# Practice Study Questions Chapter 15

Course: Macroeconomics: A Contemporary Introduction, 7e (McEachern) Instructor: Jonathan Fink

| Instructions: |
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1. The demand for money is depicted by a curve downward sloping curve because if the interest rate falls, the opportunity cost of holding assets in the form of money decreases.
   a. True
   b. False

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2. If the price level rises, the money demand curve will shift to the right.
   a. True
   b. False

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3. Speaking of the demand for money
   a. makes no sense in a modern society in which most people use credit cards
   b. makes no sense in a modern society in which most people use checks
   c. makes sense in a modern society in which most people use checks, since demand deposits are included in M1, but it does not make sense in a society in which the primary payment is by credit card
   d. makes sense in a modern society in which most people use credit cards, since credit cards are included in M1, but it does not make sense in a society in which the primary payment is by check
   e. is relevant even in a society in which primary payment is by credit card, since eventually all accounts must be settled with money

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4. The demand for money varies
   a. directly with both the price level and the level of real GDP
   b. inversely with both the price level and the level of real GDP
   c. inversely with the price level and directly with the level of real GDP
   d. directly with the price level and inversely with the level of real GDP
   e. inversely with the level of nominal GDP

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5. If the interest rate rises, people hold
   a. less money because its opportunity cost has increased
   b. more money because its opportunity cost has increased
   c. less money because its opportunity cost has declined
   d. more money because its opportunity cost has declined
   e. the same amount of money

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6. Which of the following, other things constant, will shift the money demand curve to the right?
   a. an increase in the interest rate
   b. a decrease in the interest rate
   c. an increase in real GDP
   d. a decrease in real GDP
   e. a decrease in the price level

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7. Which of the following, other things constant, will shift the money demand curve to the left?
   a. an increase in the interest rate
   b. a decrease in the interest rate
   c. a decrease in real GDP
   d. an increase in real GDP
   e. an increase in the price level

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8. Which of the following would cause a downward movement along the money demand curve?
   a. an increase in the interest rate
   b. a decrease in the interest rate
   c. a decrease in real GDP
   d. an increase in real GDP
   e. an increase in the price level

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9. If the money supply decreases, the opportunity cost of holding money __________ and people will want to hold __________ quantity of money.
   a. rises; a greater
   b. rises; a smaller
   c. does not change; the same
   d. falls; a greater
   e. falls; a smaller

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10. If the money supply increases, the interest rate will __________ and people will want to hold a __________ quantity of money.
    a. rise; greater
    b. rise; smaller
    c. not change; greater
    d. fall; greater
    e. fall; smaller

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11. The equilibrium interest rate is determined by
    a. the Fed
    b. Congress
    c. the demand for money alone
    d. the supply of money alone
    e. both the supply of and demand for money

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12. When an increase in the money supply reduces the interest rate, investment and nominal GDP increase.
    a. True
    b. False

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13. In a macroeconomic model, increases in the money supply decrease the interest rate, increase investment, and thus raise employment and real GDP.
    a. True
    b. False

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14. What is the effect of an expansionary monetary policy on the demand for investment curve?
    a. It causes the curve to shift left.
    b. It causes the curve to shift right.
    c. It causes downward movement along the curve.
    d. It causes an upward movement along the curve.
    e. It has no effect on the quantity of investment demanded.

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15. If the Fed decreases the money supply, causing the interest rate to rise, GDP
    a. increases by the same amount as the increase in the interest rate
    b. decreases by more than the increase in the interest rate because of the multiplier
    c. decreases by the same amount as the decrease in investment
    d. decreases by more than the decrease in investment because of the multiplier
    e. decreases by less than the decrease in investment because of the multiplier

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16. If the Fed decreases the money supply, GDP
    a. increases because the resulting increase in the interest rate leads to a decrease in investment
    b. increases because the resulting decrease in the interest rate leads to an increase in investment
    c. decreases because the resulting increase in the interest rate leads to a decrease in investment
    d. decreases because the resulting increase in the interest rate leads to an increase in investment
    e. decreases because the resulting decrease in the interest rate leads to an increase in investment

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17. If investment is *not* sensitive to changes in the interest rate, then changes in the money supply
    a. will have no effect on interest rates
    b. will have a major impact on investment
    c. will have no effect on aggregate demand
    d. will have a major impact on aggregate demand
    e. mean the money supply curve will not be vertical

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18. A decrease in the money supply causes interest rates to __________, investment spending to __________ and Gross Domestic Product to __________.
    a. fall; rise; fall
    b. fall; fall; rise
    c. rise; rise; rise
    d. rise; fall; fall
    e. rise; fall; rise

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19. If interest rates are __________ to changes in the money supply and planned investment expenditures are __________ to interest rate changes, then monetary policy will be effective in changing aggregate demand.
    a. responsive; sensitive
    b. responsive; insensitive
    c. not responsive; sensitive
    d. not responsive; insensitive
    e. none of the above

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20. If interest rates are __________ to changes in the money supply and planned investment expenditures are __________ to interest rate changes, then monetary policy will be ineffective in changing aggregate demand.
    a. responsive; sensitive
    b. responsive; insensitive
    c. not responsive; sensitive
    d. not responsive; insensitive
    e. none of the above

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21. When the short-run aggregate supply curve is steep, then for a given increase in aggregate demand,
    a. the increase in real GDP will be relatively small and the increase in the price level will be relatively large
    b. the increase in real GDP will be relatively large and the increase in the price level will be relatively small
    c. the increases in real GDP and the price level will be large
    d. the increases in real GDP and the price level will be small
    e. the decrease in real GDP will be larger than the decrease in the price level

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27. Suppose the economy is in long-run equilibrium at the level of potential output. What will be the long-run effect of an expansionary monetary policy?
    a. a higher price level
    b. a higher level of real output
    c. both a higher price level and a higher level of real output
    d. a lower price level
    e. a lower level of real output

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28. If the Fed expands the money supply, a short-run aggregate supply curve ___________ would yield the largest short-run increase in real GDP.
    a. that is vertical
    b. with a steep slope
    c. that coincides with the 45-degree line
    d. that is relatively flat
    e. that shifts leftward

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29. In an economy in which velocity is constant and the same level of real output is produced year after year, a slow increase in the money supply would result in a
    a. constant price level
    b. slowly increasing price level
    c. rapidly increasing price level
    d. slowly increasing real GDP
    e. rapidly increasing real GDP

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30. If the money supply is increasing at a constant 8 percent, velocity is constant, real GDP is increasing at 5 percent, and the inflation rate is 3 percent, which of the following is true?
    a. The growth rate of GDP is too low to be maintained.
    b. The inflation rate is too low to be maintained.
    c. Velocity is too low to be maintained.
    d. The money supply growth rate is too low to be maintained.
    e. This situation can continue indefinitely.

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31. If real output and velocity are stable and predictable, then the equation of exchange can be used to derive a simple relationship between
    a. the money supply and the price level
    b. the money supply and the interest rate
    c. the money supply and the foreign exchange rate
    d. velocity and real GDP
    e. velocity and nominal GDP

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32. The quantity theory of money
    a. states that fiscal policy plays an important role in determining economic activity
    b. states that the quantity of money in circulation determines aggregate spending
    c. argues that velocity is unpredictable
    d. states that the quantity of money in circulation determines only the price level in the long run
    e. states that the quantity of money in circulation determines only real spending in the short run

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33. Which of the following statements best describes the historical relationship between increases in the money supply (M1) and inflation in the U.S.?
    a. All three major episodes of inflation since 1914 were preceded and accompanied by an increase in the growth rate of M1.
    b. There is no strong evidence of any relationship between inflation and increases in the money supply in the 20th century.
    c. Since the formation of the Fed in 1914, there have been no significant periods of inflation
    d. In all three major episodes of inflation since 1914, increases in the growth rate of M1 occurred *after* the inflation subsided.
    e. There were significant periods of inflation during each decade of the 20th century and each was preceded and accompanied by an increase in the growth rate of M1.

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34. Economic theory suggests that
    a. increases in the money supply lead to increases in the inflation rate
    b. a higher price level leads to a higher inflation rate
    c. rapid growth in the money supply leads to rapid growth in the price level
    d. the inflation rate always increases whenever the money supply increases
    e. the inflation rate always decreases whenever the money supply increases

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35. Which of the following would cause an increase in the velocity of money?
    a. increased use of credit cards
    b. an increase in the money supply
    c. an increase in demand for money
    d. a decrease in interest rates
    e. a decrease in nominal GDP and a constant money supply

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36. Velocity will be higher
    a. the less frequently workers are paid
    b. the fewer transactions there are to make
    c. the less effective money is as a store of value
    d. the less people use credit cards to make purchases
    e. the slower the physical transportation of money between one person and another

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37. In the United States over the last decade, the velocity of
    a. M1 has been more stable than the velocity of M2, possibly because of the deregulation of the interest paid on checkable deposits
    b. M1 has been more stable than the velocity of M2, leading the Fed to rely more on M1 targets
    c. M2 has been more stable than the velocity of M1, but the Fed still relies on M1 targets
    d. M2 has been more stable than the velocity of M1, possibly because of the deregulation of the interest paid on checkable deposits
    e. both c and d are true

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38. The velocity of M1 money has moved erratically in the past several years because
    a. of low and stable rates of inflation
    b. of regulatory changes allowing banks to pay interest on checkable deposits
    c. interest rates have been stable
    d. monetary policy has been highly erratic
    e. a large number of banks and savings and loan associations have gone bankrupt

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39. Suppose the money demand curve shifts rightward. Which of the following is true about the Fed's options?
    a. The Fed can keep the interest rate from rising only if it increases the money supply.
    b. The Fed cannot prevent the interest rate from rising.
    c. The Fed can prevent the interest rate from rising without changing the money supply.
    d. If the Fed expands the money supply, the interest rate will rise even further.
    e. The Fed should reduce the money supply if it wishes to prevent the interest rate from rising.

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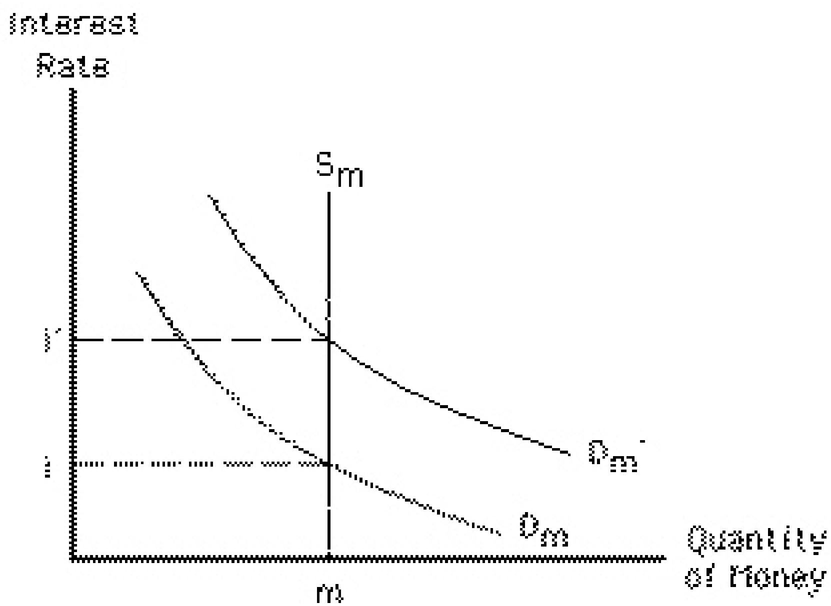
40. **Exhibit 15-4**




If the Fed is *targeting interest rates* and money demand shifts from $D_m$ to $D_m$' in Exhibit 15-4, the Fed will

a. do nothing and the interest rate will rise to i'

b. do nothing and the interest rate will settle at i

c. decrease the money supply to restore its target of i

d. increase the money supply to restore its target of i

e. decrease money demand back to $D_m$ to restore its target of i

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ANSWER KEY

| Quesion # | Answer |
| --- | --- |
| 1 | a |
| 2 | a |
| 3 | e |
| 4 | a |
| 5 | a |
| 6 | c |
| 7 | c |
| 8 | b |
| 9 | b |
| 10 | d |
| 11 | e |
| 12 | a |
| 13 | a |
| 14 | c |
| 15 | d |
| 16 | c |
| 17 | c |
| 18 | d |
| 19 | a |
| 20 | d |
| 21 | a |
| 22 | b |
| 23 | d |
| 24 | e |
| 25 | b |
| 26 | a |
| 27 | a |
| 28 | d |
| 29 | b |
| 30 | e |
| 31 | a |
| 32 | d |
| 33 | a |
| 34 | c |
| 35 | a |

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ANSWER KEY

| Quesion # | Answer |
|---|---|
| 36 | c |
| 37 | d |
| 38 | b |
| 39 | a |
| 40 | d |

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