Sample Multiple-Choice Questions

Circle the letter of each correct answer.

1. The M1 definition of money includes which of the following?
   I. Currency
   II. Demand deposits (checkable deposits)
   III. Savings accounts and small time deposits
   IV. Eurodollars
   (A) I only
   (B) II only
   (C) III only
   (D) I and II only
   (E) II, III and IV only

2. If the legal reserve requirement is 25 percent, the value of the simple deposit expansion multiplier is
   (A) 2.  (B) 4.  (C) 5.
   (D) 10.  (E) 1.0.

3. When money is used as a standard of value, a person is
   (A) earning more money than before.
   (B) purchasing a necessity.
   (C) making a financial transaction.
   (D) making price comparisons among products.
   (E) writing a check for groceries.

4. Which of the following are true statements about the federal funds rate?
   I. It is the same thing as the discount rate.
   II. It is the interest rate that banks charge each other for short-term loans.
   III. It is influenced by open market operations.
   (A) I only
   (B) II only
   (C) III only
   (D) I and II only
   (E) II and III only

5. Suppose the Federal Reserve buys $400,000 worth of securities from the securities dealers on the open market. If the reserve requirement is 20 percent and the banks hold no excess reserves, what will happen to the total money supply?
   (A) It will be unchanged.
   (B) It will contract by $2,000,000.
   (C) It will contract by $800,000.
   (D) It will expand by $2,000,000.
   (E) It will expand by $800,000.

6. The money market is definitely in equilibrium in which of the following cases?
   (A) When velocity is constant
   (B) When the quantity of money demanded equals the quantity of money supplied
   (C) When the present value is equal to the interest rate
   (D) When the present value is greater than the interest rate
   (E) When the interest rate is equal to the price of bonds

7. A commercial bank holds $500,000 in demand deposit liabilities and $120,000 in reserves. If the required reserve ratio is 20 percent, which of the following is the maximum amount by which this single commercial bank and the maximum amount by which the banking system can increase loans?

<table>
<thead>
<tr>
<th>Amount Created by Single Bank</th>
<th>Amount Created by Banking System</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) $5,000</td>
<td>$25,000</td>
</tr>
<tr>
<td>(B) $20,000</td>
<td>$80,000</td>
</tr>
<tr>
<td>(C) $20,000</td>
<td>$100,000</td>
</tr>
<tr>
<td>(D) $30,000</td>
<td>$150,000</td>
</tr>
<tr>
<td>(E) $120,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>
8. Which of the following does the Federal Reserve use most often to combat a recession?
   (A) Selling securities
   (B) Buying securities
   (C) Reducing the reserve requirement
   (D) Increasing the discount rate
   (E) Increasing the federal funds rate

9. To reduce inflation, the Federal Reserve could
   (A) expand the money supply in order to raise interest rates, which increases investment.
   (B) expand the money supply in order to lower interest rates, which increases investment.
   (C) contract the money supply in order to lower interest rates, which increases investment.
   (D) contract the money supply in order to raise interest rates, which decreases investment.
   (E) buy bonds and decrease the discount rate to encourage borrowing.

10. Reserves, the money supply and interest rates are most likely to change in which of the following ways when the Federal Reserve sells bonds?

<table>
<thead>
<tr>
<th>Reserves</th>
<th>Money Supply</th>
<th>Interest Rates</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Increase</td>
<td>Increase</td>
<td>Increase</td>
</tr>
<tr>
<td>(B) Increase</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>(C) Decrease</td>
<td>Increase</td>
<td>Decrease</td>
</tr>
<tr>
<td>(D) Decrease</td>
<td>Decrease</td>
<td>Increase</td>
</tr>
<tr>
<td>(E) Decrease</td>
<td>Decrease</td>
<td>Decrease</td>
</tr>
</tbody>
</table>

11. Which of the following actions by the Federal Reserve will result in an increase in banks' excess reserves?
   (A) Buying bonds on the open market
   (B) Selling bonds on the open market
   (C) Increasing the discount rate
   (D) Increasing the reserve requirement
   (E) Increasing the federal funds rate

12. Aggregate demand and aggregate supply analysis suggests that, in the short run, an expansionary monetary policy will result in
   (A) a shift in the aggregate demand curve to the left.
   (B) a shift in the aggregate supply curve to the left.
   (C) an increase in real GDP without much inflation when the economy is on the horizontal portion of the aggregate supply curve.
   (D) an increase in real GDP with high inflation when the economy is on the horizontal portion of the aggregate supply curve.
   (E) an increase in real GDP and no inflation when the economy is on the vertical portion of the aggregate supply curve.

13. Which of the following combinations of monetary policy actions would definitely cause a decrease in aggregate demand?

<table>
<thead>
<tr>
<th>Discount Rate</th>
<th>Open Market Operations</th>
<th>Reserve Requirement</th>
</tr>
</thead>
<tbody>
<tr>
<td>(A) Decrease</td>
<td>Buy bonds</td>
<td>Decrease</td>
</tr>
<tr>
<td>(B) Decrease</td>
<td>Sell bonds</td>
<td>Decrease</td>
</tr>
<tr>
<td>(C) Increase</td>
<td>Buy bonds</td>
<td>Increase</td>
</tr>
<tr>
<td>(D) Increase</td>
<td>Sell bonds</td>
<td>Decrease</td>
</tr>
<tr>
<td>(E) Increase</td>
<td>Sell bonds</td>
<td>Increase</td>
</tr>
</tbody>
</table>

14. Which of the following is most likely to increase the velocity of money?
   (A) Higher frequency of paychecks
   (B) Decrease in the price level
   (C) Decrease in interest rates
   (D) Decrease in personal income
   (E) Increase in the unemployment rate
15. Which of the following characteristics of money could be found in bars of gold?
   (A) Portability, uniformity and stability in value
   (B) Portability and acceptability
   (C) Uniformity, acceptability and stability in value
   (D) Uniformity and durability
   (E) Portability and stability in value

16. The real interest rate is simply stated as the
   (A) price of borrowed money in the future.
   (B) inflation rate minus the CPI.
   (C) nominal interest rate over time.
   (D) nominal interest rate minus the expected inflation rate.
   (E) nominal interest rate plus the expected inflation rate.

17. Vault cash and reserve accounts are similar in that each
   (A) earns no interest.
   (B) provides for the bank’s use of large amounts of cash.
   (C) is maintained by the bank at a fixed percentage set by the Federal Reserve.
   (D) is kept on account at the Federal Reserve Bank.
   (E) is part of the money supply.

18. The neutrality of money refers to the situation where
   (A) money has not been the cause of war.
   (B) increases in interest rates are matched by decreases in the price of bonds.
   (C) increases in interest rates are matched by increases in the price of bonds.
   (D) increases in the money supply eventually result in no change in real output.
   (E) decreases in the money supply result in increases in the interest rate in the short run.

19. Expansionary monetary policy results in which of the following in the short run?
   I. The money supply increases.
   II. The nominal interest rate decreases.
   III. The real interest rate decreases.
   IV. Bond prices decrease.
   (A) I and II only
   (B) I, II and III only
   (C) I, II and IV only
   (D) III and IV only
   (E) IV only

20. True statements about expansionary monetary policy in the long run include which of the following?
   I. Price level increases to match the increase in the money supply.
   II. The nominal interest rate equals the real interest rate plus the expected inflation rate.
   III. The real output level has not permanently increased.
   (A) I only
   (B) II only
   (C) III only
   (D) I and II only
   (E) I, II and III