the flow of spending.
    Answer: C

D2 Interpretive

63. Changes in the money supply do not always cause predictable changes in the level of spending because

A) the velocity of money is not always constant.
B) the inflation rate varies.
C) the economy's proximity to full employment varies.
D) the saving rate varies.
Answer: A

D2 Factual

64. Hyperinflation is most likely when it is fueled by

A) ever-increasing levels of government spending.
B) declines in the velocity of money.
C) continuously rising money demand.
D) continuous increases in the money supply in ever-increasing volume.
Answer: D

D3 Applied

65. If inflation in a country consistently averages 3 percent a year, prices will double in

A) 3 years.
B) 72 years.
C) 24 years.
D) 36 years.
Answer: C

D2 Factual

66. During the 1930s, the money supply increased 35 percent while consumer prices

A) rose 70 percent.
B) also rose 35 percent.
C) were virtually unchanged.
D) fell 20 percent.
Answer: D

D2 Factual

67. During the 1980s, M1 doubled, and the price level increased about ___________________ percent.

A) 100
B) 60
C) 200
D) 300
Answer: B

D2 Interpretive

68. Increases in the money supply will not necessarily cause inflation if the increase in the money supply is offset by

A) a falling velocity of money.
B) a constant velocity of money.
C) falling GDP levels.
D) full employment.
Answer: A

D2 Interpretive

69. A necessary but not sufficient condition for the continuation of inflation is

A) an expanding money supply.
B) increasing government deficits.
C) rising interest rates.
D) decreasing velocity.
Answer: A

D2 Interpretive

70. If a country is experiencing hyperinflation, it is safe to assume that

A) the velocity of money has decreased.
B) the country has returned to a barter economy.
C) the country's money supply has risen rapidly.
D) real GDP in the country has fallen.
Answer: C

D2 Interpretive

71. In a recession, an increase in the money supply is likely to cause

A) some increase in interest rates.
B) some increase in output.
C) some increase in velocity.
D) an equal increase in inflation.
Answer: B

D2 Interpretive

72. An increase in the money supply is most likely to lead to rising prices when

A) velocity is declining.
B) money demand is rising.
C) supply and demand are equal.
D) the economy is producing under conditions of high employment.
Answer: D

D2 Interpretive

73. Which of the following is a possible cause of short-run inflation?

    A) A decrease in the money supply
    B) An increase in velocity
    C) An increase in output
    D) A decrease in velocity

    Answer: B

D2 Applied

74. The country of Zamula is currently experiencing conditions of full employment and capacity output. Which of the following is incorrect?

    A) Increases in the money supply by the central bank of Zamula become more and more likely to generate rising prices.
    B) Real economic growth in Zamula is likely to increase.
    C) Inflation will result in Zamula if the increase in the money supply is exactly large enough to provide funds for the enlarged volume of transactions.
    D) All of the above are true.

    Answer: C