

Principles of Money, Banking, and Financial Markets, 12e (Ritter / Silber / Udell)
Chapter 2 The Role of Money in the Macroeconomy

2.1 Introducing Money

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

Diff: 2

Skill: Interpretive

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

Diff: 1

Skill: Applied

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

Diff: 1

Skill: Factual

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

Diff: 1

Skill: Interpretive

- 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

Diff: 1

Skill: 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

Diff: 1

Skill: Factual

- 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

Diff: 2

Skill: 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

Diff: 2

Skill: 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

Diff: 2

Skill: Applied

10) Noninterest-bearing checking accounts are known as

- A) demand deposits.
- B) NOW accounts.
- C) money market deposit accounts.
- D) money market mutual funds.

Answer: A

Diff: 2

11) 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

Diff: 2

Skill: Factual

12) 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

Diff: 3

Skill: Factual

13) 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

Diff: 2

Skill: Factual

14) 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

Diff: 2

Skill: Factual

15) 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

Diff: 3

Skill: Factual

16) 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

Diff: 3

Skill: Factual

17) 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

Diff: 2

Skill: Interpretive

18) _____ is the narrowest and most traditional definition of money.

- A) M1
- B) M2
- C) M3
- D) M4

Answer: A

Diff: 1

Skill: Factual

19) 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

Diff: 1

Skill: Applied

20) 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

Diff: 1

Skill: Factual

21) 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

Diff: 2

Skill: Applied

22) The Federal Reserve satisfies the public's demand for currency by

- A) printing paper bills.
- 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

Diff: 2

Skill: Interpretive

23) 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

Diff: 1

Skill: Factual

24) 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

Diff: 2

Skill: Interpretive

- 25) 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

Diff: 1

Skill: Factual

- 26) 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

Diff: 1

Skill: Interpretive

- 27) 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

Diff: 2

Skill: Interpretive

- 28) A rising price level (inflation) 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

Diff: 2

Skill: Interpretive

- 29) 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

Diff: 1

Skill: Interpretive

30) 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

Diff: 2

Skill: Interpretive

31) 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

Diff: 2

Skill: Interpretive

32) 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

Diff: 1

Skill: Factual

33) 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

Diff: 2

Skill: Interpretive

34) 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

Diff: 1

Skill: Interpretive

35) 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

Diff: 2

Skill: Interpretive

36) Rising prices at a fast and furious pace is referred to as

- A) inflation.
- B) hyperinflation.
- C) deflation.
- D) a recession.

Answer: B

Diff: 1

Skill: Factual

37) Deflation is another word for

- A) falling prices.
- B) hyperinflation.
- C) recession.
- D) depression.

Answer: A

Diff: 1

2.2 Money, the Economy, and Inflation

1) 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

Diff: 1

Skill: Factual

2) 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

Diff: 1

Skill: Factual

3) 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

Diff: 1

Skill: Factual

4) 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

Diff: 1

Skill: Interpretive

5) For a commercial bank, a new loan is

- A) a reserve.
- B) capital.
- C) a liability.
- D) an asset.

Answer: D

Diff: 2

Skill: Factual

6) Bank _____ must be held in the form of vault cash and deposits with the central bank.

- A) assets
- B) liabilities
- C) capital
- D) reserves

Answer: D

Diff: 1

Skill: Factual

7) 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

Diff: 1

Skill: Factual

8) 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

Diff: 2

Skill: Factual

9) A bank can make new loans as long as it has

- A) excess reserves.
- B) required reserves.
- C) reserves.
- D) capital.

Answer: A

Diff: 1

Skill: Interpretive

10) A bank is fully loaned up when it has no

- A) capital.
- B) reserves.
- C) excess reserves.
- D) vault cash.

Answer: C

Diff: 2

Skill: Interpretive

11) 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

Diff: 2

Skill: Interpretive

12) Banks destroy money when they

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

Answer: B

Diff: 2

Skill: Applied

13) 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

Diff: 2

Skill: Applied

14) 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

Diff: 1

Skill: Factual

15) 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 prices while allowing a high level of employment.

Answer: D

Diff: 2

Skill: Factual

16) Changes in the money supply have an immediate effect on an economy's

- A) liquidity.
- B) GDP.
- C) price level.
- D) employment.

Answer: A

Diff: 2

Skill: Interpretive

17) 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

Diff: 2

Skill: Interpretive

- 18) 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

Diff: 2

Skill: Applied

- 19) The rate at which money turns over is the definition of

- A) velocity.
B) liquidity.
C) GDP.
D) aggregate demand.

Answer: A

Diff: 2

Skill: Factual

- 20) 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

Diff: 2

Skill: Interpretive

- 21) 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

Diff: 2

Skill: Interpretive

- 22) 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

Diff: 2

Skill: Interpretive

23) 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

Diff: 2

Skill: Applied

24) 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

Diff: 2

Skill: Applied

25) 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

Diff: 2

Skill: Interpretive

26) 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

Diff: 3

Skill: Interpretive

27) 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

Diff: 2

Skill: Interpretive

28) 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

Diff: 2

Skill: Factual

29) 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

Diff: 3

Skill: Applied

30) 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

Diff: 2

Skill: Factual

31) During the 1980s, M1 doubled, and the price level increased about _____ percent.

- A) 100
- B) 60
- C) 200
- D) 300

Answer: B

Diff: 2

Skill: Factual

32) 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

Diff: 2

Skill: Interpretive

33) 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

Diff: 2

Skill: Interpretive

34) 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

Diff: 2

Skill: Interpretive

35) 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

Diff: 2

Skill: Interpretive

36) 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

Diff: 2

Skill: Interpretive

37) 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

Diff: 2

Skill: Interpretive

38) 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

Diff: 2

Skill: Applied