Chapter 11

MONEY, INTEREST, REAL GDP, AND THE PRICE LEVEL*

The Demand for Money

Topic: Influences on Money Holding
Skill: Recognition
1) The quantity of money that people choose to hold depends on which of the following?
   I. The price level.
   II. Financial innovation.
   III. The exchange rate.
   A) I.
   B) I and II.
   C) I and III.
   D) I, II, and III.
   Answer: B

Topic: Influences on Money Holding, The Price Level
Skill: Conceptual
2) The nominal demand for money is
   A) inversely related to GDP.
   B) measured in constant dollars.
   C) inversely related to the price level.
   D) proportional to the price level.
   Answer: D

Topic: Influences on Money Holding, The Price Level
Skill: Conceptual
3) If the price level doubles, the
   A) nominal demand for money increases.
   B) nominal demand for money decreases.
   C) real demand for money decreases.
   D) real demand for money increases.
   Answer: A

Topic: Influences on Money Holding, The Price Level
Skill: Recognition
4) Suppose you hold $50 to buy groceries weekly and then the price of groceries increases by 5 percent. To be able to buy the same amount of groceries, what must happen to your nominal money holdings?
   A) They must increase by $5.
   B) They can decrease by $5.
   C) They must increase by $2.50.
   D) They must increase, but the amount of the increase is different than the above answers.
   Answer: C

Topic: Influences on Money Holding, The Price Level
Skill: Recognition
5) The real quantity of money is
   A) inversely related to GDP.
   B) measured in current dollars.
   C) inversely related to the price level.
   D) measured in constant dollars.
   Answer: D

Topic: Influences on Money Holding, The Interest Rate
Skill: Recognition
6) The opportunity cost of holding money is the
   A) interest rate.
   B) price of goods and services.
   C) level of wage and rental income.
   D) ease with which an asset can become money.
   Answer: A

* This is Chapter 27 in Economics.
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**Topic: Influences on Money Holding, The Interest Rate**
**Skill: Conceptual**

7) The opportunity cost of holding money balances increases when
   A) the purchasing power of money rises.
   B) the interest rate rises.
   C) the price of goods and services falls.
   D) consumers’ incomes increase.

   **Answer: B**

**Topic: Influences on Money Holding, The Interest Rate**
**Skill: Conceptual**

8) When the interest rate rises, the quantity of money demanded decreases because
   A) people will buy fewer goods and hold less money.
   B) the price level also rises and people decrease their demand for money.
   C) people move funds from interest-bearing assets into money.
   D) people shift funds from money holdings to interest-bearing assets.

   **Answer: D**

**Topic: Influences on Money Holding, Real GDP**
**Skill: Conceptual**

9) Which of the following is correct? The demand for money
   A) increases as real GDP increases.
   B) decreases as the price level increases.
   C) depends on the quantity of money.
   D) increases when the interest rate increases.

   **Answer: A**

**Topic: Influences on Money Holding, Financial Innovation**
**Skill: Conceptual**

11) All of the following are examples of financial innovations that have decreased the demand for money EXCEPT
   A) inflation.
   B) ATM machines.
   C) credit cards.
   D) automatic transfers between deposits.

   **Answer: A**

**Topic: The Demand for Money Curve**
**Skill: Recognition**

12) The graph of the demand for money curve has
   A) real GDP on the y-axis.
   B) consumption on the y-axis.
   C) the interest rate on the y-axis.
   D) the price level on the y-axis.

   **Answer: C**

**Topic: The Demand for Money Curve**
**Skill: Recognition**

13) The demand for money curve
   A) is horizontal.
   B) has a positive slope.
   C) is vertical.
   D) has a negative slope.

   **Answer: D**

**Topic: Influences on Money Holding**
**Skill: Conceptual**

10) ____ real GDP increases the demand for money and ____ the interest rate decreases the quantity of money demanded.
   A) Increasing; increasing
   B) Increasing; decreasing
   C) Decreasing; increasing
   D) Decreasing; decreasing

   **Answer: A**
14) Use the figure above to answer this question. Suppose the economy is operating at point \( a \). A move to ____ could be explained by ____.

A) point \( e \); a decrease in the interest rate
B) point \( c \); an increase in the interest rate
C) point \( d \); an increase in real GDP
D) point \( b \); an increase in real GDP

Answer: C

15) Use the figure above to answer this question. Suppose the economy is operating at point \( a \). A move to ____ could be explained by ____.

A) point \( c \); an increase in the use of credit cards
B) point \( b \); an increase in real GDP
C) point \( b \); an increase in interest rates
D) point \( e \); an increase in U.S. exports

Answer: D

16) In the above figure, suppose the economy is initially on the demand for money curve \( MD_1 \). What is the effect of a fall in the interest rate?

A) The demand for money curve would shift rightward to \( MD_2 \)
B) The demand for money curve would shift leftward to \( MD_0 \)
C) There would be a movement upward along the demand for money curve \( MD_1 \)
D) There would be a movement downward along the demand for money curve \( MD_1 \)

Answer: D

17) In the above figure, suppose the economy is initially on the demand for money curve \( MD_1 \). What is the effect of a rise in the interest rate?

A) The demand for money curve would shift rightward to \( MD_2 \)
B) The demand for money curve would shift leftward to \( MD_0 \)
C) There would be a movement upward along the demand for money curve \( MD_1 \)
D) There would be a movement downward along the demand for money curve \( MD_1 \)

Answer: C
18) In the above figure, suppose the economy is initially on the demand for money curve $MD_1$. What is the effect of an increase in real GDP?
A) The demand for money curve would shift rightward to $MD_2$.
B) The demand for money curve would shift leftward to $MD_0$.
C) There would be a movement upward along the demand for money curve $MD_1$.
D) There would be a movement downward along the demand for money curve $MD_1$.

Answer: A

19) In the above figure, suppose the economy is initially on the demand for money curve $MD_1$. What is the effect of an increase in financial innovation such as the introduction of ATMs?
A) The demand for money curve would shift rightward to $MD_2$.
B) The demand for money curve would shift leftward to $MD_0$.
C) There would be a movement upward along the demand for money curve $MD_1$.
D) There would be a movement downward along the demand for money curve $MD_1$.

Answer: B

20) In the above figure, suppose the economy is initially on the demand for money curve $MD_1$. What is the effect of increased use of credit cards?
A) The demand for money curve would shift rightward to $MD_2$.
B) The demand for money curve would shift leftward to $MD_0$.
C) There would be a movement upward along the demand for money curve $MD_1$.
D) There would be a movement downward along the demand for money curve $MD_1$.

Answer: B

21) If a $500 bond promises to pay $75 a year, the interest rate is
A) 10 percent.
B) 7.5 percent.
C) 15 percent.
D) 50 percent.

Answer: C

22) If a $750 bond promises to pay $30 a year, the interest rate is
A) 4 percent.
B) 20 percent.
C) 30 percent.
D) 40 percent.

Answer: A

23) Bond prices and interest rates are
A) positively related.
B) inversely related.
C) unrelated.
D) independent of Fed action.

Answer: B

24) If bond prices fall,
A) interest rates rise.
B) interest rates fall.
C) bank reserves grow.
D) households increase cash holdings.

Answer: A

25) On a given day the quantity of money is _____ and the supply of money curve is _____.
A) fixed; horizontal
B) fixed; vertical
C) variable; horizontal
D) variable; vertical

Answer: B
26) In the figure above, the Fed's increasing the monetary base would create a change such as
A) a movement from point $a$ to point $b$ along the supply of money curve $MS_0$.
B) a movement from point $b$ to point $a$ along the supply of money curve $MS_0$.
C) a shift from the supply of money curve $MS_0$ to the supply of money curve $MS_1$.
D) a shift from the supply of money curve $MS_1$ to the supply of money curve $MS_0$.

Answer: C

27) In the figure above, the Fed's decreasing the monetary base would create a change such as
A) a movement from point $a$ to point $b$ along the supply of money curve $MS_0$.
B) a movement from point $b$ to point $a$ along the supply of money curve $MS_0$.
C) a shift from the supply of money curve $MS_0$ to the supply of money curve $MS_1$.
D) a shift from the supply of money curve $MS_1$ to the supply of money curve $MS_0$.

Answer: D

28) In the figure above, the Fed's raising the required reserve ratio would create a change such as
A) a movement from point $a$ to point $b$ along the supply of money curve $MS_0$.
B) a movement from point $b$ to point $a$ along the supply of money curve $MS_0$.
C) a shift from the supply of money curve $MS_0$ to the supply of money curve $MS_1$.
D) a shift from the supply of money curve $MS_1$ to the supply of money curve $MS_0$.

Answer: D

29) In the figure above, the Fed's lowering the required reserve ratio would create a change such as
A) a movement from point $a$ to point $b$ along the supply of money curve $MS_0$.
B) a movement from point $b$ to point $a$ along the supply of money curve $MS_0$.
C) a shift from the supply of money curve $MS_0$ to the supply of money curve $MS_1$.
D) a shift from the supply of money curve $MS_1$ to the supply of money curve $MS_0$.

Answer: C

30) Suppose that the interest rate is greater than the equilibrium interest rate. Which of the following occurs?
I. There is an excess quantity of money.
II. The quantity of money automatically increases.
III. People start buying bonds.
A) I.
B) I and II.
C) I and III.
D) I, II and III.

Answer: C
Topic: Money Market Equilibrium  
Skill: Analytical  
31) In the figure above, if the interest rate is 8 percent, people demand $0.1 trillion  
A) less money than the quantity supplied and the interest rate will rise.  
B) less money than the quantity supplied and the interest rate will fall.  
C) more money than the quantity supplied and the interest rate will fall.  
D) more money than the quantity supplied and the interest rate will rise.  
Answer: B  

32) In the figure above, if the interest rate is 8 percent, people demand $0.1 trillion  
A) less money than the quantity supplied and bond prices will rise.  
B) less money than the quantity supplied and bond prices will fall.  
C) more money than the quantity supplied and bond prices will fall.  
D) more money than the quantity supplied and bond prices will rise.  
Answer: A  

33) In the figure above, if the interest rate is 4 percent, there is a $0.1 trillion excess  
A) quantity of money and the interest rate will rise.  
B) quantity of money and the interest rate will fall.  
C) demand for money and the interest rate will fall.  
D) demand for money and the interest rate will rise.  
Answer: D  

34) In the figure above, if the interest rate is 4 percent, there is a $0.1 trillion excess  
A) quantity of money and bond prices will rise.  
B) quantity of money and bond prices will fall.  
C) demand for money and bond prices will fall.  
D) demand for money and bond prices will rise.  
Answer: C  

35) In the figure above, if the interest rate is 6 percent,  
A) there is a $0.1 trillion excess quantity of money and the interest rate will rise.  
B) there is a $0.1 trillion excess quantity of money and the interest rate will fall.  
C) the money market is in equilibrium and the interest rate will remain constant.  
D) there is a $0.1 trillion excess demand for money and the interest rate will rise.  
Answer: C  

Topic: Changing the Interest Rate  
Skill: Conceptual  
36) Which of the following actions raise the interest rate?  
A) A decrease in the demand for money.  
B) An increase in bond prices.  
C) An increase in the quantity of money.  
D) An increase in the demand for money.  
Answer: D
37) Which of the following actions lower the interest rate?
   A) A decrease in the demand for money.
   B) An increase in the demand for money.
   C) A decrease in the quantity of money.
   D) A decrease in bond prices.
   Answer: A

38) The figure above illustrates the effect of
   A) an increase in real GDP.
   B) a decrease in real GDP.
   C) an open market purchase by the Fed of government securities.
   D) an open market sale by the Fed of government securities.
   Answer: B

39) The figure above illustrates the effect of
   A) an increase in real GDP.
   B) a decrease in real GDP.
   C) an open market purchase by the Fed of government securities.
   D) an open market sale by the Fed of government securities.
   Answer: B

40) Which of the following would raise the interest rate?
   A) An increase in the quantity of money.
   B) A decrease in the quantity of money.
   C) A decrease in the demand for money.
   D) A decrease in real GDP.
   Answer: B

41) Which of the following would increase the interest rate?
   A) An increase in the quantity of money.
   B) An open market purchase of government securities by the Fed.
   C) The Fed lowering the required reserve ratio.
   D) An increase in real GDP.
   Answer: D
42) Which of the following would lower the interest rate?
A) A decrease in the quantity of money.
B) An increase in the price level.
C) The Fed lowering the required reserve ratio.
D) An increase in real GDP.
Answer: C

43) If the Fed carries out an open market operation and buys U.S. government securities, the interest rate
A) falls and the quantity of money increases.
B) rises and the quantity of money increases.
C) falls and the quantity of money decreases.
D) rises and the quantity of money decreases.
Answer: A

44) If the Fed carries out an open market operation and sells U.S. government securities, the interest rate
A) falls and the quantity of money increases.
B) rises and the quantity of money increases.
C) falls and the quantity of money decreases.
D) rises and the quantity of money decreases.
Answer: D

45) The figure above illustrates the effect of
A) an increase in real GDP.
B) a decrease in real GDP.
C) a Fed open market purchase of government securities.
D) a Fed open market sale of government securities.
Answer: D
Short-Run Effects of Money on Real GDP and the Price Level

Topic: The Ripple Effects of Monetary Policy
Skill: Recognition
49) If the Fed decreases the interest rate, then
A) investment and consumption expenditure decrease.
B) the price of the dollar rises on the foreign exchange market and so net exports decrease.
C) a multiplier process that affects aggregate demand occurs.
D) All of the above answers are correct.
Answer: C

Topic: The Ripple Effects of Monetary Policy
Skill: Conceptual
50) When the Fed sells securities in the open market,
A) net exports increase.
B) the value of the dollar falls on the foreign exchange market.
C) the value of the dollar rises on the foreign exchange market.
D) consumption increases.
Answer: C

Topic: The Ripple Effects of Monetary Policy
Skill: Conceptual*
51) If the Fed decreases the quantity of money so that the exchange rate value of the dollar rises, then imports ____ and exports ____.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: B

Topic: The Ripple Effects of Monetary Policy
Skill: Conceptual*
52) If the Fed increases the quantity of money so that the exchange rate value of the dollar falls, then imports ____ and exports ____.
A) increase; increase
B) increase; decrease
C) decrease; increase
D) decrease; decrease
Answer: C
53) If the U.S. interest rate rises, the exchange rate value of the dollar ____ and net exports ____.
   A) rises; increase
   B) rises; decrease
   C) falls; increase
   D) falls; decrease
   Answer: B

54) If the Fed chose to slow monetary growth, one would see a
   A) fall in the interest rate and a decrease in the real quantity of money.
   B) fall in the interest rate and an increase in the real quantity of money.
   C) rise in the interest rate and a decrease in the real quantity of money.
   D) rise in the interest rate and an increase in the real quantity of money.
   Answer: C

55) When the Fed decreases the quantity of money,
   A) interest rates fall, consumption, investment and net exports increase, and the aggregate demand curve shifts rightward.
   B) interest rates fall, consumption, investment and net exports decrease, and the aggregate demand curve shifts leftward.
   C) interest rates rise, consumption, investment and net exports decrease, and the aggregate demand curve shifts leftward.
   D) interest rates rise, consumption, investment and net exports increase, and the aggregate demand curve shifts rightward.
   Answer: C

56) When the Fed increases the quantity of money,
   A) consumption expenditures decrease.
   B) the dollar increases in value on foreign exchange markets.
   C) net exports decrease.
   D) investment expenditures increase.
   Answer: D

57) In an AS/AD figure, the first effect of an increase in the quantity of money is to shift the
   A) AD curve leftward.
   B) AD curve rightward.
   C) long-run AS curve leftward.
   D) long-run AS curve rightward.
   Answer: B

58) In the short run, if the quantity of money decreases then
   A) aggregate demand will increase.
   B) aggregate demand will decrease.
   C) long-run aggregate supply will increase.
   D) long-run aggregate supply will decrease.
   Answer: B

59) In the short run, a decrease in the quantity of money
   A) shifts the long-run aggregate supply curve rightward.
   B) shifts the long-run aggregate supply curve leftward.
   C) shifts the aggregate demand curve rightward.
   D) shifts the aggregate demand curve leftward.
   Answer: D

60) If the Fed lowers the interest rate, the first effect in an AS/AD figure is a _____ shift of the _____ curve.
   A) rightward; AD
   B) leftward; AD
   C) rightward; SAS
   D) leftward; SAS
   Answer: A
MONEY, INTEREST, REAL GDP, AND THE PRICE LEVEL

61) In the short-run, an increase in the quantity of money will shift the _____ curve _____ and _____ real GDP.
   A) aggregate demand; leftward; decreases
   B) aggregate demand; rightward; increases
   C) aggregate supply; rightward; increases
   D) aggregate demand; leftward; increases
   Answer: B

62) The short-run effect of an increase in the quantity of money
   A) raises the price level and increases real GDP.
   B) raises the price level and decreases real GDP.
   C) lowers the price level and increases real GDP.
   D) lowers the price level and decreases real GDP.
   Answer: A

63) In the short run, an increase in the quantity of money ____ real GDP and ____ the price level.
   A) increases; raises
   B) does not change; lowers
   C) decreases; raises
   D) decreases; lowers
   Answer: A

64) Suppose the economy is in a recession and the Fed increases the quantity of money. Then in the short-run
   A) real GDP and the price level will both decrease.
   B) real GDP will increase and the price level will decrease.
   C) real GDP will decrease and the price level will increase.
   D) real GDP and the price level will both increase.
   Answer: D

65) In order to combat a recession, the Fed will ____ the quantity of money and ____ the interest rate.
   A) increase; raise
   B) increase; lower
   C) decrease; raise
   D) decrease; lower
   Answer: B

66) In response to an inflationary gap, the Fed
   A) waits until the price level falls before acting.
   B) increases the quantity of money supply buying U.S. government securities.
   C) decreases the quantity of money by selling U.S. government securities.
   D) decreases the quantity of money by buying U.S. government securities.
   Answer: C

67) In the short run, the Fed’s actions to fight inflation shift the
   A) aggregate demand curve rightward.
   B) aggregate demand curve leftward.
   C) short-run aggregate supply curve rightward.
   D) short-run aggregate supply curve leftward.
   Answer: B

68) If the Fed raises the interest rate, the first effect in an AS/AD figure is a ____ shift of the ____ curve.
   A) rightward; AD
   B) leftward; AD
   C) rightward; SAS
   D) leftward; SAS
   Answer: B

69) The short-run effect of a decrease in the quantity of money
   A) raises the price level and increases real GDP.
   B) raises the price level and decreases real GDP.
   C) lowers the price level and increases real GDP.
   D) lowers the price level and decreases real GDP.
   Answer: D
Topic: Fed Tightens to Fight Inflation
Skill: Conceptual
70) According to the AS/AD model, in the short run a decrease in the quantity of money will
A) decrease the equilibrium price level and decrease equilibrium output.
B) increase the equilibrium price level and decrease equilibrium output.
C) decrease the equilibrium price level but leave equilibrium output unchanged.
D) decrease equilibrium output but leave the equilibrium price level unchanged.

Answer: A

Long-Run Effects of Money on Real GDP and the Price Level

Topic: The Long-Run Effects of a Change in the Quantity of Money
Skill: Conceptual
71) Real GDP equals potential GDP and the quantity of money decreases. In the long run, the decrease in the quantity of money
A) increases real GDP.
B) decreases real GDP.
C) lowers the price level.
D) raises the price level.

Answer: C

Topic: The Long-Run Effects of a Change in the Quantity of Money
Skill: Conceptual
72) The long-run effect of a decrease in the quantity of money decreases
A) the price level.
B) potential GDP.
C) the natural rate of unemployment.
D) real wages.

Answer: A

Topic: The Long-Run Effects of a Change in the Quantity of Money
Skill: Conceptual
73) In the long run, an increase in the quantity of money ____ real GDP and ____ the price level.
A) increases; raises
B) does not change; raises
C) decreases; raises
D) decreases; lowers

Answer: B

Topic: The Short-Run Effects of a Change in the Quantity of Money
Skill: Analytical
74) In the figure above, the graph that depicts only the short-run effect of a decrease in the quantity of money is
A) Figure A.
B) Figure B.
C) Figure C.
D) Figure D.

Answer: B

Topic: The Long-Run Effects of a Change in the Quantity of Money
Skill: Analytical
75) In the figure above, the graph that best depicts the long-run effects of an increase in the quantity of money is
A) Figure A.
B) Figure B.
C) Figure C.
D) Figure D.

Answer: C
**Topic: The Short-Run Effects of a Change in the Quantity of Money**

**Skill: Analytical**

76) In the figure above, the graph that depicts only the short-run effect of an increase in the quantity of money is

A) Figure A.
B) Figure B.
C) Figure C.
D) Figure D.

**Answer: A**

**Topic: Effects of a Change in the Quantity of Money**

**Skill: Analytical**

77) In the figure above, the graph that best depicts the short-run effects of an increase in the quantity of money is ____ and the figure that best represents the long-run effects of an increase in the quantity of money is ____.

A) Figure A; Figure B
B) Figure A; Figure C
C) Figure B; Figure D
D) Figure D; Figure B

**Answer: B**

**Topic: Effects of a Change in the Quantity of Money**

**Skill: Analytical**

78) In the figure above, Figure A depicts the short-run effects of ____ in the quantity of money and Figure B depicts the short-run effects of ____ in the quantity of money.

A) an increase; an increase
B) no change; an increase
C) an increase; no change
D) an increase; a decrease

**Answer: D**

**Topic: The Short-Run Effects of a Change in the Quantity of Money**

**Skill: Analytical**

79) In the above figure, if the economy is initially at point a, the short-run effect of an increase in the quantity of money is given by movement from point

A) a to point b, increasing output and the unemployment rate.
B) a to point b, increasing output and decreasing the unemployment rate.
C) a to point d, decreasing output and increasing the unemployment rate.
D) a to point c, keeping output and the unemployment rate constant.

**Answer: B**

**Topic: The Short-Run Effects of a Change in the Quantity of Money**

**Skill: Analytical**

80) In the above figure, if the economy is initially at point c, the short-run effect of a decrease in the quantity of money is given by movement from point

A) c to point d, decreasing output and increasing the unemployment rate.
B) c to point d, increasing output and decreasing the unemployment rate.
C) c to point b, increasing output and decreasing the unemployment rate.
D) c to point a, keeping output and the unemployment rate constant.

**Answer: A**
81) In the above figure, if the economy is initially at point \( a \), the long-run effect of an increase in the quantity of money is given by movement from point

A) \( a \) to point \( b \), increasing output and decreasing the unemployment rate.
B) \( a \) to point \( c \), increasing output and decreasing the unemployment rate.
C) \( a \) to point \( d \), decreasing output and increasing the unemployment rate.
D) \( a \) to point \( c \), keeping output and the unemployment rate constant.

**Answer: D**

82) In the above figure, if the economy is initially at point \( c \), the long-run effect of a decrease in the quantity of money is given by movement from point

A) \( c \) to point \( d \), decreasing output and increasing the unemployment rate.
B) \( c \) to point \( b \), increasing output and decreasing the unemployment rate.
C) \( c \) to point \( d \), decreasing output and the unemployment rate.
D) \( c \) to point \( a \), keeping output and the unemployment rate constant.

**Answer: D**

83) Which of the following equations represents the quantity theory of money?

A) \( PM = VQ \)
B) \( MQ = PV \)
C) \( MV = PQ \)
D) \( M = VP/Q \)

**Answer: C**

84) The velocity of circulation is

A) the rate of change of the GDP deflator.
B) the average number of times a dollar of money is used in a year to buy goods and services in GDP.
C) the changes in the purchasing power of money over a given time period.
D) constant.

**Answer: B**

85) In the quantity theory of money, the velocity of circulation is assumed to

A) be not influenced by the quantity of money.
B) rise during recessions.
C) fall during recessions.
D) be unrelated to the equation of exchange.

**Answer: A**

86) According to the quantity theory of money,

A) \( V \) and \( M \) are constant.
B) \( V \) and \( Y \) are not affected by the quantity of money.
C) \( V \) and \( P \) are not affected by the quantity of money.
D) \( V \) and \( M \) are not affected by changes in the price level.

**Answer: B**

87) The quantity theory of money predicts how changes in

A) the price level affect nominal GDP.
B) the price level affect real GDP.
C) the quantity of money affect the price level.
D) real GDP affect the nominal GDP.

**Answer: C**
88) The quantity theory of money addresses the long-run effect the quantity of money has on the price level. 

- A) determinants of potential GDP.
- B) determinants of the equilibrium unemployment rate.
- C) short-run effect the quantity of money has on the price level.

Answer: A

89) An increase in the quantity of money leads to a proportional increase in the price level according to the

- A) equation of exchange.
- B) short-run AS/AD model.
- C) quantity theory of money.
- D) short-run theory of inflation.

Answer: C

90) The quantity theory of money asserts that sustained increases in the price level are caused by sustained increases in

- A) the quantity of money.
- B) potential GDP.
- C) the natural rate of unemployment.
- D) money wages.

Answer: A

91) The quantity theory of money asserts that an increase in the quantity of money

- A) will decrease the price level by an offsetting amount.
- B) by n percent will lead to an increase in the price level by n + 1 percent.
- C) will lead to an equal percentage increase in real GDP.
- D) will lead to an equal percentage increase in the price level.

Answer: D

92) The quantity theory of money argues that, in the long run, the percentage change in money will equal the percentage change in

- A) velocity.
- B) real GDP.
- C) potential GDP.
- D) the price level.

Answer: D

93) The quantity theory of money predicts that

- A) in the long run, a 10 percent increase in the quantity of money leads to a 10 percent increase in real GDP.
- B) in the short run, a 10 percent increase in the quantity of money leads to a 10 percent increase in velocity.
- C) in the long run, a 10 percent increase in the quantity of money leads to a 10 percent increase in velocity.
- D) in the long run a 10 percent increase in the quantity of money leads to a 10 percent increase in the price level.

Answer: D

94) According to the quantity theory of money, a 15 percent increase in the quantity of money causes a 15 percent rise in

- A) the price level.
- B) the velocity of circulation.
- C) real GDP.
- D) the unemployment rate.

Answer: A
**Topic: Predictions of the Quantity Theory of Money**

**Skill: Conceptual**

95) According to the quantity theory of money, in the long run

A) an increase in the quantity of money creates an increase in prices but no additional increase in real GDP.
B) the quantity of money in a society will always be just the right amount.
C) an increase in the quantity of money creates an increase in real GDP.
D) None of the above answers are correct.

**Answer: A**

**Topic: Predictions of the Quantity Theory of Money**

**Skill: Analytical**

96) According to the quantity theory of money, a 25 percent change in \( M \), the quantity of money, leads to a 25 percent change in

A) \( V \), the velocity of circulation.
B) \( P \), the price level.
C) \( Y \), real GDP.
D) \( R \), the interest rate.

**Answer: B**

**Topic: Predictions of the Quantity Theory of Money**

**Skill: Conceptual**

97) Read the following statements and determine if they are true or false.

I. According to the quantity theory of money, an increase in the growth rate of the quantity of money increases inflation in the long run.
II. Historical and international data show that there is no correlation between inflation and money growth.

A) I and II are both true
B) I and II are both false
C) I is true and II is false
D) I is false and II is true

**Answer: C**

**Topic: International Evidence on the Quantity Theory of Money**

**Skill: Conceptual**

98) Looking at historical evidence for the United States and other countries, which of the following are true?

I. The quantity theory of money explains the correlation between money growth and inflation in the short run.
II. The quantity theory of money explains the correlation between money growth and inflation in the long run.

A) only I is true.
B) only II is true.
C) both I and II are true.
D) neither I or II is true.

**Answer: B**

### Study Guide Questions

**Topic: Study Guide Question, Influences on Money Holding, Interest Rate**

**Skill: Conceptual**

99) An increase in ____ decreases the quantity of money people want to hold.

A) the price level
B) real GDP
C) the interest rate
D) the quantity of money

**Answer: C**

**Topic: Study Guide Question, Influences on Money Holding, Real GDP**

**Skill: Conceptual**

100) A decrease in ____ decreases the demand for money.

A) the discount rate
B) real GDP
C) the interest rate
D) the quantity of money

**Answer: B**
Topic: Study Guide Question, Changing the Interest Rate
Skill: Conceptual
101) A decrease in the quantity of money
A) raises the interest rate.
B) does not change the interest rate.
C) lowers the interest rate.
D) may raise or lower the interest rate, depending on whether the demand for money curve has a negative or a positive slope.
Answer: A

Topic: Study Guide Question, Changing the Interest Rate
Skill: Conceptual
102) Decreases in the quantity of money
A) raise interest rates.
B) have no effect on interest rates.
C) lower interest rates.
D) lower interest rates only if the decrease in the quantity of money was accomplished using an open market operation.
Answer: A

Topic: Study Guide Question, Shifts in the Demand for Money Curve
Skill: Conceptual
103) If real GDP decreases, the demand for money curve will shift
A) leftward and the interest rate will rise.
B) leftward and the interest rate will fall.
C) rightward and the interest rate will rise.
D) rightward and the interest rate will fall.
Answer: B

Topic: Study Guide Question, Fed Tightens to Fight Inflation
Skill: Conceptual
104) In order to combat inflation, the Fed will __________ the quantity of money and __________ the interest rate.
A) increase; raise
B) increase; lower
C) decrease; raise
D) decrease; lower
Answer: C

Topic: Study Guide Question, Fed Tightens to Fight Inflation
Skill: Conceptual
105) In the short run, the Fed’s actions to fight an inflationary gap shift the
A) aggregate demand curve rightward.
B) aggregate demand curve leftward.
C) short-run aggregate supply curve rightward.
D) short-run aggregate supply curve leftward.
Answer: B

Topic: Study Guide Question, Effect of Monetary Policy
Skill: Conceptual
106) In the short run, a decrease in the quantity of money shifts the
A) AD curve leftward.
B) SAS curve leftward.
C) LAS curve leftward.
D) None of the above because a decrease in the quantity of money does not shift a curve.
Answer: A

Topic: Study Guide Question, Fed Tightens to Fight Inflation
Skill: Analytical
107) In the short run, a decrease in the quantity of money ______ the price level and ______ real GDP.
A) lowers; decreases
B) lowers; does not change
C) lowers; increases
D) does not change; increases
Answer: A

Topic: Study Guide Question, Effects of a Change in the Quantity of Money
Skill: Conceptual
108) In the long run, a decrease in the quantity of money
A) shifts the AD curve rightward.
B) shifts the SAS curve rightward.
C) shifts the SAS curve leftward.
D) does not shift the AD curve
Answer: A
CHAPTER 11

**Topic: Study Guide Question, Effects of a Change in the Quantity of Money**
**Skill: Conceptual**
109) In the long run, a(n) _____ in the quantity of money lowers the price level and _____ real GDP.
A) decrease; increases
B) increase; does not change
C) decrease; does not change
D) increase; decreases
**Answer: C**

**Topic: Study Guide Question, Quantity Theory of Money**
**Skill: Recognition**
110) The quantity theory of money is the idea that
A) the quantity of money is determined by banks.
B) the quantity of money serves as a good indicator of how well money functions as a store of value.
C) the quantity of money determines real GDP.
D) in the long run, an increase in the quantity of money causes an equal percentage increase in the price level.
**Answer: D**

**Topic: Study Guide Question, The Quantity Theory of Money**
**Skill: Analytical**
111) Nominal GDP, $PY$, is $7.5$ trillion. The quantity of money is $3$ trillion. The velocity of circulation is
A) 22.5.
B) 10.5.
C) 2.5.
D) 3.
**Answer: C**

**MyEconLab Questions**

**Topic: Predictions of the Quantity Theory of Money**
**Level 2: Using Definitions and Concepts**
112) According to the quantity theory of money, in the long run, an increase in the quantity of money results in an equal percentage increase in _____.
A) the price level
B) the growth rate of real GDP
C) the inflation level
D) the growth rate of potential GDP
**Answer: A**

**Topic: Equation of Exchange**
**Level 2: Using Definitions and Concepts**
113) If nothing else changes, the velocity of circulation increases when _____.
A) the quantity of money increases
B) real GDP decreases
C) the price level decreases and potential GDP decreases
D) the price level increases
**Answer: D**

**Topic: The Demand for Money Curve**
**Level 2: Using Definitions and Concepts**
114) An increase in the interest rate creates a _____ the money demand curve, and an increase in real GDP creates a _____ the money demand curve.
A) movement down along; leftward shift of
B) rightward shift of; movement up along
C) movement up along; rightward shift of
D) leftward shift of; rightward shift of
**Answer: C**

**Topic: The Ripple Effects of Monetary Policy**
**Level 2: Using Definitions and Concepts**
115) The ripple effects that occur when the Fed sells securities in the open market include _____.
A) a decrease in consumption and investment
B) an increase in net exports
C) a decrease in interest rates
D) an increase in short-run aggregate supply
**Answer: A**

**Topic: The Demand for Money Curve**
**Level 2: Using Definitions and Concepts**
116) The demand for money curve is the relationship between ____ and ____, other things remaining the same.
A) the quantity of real money demanded; the quantity of real money supplied
B) the quantity of money demanded; the real interest rate
C) the money demanded; the money supplied
D) the quantity of real money demanded; the interest rate
**Answer: D**
117) In the United States, the demand curve for M1 after 1970 shifted leftward as a result of ____ and shifted rightward as a result of ____.
A) financial innovation; an increase in real GDP
B) an increase in the price level; financial innovation
C) a decrease in real GDP; financial innovation
D) an increase in interest rates; an increase in real GDP
Answer: A

118) When the quantity of money demanded is greater than the quantity of money supplied, people ____ bonds and the interest rate ____.
A) sell; rises
B) sell; falls
C) buy; rises
D) buy; falls
Answer: A

119) When the Fed raises the interest rate, in the foreign exchange market people ____ dollars and the price of the dollar ____ on the foreign exchange market.
A) sell; rises
B) sell; falls
C) buy; rises
D) buy; falls
Answer: C

120) The quantity of money in an economy is $9 million, and the velocity of circulation is 3. Nominal GDP in this economy is ____.
A) $6 million
B) $9 million
C) $3 million
D) $27 million
Answer: D
CHAPTER 11

Topic: Interest Rate Determination
Level 3: Calculations and Predictions
125) If people are holding more money than they would willingly hold, they will ____ bonds. The price of a bond will ____ and the interest rate will ____.
A) sell; rise; fall
B) sell; fall; rise
C) purchase; rise; fall
D) purchase; fall; rise
Answer: C

Topic: Interest Rate Determination
Level 4: Advanced Calculations and Predictions
126) The figure above shows the money market in Futureland. If the Bank of Futureland undertakes an open market purchase of government securities that changes the quantity of money by $1 trillion, then the interest rate will ____.
A) rise to 8 percent a year
B) remain at 6 percent a year
C) fall to 4 percent a year
D) None of the above answers is correct.
Answer: C

Topic: Interest Rate Determination
Level 4: Advanced Calculations and Predictions
127) The figure above shows the money market in Futureland. If the Bank of Futureland undertakes an open market sale of government securities that changes the quantity of money by $1 trillion, then the interest rate will ____.
A) rise to 8 percent a year
B) remain at 6 percent a year
C) fall to 4 percent a year
D) None of the above answers is correct.
Answer: A

Topic: Fed Tightens to Fight Inflation
Level 4: Advanced Calculations and Predictions
128) If a central bank wants to implement a contractionary policy it will conduct an open market operation by ____ securities. Bank reserves will ____ and bank lending will ____ leading to a ____ in the quantity of money.
A) selling; decrease; decrease; decrease
B) purchasing; decrease; decrease; decrease
C) purchasing; decrease; increase; decrease
D) selling; increase; increase; increase
Answer: A

Topic: Effect of Monetary Policy on Aggregate Demand
Level 4: Advanced Calculations and Predictions
129) The central bank of Cobra sells securities in an open market operation. In the short run, aggregate demand ____ , real GDP ____ , and the price level ____.
A) does not change; increases; falls
B) decreases; decreases; falls
C) increases; increases; rises
D) does not change; decreases; rises
Answer: B

Topic: The Demand for Money Curve
Level 4: Advanced Calculations and Predictions
130) An increase in the opportunity cost of holding money creates a ____ the money demand curve and an increase in real GDP creates a ____ the money demand curve.
A) leftward shift of; movement down along
B) rightward shift of; movement down along
C) movement up along; leftward shift of
D) movement up along; rightward shift of
Answer: D
The economy is currently at point $c$. The quantity of money in Slag decreases. Slag moves to point ____ in the short run and to point ____ in the long run.

A) $d$; $c$
B) $a$; $c$
C) $d$; $a$
D) $b$; $a$

Answer: C

If the quantity of money increases when the economy is at full employment, aggregate demand _____. In the long run, the price level ____ and real GDP will ____.

A) decreases; the price level falls; return to potential GDP
B) decreases; real GDP decreases; increase to potential GDP
C) increases; the price level rises; return to potential GDP
D) increases; real GDP increases; increase further

Answer: C