Chapter 1
Why Study Money, Banking, and Financial Markets?

Multiple Choice

1) Financial markets and institutions
   (a) involve the movement of huge flows of money.
   (b) affect the profits of businesses.
   (c) affect the types of goods and services produced in an economy.
   (d) do each of the above.
   (e) do only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

2) Financial markets and institutions
   (a) involve the movement of huge flows of money.
   (b) affect the location of businesses.
   (c) affect the types of goods and services produced in an economy.
   (d) do each of the above.
   (e) do only (a) and (c) of the above.
   Answer: E
   Question Status: Previous Edition

3) Money, financial institutions, and financial markets in the United States can have a major impact on
   (a) economic well being of other countries besides the United States.
   (b) the kinds of goods and services that are produced.
   (c) the outcome of political elections.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

4) Markets in which funds are transferred from those who have excess funds available to those who
   have a shortage of available funds are called
   (a) commodity markets.
   (b) fund-available markets.
   (c) derivative exchange markets.
   (d) financial markets.
   Answer: D
   Question Status: Previous Edition
5) Channeling funds from individuals with surplus funds to those desiring funds when the saver does not purchase the borrower’s security is known as
(a) barter.
(b) redistribution.
(c) theft.
(d) taxation.
(e) financial intermediation.
Answer: E
Question Status: Study Guide

6) Financial markets promote economic efficiency by
(a) channeling funds from investors to savers.
(b) creating inflation.
(c) causing recessions.
(d) channeling funds from savers to investors.
(e) reducing investment.
Answer: D
Question Status: New

7) Well-functioning financial markets promote
(a) inflation.
(b) deflation.
(c) unemployment.
(d) growth.
(e) none of the above.
Answer: D
Question Status: New

8) Poorly performing financial markets can be the cause of
(a) wealth.
(b) poverty.
(c) financial stability.
(d) all of the above.
(e) none of the above.
Answer: B
Question Status: New

9) The bond markets are important because
(a) they are easily the most widely followed financial markets in the United States.
(b) they are the markets where foreign exchange rates are determined.
(c) they are the markets where interest rates are determined.
(d) of each of the above.
(e) of only (a) and (b) of the above.
Answer: C
Question Status: Previous Edition
10) The bond markets are important because
   (a) they are the markets where interest rates are determined.
   (b) they are the markets where most borrowers get their funds.
   (c) they are easily the most widely followed financial markets in the United States.
   (d) of each of the above.
   (e) of only (a) and (b) of the above.
   Answer: A

11) The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of
    $100 per year) is commonly referred to as the
    (a) inflation rate.
    (b) exchange rate.
    (c) interest rate.
    (d) aggregate price level.
    Answer: C

12) Compared to interest rates on long-term U.S. government bonds, interest rates on _____ fluctuate
    more and are lower on average.
    (a) medium-quality corporate bonds
    (b) low-quality corporate bonds
    (c) high-quality corporate bonds
    (d) three-month Treasury bills
    (e) none of the above
    Answer: D

13) Compared to interest rates on long-term U.S. government bonds, interest rates on three-month
    Treasury bills fluctuate _____ and are _____ on average.
    (a) more; lower
    (b) less; lower
    (c) more; higher
    (d) less; higher
    Answer: A

14) The interest rate on Baa (medium quality) corporate bonds is _____, on average, than other interest
    rates, and the spread between it and other rates became _____ in the 1970s.
    (a) lower; smaller
    (b) lower; larger
    (c) higher; smaller
    (d) higher; larger
    Answer: D
15) A decline in interest rates will cause spending on housing to
   (a) fall.
   (b) remain unchanged.
   (c) cannot be determined.
   (d) rise.
   (e) none of the above.
   Answer: D
   Question Status: Study Guide

16) An increase in interest rates on student loans
   (a) increases the cost of a college education.
   (b) reduces the cost of a college education.
   (c) has no effect on educational costs.
   (d) increases costs for students with no loans.
   (e) none of the above.
   Answer: A
   Question Status: New

17) Interest rates affect
   (a) individuals.
   (b) businesses.
   (c) the overall economy.
   (d) all of the above.
   (e) only (b) and (c) of the above.
   Answer: D
   Question Status: New

18) Stock prices boomed in the 1980s until “Black Monday” in _____ , when the DJIA fell by more than 500 points, a 22 percent decline.
   (a) 1985
   (b) 1986
   (c) 1987
   (d) 1988
   Answer: C
   Question Status: Previous Edition

19) The stock market is important because
   (a) it is where interest rates are determined.
   (b) it is the most widely followed financial market in the United States.
   (c) it is where foreign exchange rates are determined.
   (d) all of the above.
   Answer: B
   Question Status: Previous Edition
20) Stock prices since the 1950s have been
   (a) relatively stable trending upward at a steady pace.
   (b) relatively stable trending downward at a moderate rate.
   (c) extremely volatile.
   (d) unstable trending downward at a moderate rate.
   Answer: C
   Question Status: Previous Edition

21) A rising stock market index due to higher share prices
   (a) increases people’s wealth, but is unlikely to increase their willingness to spend.
   (b) increases people’s wealth and as a result may increase their willingness to spend.
   (c) increases the amount of funds that business firms can raise by selling newly-issued stock.
   (d) both (b) and (c) of the above.
   Answer: D
   Question Status: Previous Edition

22) A rising stock market index due to higher share prices
   (a) increases people’s wealth and as a result may increase their willingness to spend.
   (b) increases the amount of funds that business firms can raise by selling newly-issued stock.
   (c) decreases the amount of funds that business firms can raise by selling newly-issued stock.
   (d) both (a) and (b) of the above.
   Answer: D
   Question Status: Previous Edition

23) A rising stock market index due to higher share prices
   (a) increases people’s wealth, but is unlikely to increase their willingness to spend.
   (b) increases people’s wealth and as a result may increase their willingness to spend.
   (c) decreases the amount of funds that business firms can raise by selling newly-issued stock.
   (d) both (a) and (c) of the above.
   (e) both (b) and (c) of the above.
   Answer: B
   Question Status: Previous Edition

24) A declining stock market index due to lower share prices
   (a) reduces people’s wealth and as a result may reduce their willingness to spend.
   (b) increases people’s wealth and as a result may increase their willingness to spend.
   (c) increases the amount of funds that business firms can raise by selling newly-issued stock.
   (d) both (a) and (c) of the above.
   (e) both (b) and (c) of the above.
   Answer: A
   Question Status: Previous Edition
25) A declining stock market index due to lower share prices
   (a) reduces people's wealth and as a result may reduce their willingness to spend.
   (b) increases people's wealth and as a result may increase their willingness to spend.
   (c) decreases the amount of funds that business firms can raise by selling newly-issued stock.
   (d) both (a) and (c) of the above.
   (e) both (b) and (c) of the above.
   Answer: D

Question Status: Previous Edition

26) Changes in stock prices
   (a) affect people's wealth and their willingness to spend
   (b) affect firms' decisions to sell stock to finance investment spending.
   (c) are characterized by considerable fluctuations.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: D

Question Status: Previous Edition

27) Fear of a major recession causes stock prices to fall, which in turn causes consumer spending to
   (a) increase.
   (b) remain unchanged.
   (c) decrease.
   (d) cannot be determined.
   (e) none of the above.
   Answer: C

Question Status: Study Guide

28) A common stock is a claim on a corporation’s
   (a) debt.
   (b) liabilities.
   (c) expenses.
   (d) employees.
   (e) earnings and assets.
   Answer: E

Question Status: New

29) The decline in stock prices from 2000 through 2002
   (a) increased individuals’ willingness to spend.
   (b) had no effect on individual spending.
   (c) reduced individual’s willingness to spend.
   (d) increased individual wealth.
   (e) both (a) and (d) are correct.
   Answer: C

Question Status: New
30) The price of one country’s currency in terms of another’s is called
(a) the exchange rate.
(b) the interest rate.
(c) the Dow Jones industrial average.
(d) none of the above.
Answer: A
Question Status: Previous Edition

31) Everything else constant, a stronger dollar will mean that
(a) vacationing in England becomes more expensive.
(b) vacationing in England becomes less expensive.
(c) French cheese becomes more expensive.
(d) Japanese cars become more expensive.
Answer: B
Question Status: Previous Edition

32) All else constant, as the dollar becomes stronger,
(a) Americans will purchase fewer foreign goods.
(b) U.S. goods exported abroad will cost less in foreign countries, and so foreigners will buy more of them.
(c) the U.S. is unquestionably made better off.
(d) none of the above.
Answer: D
Question Status: Previous Edition

33) Which of the following is most likely to result from a stronger dollar?
(a) U.S. goods exported abroad will cost less in foreign countries, and so foreigners will buy more of them.
(b) U.S. goods exported abroad will cost more in foreign countries and so foreigners will buy more of them.
(c) U.S. goods exported abroad will cost more in foreign countries, and so foreigners will buy fewer of them.
(d) Americans will purchase fewer foreign goods.
Answer: C
Question Status: Previous Edition

34) A change in the exchange rate has a direct effect on Americans because it affects
(a) the price of foreign goods to American consumers.
(b) the price of American goods to foreign consumers.
(c) the price Americans will pay to travel abroad.
(d) the price foreigners will pay to travel to the U.S.
(e) all of the above.
Answer: E
Question Status: Previous Edition
35) A stronger dollar will likely hurt
(a) textile producers in South Carolina.
(b) wheat farmers in Montana.
(c) automobile manufacturers in Michigan.
(d) all of the above since their exports will decline.
(e) none of the above since their exports will increase.
Answer: D
Question Status: Previous Edition

36) A weaker dollar will likely hurt
(a) textile producers in South Carolina.
(b) wheat farmers in Montana.
(c) automobile manufacturers in Michigan.
(d) all of the above since their exports will decline.
(e) none of the above since their exports will increase.
Answer: E
Question Status: Previous Edition

37) A stronger dollar benefits _____ and hurts _____.
(a) American businesses; American consumers
(b) American businesses; foreign businesses
(c) American consumers; American businesses
(d) foreign businesses; American consumers
Answer: C
Question Status: Previous Edition

38) A weaker dollar benefits _____ and hurts _____.
(a) American businesses; American consumers
(b) American businesses; foreign consumers
(c) American consumers; American businesses
(d) foreign businesses; American consumers
Answer: A
Question Status: Previous Edition

39) From 1980 to early 1985 the dollar appreciated in value, thereby benefiting _____ and harming _____.
(a) American businesses; American consumers
(b) American businesses; foreign businesses
(c) American consumers; American businesses
(d) foreign businesses; American consumers
Answer: C
Question Status: Previous Edition
40) From 1980 to early 1985 the dollar _____ in value, thereby benefiting American _____.
   (a) appreciated; consumers
   (b) appreciated, businesses
   (c) depreciated; consumers
   (d) depreciated, businesses
   Answer: A
   Question Status: Previous Edition

41) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,
   (a) more Americans traveled to England in 1985.
   (b) Americans imported more Shetland sweaters from England in 1985.
   (c) Britons imported more wine from California in 1985.
   (d) all of the above.
   (e) only (a) and (b) of the above.
   Answer: E
   Question Status: Previous Edition

42) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,
   (a) more Britons traveled to the United States in 1985.
   (b) Britons imported more wine from California in 1985.
   (c) Americans imported more Shetland sweaters from England in 1985.
   (d) only (a) and (b) of the above.
   Answer: C
   Question Status: Previous Edition

43) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,
   (a) more Britons traveled to the United States in 1985.
   (b) Britons imported more wine from California in 1985.
   (c) Americans exported more wheat to England in 1985.
   (d) all of the above.
   (e) none of the above.
   Answer: E
   Question Status: Previous Edition

44) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,
   (a) fewer Britons traveled to the United States in 1985.
   (b) Britons imported more wine from California in 1985.
   (c) Americans exported more wheat to England in 1985.
   (d) more Britons traveled to the United States in 1985.
   Answer: A
   Question Status: Previous Edition
45) When in 1980 a British pound cost approximately $2.40, a Shetland sweater that cost 50 British pounds would have cost $120. With a stronger dollar, the same Shetland sweater would have cost
(a) less than $120.
(b) more than $120.
(c) $120, since the exchange rate does not affect the prices that American consumers pay for foreign goods.
(d) $120, since the demand for Shetland sweaters will decrease to prevent an increase in price due to the stronger dollar.
Answer: A
Question Status: Previous Edition

46) When in 1985 a British pound cost approximately $1.30, a Shetland sweater that cost 100 British pounds would have cost $130. With a weaker dollar, the same Shetland sweater would have cost
(a) less than $130.
(b) more than $130.
(c) $130, since the exchange rate does not affect the prices that American consumers pay for foreign goods.
(d) $130, since the demand for Shetland sweaters will decrease to prevent an increase in price due to the stronger dollar.
Answer: B
Question Status: Previous Edition

47) In 1980 a Shetland sweater would have cost $120. With a stronger dollar, the same Shetland sweater would have cost
(a) less than $120.
(b) more than $120.
(c) $120, since the exchange rate does not affect the prices that American consumers pay for foreign goods.
(d) $120, since the demand for Shetland sweaters will decrease to prevent an increase in price due to the stronger dollar.
Answer: A
Question Status: Previous Edition

48) In 1985 a Shetland sweater would have cost $130. With a weaker dollar, the same Shetland sweater would have cost
(a) less than $130.
(b) more than $130.
(c) $130, since the exchange rate does not affect the prices that American consumers pay for foreign goods.
(d) $130, since the demand for Shetland sweaters will decrease to prevent an increase in price due to the stronger dollar.
Answer: B
Question Status: Previous Edition
49) A decrease in the value of the dollar relative to all foreign currencies means that the price of foreign goods purchased by Americans
   (a) increases.
   (b) decreases.
   (c) remains unchanged.
   (d) unable to determine.
   (e) none of the above.
   Answer: A
   Question Status: Study Guide

50) If the price of a euro (the European currency) increases from $1.00 to $1.10, then
   (a) a European vacation becomes less expensive.
   (b) a European vacation becomes more expensive.
   (c) the cost of a European vacation is not affected.
   (d) foreign travel becomes impossible.
   (e) none of the above.
   Answer: B
   Question Status: New

51) Americans who love French wine benefit most from
   (a) a decrease in the dollar price of euros.
   (b) an increase in the dollar price of euros.
   (c) a constant dollar price for euros.
   (d) a ban on imports from Europe.
   (e) none of the above.
   Answer: A
   Question Status: New

52) American farmers who sell beef to Europe benefit most from
   (a) a decrease in the dollar price of euros.
   (b) an increase in the dollar price of euros.
   (c) a constant dollar price for euros.
   (d) a European ban on imports of American beef.
   (e) none of the above.
   Answer: B
   Question Status: New

53) Banks are important to the study of money and the economy because they
   (a) provide a channel for linking those who want to save with those who want to invest.
   (b) have been a source of rapid financial innovation that is expanding the alternatives available to those wanting to invest their money.
   (c) hold a large proportion of individuals’ wealth.
   (d) do each of the above.
   (e) do only (a) and (b) of the above.
   Answer: D
   Question Status: Revised
54) Banks are important to the study of money and the economy because they
(a) provide a channel for linking those who want to save with those who want to invest.
(b) have been a source of rapid financial innovation that is expanding the alternatives available to
those wanting to invest their money.
(c) are the only important financial institution in the U.S. economy.
(d) each of the above.
(e) only (a) and (b) of the above.
Answer: E
Question Status: Revised

55) Economists group commercial banks, savings and loan associations, credit unions, mutual funds,
mutual savings banks, insurance companies, pension funds, and finance companies together under
the heading financial intermediaries. Financial intermediaries
(a) act as middlemen, borrowing funds from those who have saved and lending these funds to
others.
(b) produce nothing of value and are therefore a drain on society’s resources.
(c) help promote a more efficient and dynamic economy.
(d) do each of the above.
(e) do only (a) and (c) of the above.
Answer: E
Question Status: Previous Edition

56) Economists group commercial banks, savings and loan associations, credit unions, mutual funds,
mutual savings banks, insurance companies, pension funds, and finance companies together under
the heading financial intermediaries. Financial intermediaries
(a) act as middlemen, borrowing funds from those who have saved and lending these funds to
others.
(b) hold a significant proportion of individuals’ wealth.
(c) help promote a more efficient and dynamic economy.
(d) do each of the above.
(e) do only (a) and (c) of the above.
Answer: D
Question Status: Revised

57) Banks, savings and loan associations, mutual savings banks, and credit unions
(a) link those who want to save with those who want to invest.
(b) hold a large proportion of individuals’ wealth.
(c) have been adept at innovating in response to changes in the regulatory environment.
(d) all of the above.
(e) only (a) and (c) of the above.
Answer: D
Question Status: Revised
58) Banks, savings and loan associations, mutual savings banks, and credit unions
(a) are no longer important players in financial intermediation.
(b) since deregulation now provide services only to small depositors.
(c) have been adept at innovating in response to changes in the regulatory environment.
(d) all of the above.
(e) only (a) and (c) of the above.
Answer: C
Question Status: Previous Edition

59) Banks and other financial institutions engage in financial intermediation, which
(a) can hurt the performance of the economy.
(b) can benefit economic performance.
(c) has no effect on economic performance.
(d) involves borrowing from investors and lending to savers.
(e) none of the above.
Answer: B
Question Status: New

60) Money is defined as
(a) bills of exchange.
(b) anything that is generally accepted in payment for goods and services or in the repayment of debt.
(c) a risk-free repository of spending power.
(d) the unrecognized liability of governments.
Answer: B
Question Status: Previous Edition

61) Money is defined as
(a) anything that is generally accepted in payment for goods and services or in the repayment of debt.
(b) bills of exchange.
(c) a risk-free repository of spending power.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: A
Question Status: Previous Edition

62) Economists take the study of money seriously because evidence suggests that
(a) the money supply and the price level move closely together.
(b) money and interest rate movements are related.
(c) business cycle downturns are preceded by downturns in money growth.
(d) all of the above are true.
(e) only (a) and (b) of the above are true.
Answer: D
Question Status: Previous Edition
63) Money has a major impact on
   (a) inflation.
   (b) the business cycle.
   (c) interest rates.
   (d) each of the above.
   (e) none of the above.
   Answer: D
   Question Status: Study Guide

64) A decrease in the rate of growth of money often results in
   (a) inflation.
   (b) economic expansion.
   (c) recession.
   (d) falling unemployment.
   (e) both (b) and (d).
   Answer: C
   Question Status: New

65) Evidence from the United States and other foreign countries indicates that
   (a) there is a strong positive association between inflation and growth rate of money over long
       periods of time.
   (b) there is little support for the assertion that “inflation is always and everywhere a monetary
       phenomenon.”
   (c) countries with low monetary growth rates tend to experience higher rates of inflation, all else
       being constant.
   (d) money growth is clearly unrelated to inflation.
   Answer: A
   Question Status: Previous Edition

66) Sustained downward movements in the business cycle are referred to as
   (a) inflation.
   (b) recessions.
   (c) economic recoveries.
   (d) expansions.
   Answer: B
   Question Status: Previous Edition

67) Prior to all recessions since 1900, there has been a drop in
   (a) inflation.
   (b) the money stock.
   (c) the growth rate of the money stock.
   (d) interest rates.
   Answer: C
   Question Status: Revised
68) Prior to recessions since 1900, there has been a drop in
   (a) the stock market.
   (b) the money stock.
   (c) the growth rate of the money stock.
   (d) both (a) and (b) of the above.
   (e) both (a) and (c) of the above.
   Answer: C
   Question Status: Revised

69) Every recession in the United States since 1900 has been preceded by a decline in
   (a) the hemline of women’s fashions.
   (b) the rate of money growth.
   (c) the level of sunspot activity.
   (d) the money stock.
   Answer: B
   Question Status: Revised

70) Every recession in the United States since 1900 has been preceded by a decline in
   (a) the average price level.
   (b) the exchange rate.
   (c) the rate of money growth.
   (d) the money stock.
   Answer: C
   Question Status: Revised

71) Evidence from business cycle fluctuations in the United States indicates that changes in money
   might be a driving force behind these fluctuations. Specifically, the evidence suggests that
   (a) a negative relationship between money growth and general economic activity exists.
   (b) recessions have been preceded by a decline in the growth rate of money.
   (c) recessions have been preceded by an increase in the growth rate of money.
   (d) recessions have been preceded by an increase in the growth rate of money and followed by a
   substantial decrease in money growth.
   Answer: B
   Question Status: Previous Edition

72) Evidence from business cycle fluctuations in the United States indicates that
   (a) a negative relationship between money growth and general economic activity exists.
   (b) recessions have been preceded by declines in share prices on the stock exchange.
   (c) recessions have been preceded by dollar depreciation.
   (d) recessions have been preceded by a decline in the growth rate of money.
   Answer: D
   Question Status: Previous Edition
73) A decrease in the growth rate of the money supply is likely followed by
   (a) a recession.
   (b) a recovery.
   (c) a boom.
   (d) inflation.
   (e) all of the above.
Answer: A

Question Status: Study Guide

74) A sharp increase in the growth of the money supply is likely followed by
   (a) a recession.
   (b) a depression.
   (c) inflation.
   (d) no change in the economy.
   (e) none of the above.
Answer: C

Question Status: Study Guide

75) It is true that inflation is
   (a) a continuous increase in the money supply.
   (b) a continuous fall in prices.
   (c) a decline in interest rates.
   (d) constant prices.
   (e) a continually rising price level.
Answer: E

Question Status: Study Guide

76) A rapid rate of growth of money results in
   (a) inflation.
   (b) constant prices.
   (c) deflation.
   (d) recession.
   (e) depression.
Answer: A

Question Status: New

77) The organization responsible for the conduct of monetary policy in the United States is the
   (a) Comptroller of the Currency.
   (b) U.S. Treasury.
   (c) Federal Reserve System.
   (d) Bureau of Monetary Affairs.
Answer: C

Question Status: Previous Edition
78) Which of the following are true statements?
   (a) Money or the money supply is defined as anything that is generally accepted in payment for
goods and services or in the repayment of debts.
   (b) Inflation is a condition of a continually rising price level.
   (c) The inflation rate is measured as the rate of change in the aggregate price level.
   (d) All of the above are true statements.
   (e) Only (a) and (b) of the above are true statements.
   Answer: D
   Question Status: Previous Edition

79) Which of the following are true statements?
   (a) Money or the money supply is defined as Federal Reserve notes.
   (b) The average price of goods and services in an economy is called the aggregate price level.
   (c) The inflation rate is measured as the rate of change in the federal government budget deficit.
   (d) All of the above are true statements.
   (e) Only (a) and (b) of the above are true statements.
   Answer: B
   Question Status: Previous Edition

80) Which of the following are true statements?
   (a) Money or the money supply is defined as anything that is generally accepted in payment for
goods and services or in the repayment of debts.
   (b) The inflation rate is measured as the rate of change in the aggregate price level.
   (c) Inflation occurs whenever the price level rises.
   (d) All of the above are true statements.
   (e) Only (a) and (b) of the above are true statements.
   Answer: E
   Question Status: Previous Edition

81) Which of the following are true statements?
   (a) Money or the money supply is defined as anything that is generally accepted in payment for
goods and services or in the repayment of debts.
   (b) The average price of goods and services in an economy is called the aggregate price level.
   (c) The aggregate price level is measured as the rate of change in the inflation rate.
   (d) All of the above are true statements.
   (e) Only (a) and (b) of the above are true statements.
   Answer: E
   Question Status: Previous Edition
82) Which of the following are true statements?
(a) Money or the money supply is defined as anything that is generally accepted in payment for goods and services or in the repayment of debts.
(b) The average price of goods and services in an economy is called the inflation rate.
(c) The aggregate price level is measured as the rate of change in the inflation rate.
(d) All of the above are true statements.
(e) Only (a) and (b) of the above are true statements.
Answer: A

Question Status: Previous Edition

83) Which of the following are true statements?
(a) Those countries with the highest inflation rates are also the ones with the highest money growth rates.
(b) The average price of goods and services in an economy is called the aggregate price level.
(c) The inflation rate is measured as the rate of change in the aggregate price level.
(d) All of the above are true statements.
(e) Only (a) and (b) of the above are true statements.
Answer: D

Question Status: Previous Edition

84) Which of the following are true statements?
(a) Those countries with the highest inflation rates are also the ones with the highest money growth rates.
(b) The average price of goods and services in an economy is called the inflation rate.
(c) When the average price of goods and services in an economy increases, the inflation rate increases.
(d) All of the above are true statements.
(e) Only (a) and (b) of the above are true statements.
Answer: A

Question Status: Previous Edition

85) If ten years ago the prices of the items bought last month by the average consumer would have been much lower, then one can likely conclude that
(a) the aggregate price level has risen during this ten-year period.
(b) the average inflation rate for this ten-year period has been positive.
(c) the average rate of money growth for this ten-year period has been positive.
(d) all of the above.
Answer: D

Question Status: Previous Edition
86) If ten years ago the prices of the items bought last month by the average consumer would have been much higher, then one can likely conclude that
   (a) the aggregate price level has declined during this ten-year period.
   (b) the average inflation rate for this ten-year period has been positive.
   (c) the average rate of money growth for this ten-year period has been positive.
   (d) all of the above.
   Answer: A
   Question Status: Previous Edition

87) One likely explanation for the relatively high rates of inflation experienced in many Latin American countries is the
   (a) relatively slow growth in the money supply in these countries.
   (b) relatively rapid growth in the money supply in these countries.
   (c) decline in the prices of basic commodities in these countries.
   (d) none of the above.
   Answer: B
   Question Status: Previous Edition

88) Complete Milton Friedman’s famous statement, “Inflation is always and everywhere a _____ phenomenon.”
   (a) recessionary
   (b) discretionary
   (c) repressionary
   (d) monetary
   Answer: D
   Question Status: Previous Edition

89) Milton Friedman’s restatement of the notion that “sustained inflation can come only from a continuous increase in the money supply” is as follows:
   (a) “Inflation is always and everywhere a monetary phenomenon.”
   (b) “Inflation, simply stated, is never anything other than a monetary phenomenon.”
   (c) “Inflation is ultimately and singularly a monetary phenomenon.”
   (d) “The over-issue of paper money is the initial and singular cause of inflation.”
   Answer: A
   Question Status: Previous Edition

90) Countries that experience very high rates of inflation have
   (a) balanced budgets.
   (b) budget surpluses.
   (c) falling money supplies.
   (d) constant money supplies.
   (e) rapidly growing money supplies.
   Answer: E
   Question Status: New
91) Budgets deficits can be a concern because they might

(a) ultimately lead to higher inflation.
(b) lead to a higher rate of money growth.
(c) lead to higher interest rates.
(d) cause all of the above to occur.

Answer: D
Question Status: Previous Edition

92) Budgets deficits can be a concern because they might

(a) ultimately lead to higher inflation.
(b) lead to higher interest rates.
(c) lead to a slower rate of money growth.
(d) cause all of the above to occur.
(e) cause both (a) and (b) of the above to occur.

Answer: E
Question Status: Previous Edition

93) Budget deficits are important to monetary authorities because

(a) the financing of government budget deficits may affect the conduct of monetary policy.
(b) budget deficits may increase interest rates, putting pressure on the monetary authorities to expand the quantity of money to keep interest rates from rising.
(c) budget deficits may put pressure on Federal Reserve to increase the growth rate of the money supply.
(d) of all of the above.

Answer: D
Question Status: Previous Edition

94) Budget deficits are important because

(a) deficits cause bank failures.
(b) banks would not exist without deficits.
(c) deficits can result in higher rates of monetary growth.
(d) deficits always cause prices to fall.
(e) deficits always cause interest rates to fall.

Answer: C
Question Status: Study Guide

95) Budget deficits can result in

(a) financial crises.
(b) low interest rates.
(c) higher bond prices.
(d) all of the above.
(e) none of the above.

Answer: A
Question Status: New
96) Between 1950 and 1980 in the U.S., interest rates trended upward. During this same time period,
(a) the rate of money growth declined.
(b) the rate of money growth increased.
(c) the government budget deficit (expressed as a percentage of GNP) trended downward.
(d) the aggregate price level declined quite dramatically.
Answer: B

97) In the U.S. between 1950 and 1980, interest rates trended upward. During this same time period,
(a) the rate of money growth increased.
(b) the government budget deficit (expressed as a percentage of GNP) trended upward.
(c) the aggregate price level continued to increase.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: D

98) In the U.S. between 1950 and 1980, interest rates trended upward. During this same time period,
(a) the rate of money growth decreased.
(b) the government budget deficit (expressed as a percentage of GNP) trended upward.
(c) the aggregate price level continued to decrease.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: B

99) In the U.S. between 1950 and 1980, interest rates trended upward. During this same time period,
(a) the rate of money growth increased.
(b) the government budget deficit (expressed as a percentage of GNP) trended upward.
(c) the aggregate price level continued to decrease.
(d) all of the above.
(e) only (a) and (b) of the above.
Answer: E

Appendix to Chapter 1

100) The most comprehensive measure of aggregate output is
(a) gross domestic product.
(b) net national product.
(c) the stock value of the industrial 500.
(d) national income.
Answer: A
101) When the total value of final goods and services is calculated using current prices, the resulting measure is referred to as
(a) real GDP.
(b) the GDP deflator.
(c) nominal GDP.
(d) the index of leading indicators.
Answer: C

102) GDP measured with constant prices is referred to as
(a) real GDP.
(b) nominal GDP.
(c) the GDP deflator.
(d) industrial production.
Answer: A

103) If the aggregate price level at time $t$ is denoted by $P_t$, the inflation rate from time $t - 1$ to $t$ is defined as
(a) $p_t = (P_t - P_{t - 1}) / P_{t - 1}$.
(b) $p_t = (P_t + 1 - P_{t - 1}) / P_{t - 1}$.
(c) $p_t = (P_{t + 1} - P_t) / P_t$.
(d) $p_t = (P_t - P_{t - 1}) / P_t$.
Answer: A

104) Gross domestic product includes
(a) purchases of stocks and bonds.
(b) purchases of used cars and houses.
(c) purchases of Rembrandt paintings.
(d) purchases of newly produced goods and services.
(e) all of the above.
Answer: D

105) The Gross Domestic Product is the
(a) the value of all wealth in an economy.
(b) the value of all stocks and bonds sold in an economy in a year.
(c) the market value of all final goods and services produced in an economy in a year.
(d) the market value of all intermediate goods and services produced in an economy in a year.
(e) the value of all goods and services sold to other nations in a year.
Answer: C
106) If an economy has aggregate output of $20 trillion, then aggregate income is
   (a) $10 trillion.
   (b) $20 trillion.
   (c) $30 trillion.
   (d) $40 trillion.
   (e) cannot be determined.
   Answer: B
   Question Status: New

107) If your nominal income in 1996 was $50,000, and prices doubled between 1996 and 2002, to have
   the same real income, your nominal income in 2002 must be
   (a) $50,000.
   (b) $75,000.
   (c) $90,000.
   (d) $100,000.
   (e) $200,000.
   Answer: D
   Question Status: New

108) If your nominal income in 1990 is $50,000, and prices increase by 50% between 1990 and 2000,
   then to have the same real income, your nominal income in 2000 must be
   (a) $50,000.
   (b) $75,000.
   (c) $100,000.
   (d) $150,000.
   (e) $200,000.
   Answer: B
   Question Status: New

109) If nominal GDP in 2001 is $9 trillion, and 2001 real GDP in 1996 prices is $6 trillion, the GDP
   deflator price index is
   (a) 67.
   (b) 100.
   (c) 150.
   (d) 200.
   (e) cannot be determined.
   Answer: C
   Question Status: New
110) If the price level increases from 200 in year 1 to 220 in year 2, the rate of inflation from year 1 to year 2 is
(a) 20%.
(b) 10%.
(c) 11%.
(d) 120%.
(e) 220%.
Answer: B
Question Status: Study Guide

111) If real GDP grows from $10 trillion in 2002 to $10.5 trillion in 2003, the growth rate for real GDP is
(a) 5%.
(b) 10%.
(c) 50%.
(d) 0.5%.
(e) cannot be determined.
Answer: A
Question Status: New

112) If real GDP in 2002 is $10 trillion, and in 2003 real GDP is $9.5 trillion, then real GDP growth from 2002 to 2003 is
(a) .05%.
(b) 5%.
(c) 0%.
(d) −5%.
(e) −10%.
Answer: D
Question Status: New

113) If the CPI is 120 in 1996 and 180 in 2002, then between 1996 and 2002, prices have increased by
(a) 180%.
(b) 80%.
(c) 60%.
(d) 50%.
(e) 20%.
Answer: D
Question Status: New

114) If the CPI in 2004 is 200, and in 2005 the CPI is 180, the rate of inflation from 2004 to 2005 is
(a) 20%.
(b) 10%.
(c) 0%.
(d) −10%.
(e) −20%.
Answer: D
Question Status: New
Essay Questions

1) What is a stock? How do stocks affect the economy?
   Answer: A stock represents a share of ownership of a corporation, or a claim on a firm’s earnings/assets. Stocks are part of wealth, and changes in their value affect people’s willingness to spend. Changes in stock prices affect a firm’s ability to raise funds, and thus their investment.

2) List three economic magnitudes affected by the money stock and state how money affects each of them.
   Answer: Money affects the business cycle/unemployment. Decreases in the growth rate of money precede recessions. High rates of monetary growth cause high rates of inflation. High rates of money growth lead to rising long-term bond interest rates.

3) Shortly after his election, President George W. Bush proposed legislation that resulted in a cut in income taxes. Explain how this tax cut affected the federal budget deficit. What are the possible economic consequences of this change in the budget deficit?
   Answer: The tax cut increases the deficit, which possibly results in higher interest rates, a higher rate of monetary growth, and higher inflation.