

Chapter 02 Money Money Supply and Interest

MULTICHOICE

1. The country of Bountiful is suffering from disastrous inflation of 100% per month, and as a result, the merchants and citizens have stopped using the domestic currency, bounties, for transactions. Instead they have begun to use zombies, the currency of their closest neighbor, Dark Shadows, for transactions. This practice is known as

- (A) disintermediation.
- (B) legalization.
- (C) dollarization.
- (D) monetization.

Answer : (C)

2. Dollarization occurs when

- (A) a country officially adopts another country's currency as their legal tender.
- (B) a country officially adopts the US dollar as their legal tender.
- (C) the US Treasury prints more currency.
- (D) the Federal Reserve prints more currency.

Answer : (A)

3. Following World War II, inflation became so bad that Germans stopped using Reichsmarks for transactions, and instead used cigarettes for small transactions and cognac (a type of brandy) for large transactions. Which of the following best describes this situation?

- (A) Cigarettes and cognac were popular commodities because Germans were heavy drinkers and smokers.
- (B) Germans wanted to disassociate themselves from the Third Reich.
- (C) Cigarettes and cognac functioned as money in Germany in this period following World War II.
- (D) Cigarettes and cognac were more plentiful than Reichsmarks, so Germans found them more convenient to use for transactions than Reichsmarks.

Answer : (C)

4. Money is generally thought of as

- (A) whatever a nation's government declares it to be.
- (B) being printed by the government.
- (C) a measure of the wealth of a nation.
- (D) anything generally accepted in exchange for goods and services.

Answer : (D)

5. In a barter economy with 100 goods, there would be _____ prices.

- (A) 10,000
- (B) 9,900
- (C) 4,950
- (D) 100

Answer : (C)

6. In a barter economy, the number of prices necessary will

- (A) depend on the number of people in the economy.
- (B) depend on the number of goods exchanged in the economy.
- (C) be too many to be counted.
- (D) be fewer than the number of prices in an economy with money.

Answer : (B)

7. When a coffee shop lists a tall coffee on its menu at \$2.95, the coffee shop is using money as a

- (A) unit of account.

(B) medium of exchange.

(C) store of value.

(D) source of profit.

Answer : (A)

8. On payday you get paid in cash, so each week you put \$10 into a shoebox in your closet so that you can buy a big-screen TV at the end of the year. In this situation, money is serving as a

(A) unit of account.

(B) medium of exchange.

(C) store of value.

(D) rainy day fund.

Answer : (C)

9. Assets accepted for repayment of debt to the government as well as private transactions are known as

(A) dollarization.

(B) fiat money.

(C) money aggregates.

(D) legal tender.

Answer : (D)

10. Mandy goes to the grocery store to buy groceries, and at the checkout counter she pays cash. This is an example of money being used as

(A) a store of value.

(B) barter.

(C) a medium of exchange.

(D) a unit of account.

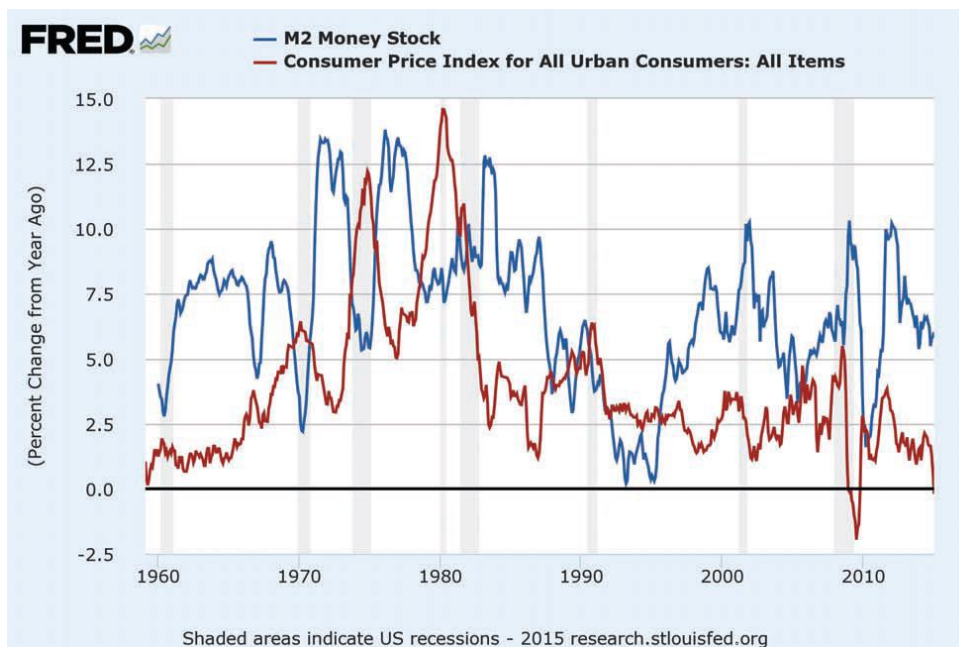
Answer : (C)

11. When there is too much money chasing too few goods, the likely impact is

- (A) unemployment.
- (B) stagflation.
- (C) inflation.
- (D) deflation.

Answer : (C)

12. What concept does the following diagram illustrate?



- (A) Movements in the price level are unrelated to movements in the money supply.
- (B) The price level tends to move in the opposite direction of the money supply.
- (C) The price level is fairly constant over time.
- (D) The price level tends to move in the same direction as the money supply.

Answer : (D)

13. Throughout time, many commodities have performed the function of money. Which of the following would NOT be a likely commodity to serve as money?

- (A) Silver
- (B) Animal furs
- (C) Milk
- (D) Grain

Answer : (C)

14. Which of the following would be most suitable as money?

- (A) Cigarettes
- (B) Flowers
- (C) Chocolate bars
- (D) Fish

Answer : (A)

15. Money that has no intrinsic value is known as

- (A) commodity money.
- (B) fiat money.
- (C) asset money.
- (D) interest.

Answer : (B)

16. Which of the following characteristics would make a commodity a good candidate to function as money?

- (A) Pleasing to the eye, broadly demanded, and easily standardized
- (B) Easily divisible, physically durable, and easy to carry around
- (C) Physically durable, easy to carry around, and difficult to lose
- (D) Broadly demanded, collectible, and easily divisible

Answer : (B)

17. Which of the following is included in the M1 definition of the money supply?

- (A) Savings deposits
- (B) Small time deposits
- (C) Demand deposits and other checkable deposits
- (D) Money market deposit accounts

Answer : (C)

18. Today, in the United States, several assets function as money. Which of the following would NOT be considered money?

- (A) Currency
- (B) Demand deposits
- (C) Checkable deposits
- (D) Credit cards

Answer : (D)

19. Regulation Q, passed following the Great Depression, set a

- (A) maximum on the interest rates banks can charge.
- (B) maximum on the interest rate that banks can pay on deposits.
- (C) maximum on the quantity of money that the US Treasury can print.

(D) floor on the interest rate that banks can pay on deposits.

Answer : (B)

20. The term monetary aggregates refers to things like

(A) M1 and M2.

(B) interest rates.

(C) the price of money.

(D) the consumer price index.

Answer : (A)

21. _____ is the removal of funds from a financial intermediary (e.g., bank) to invest them directly, as through a mutual fund.

(A) Disintermediation

(B) Dollarization

(C) Standardization

(D) Allocation

Answer : (A)

22. Interest rates

(A) are artificially low.

(B) are set by the government.

(C) can represent the price of money.

(D) are propped up by the Federal Reserve.

Answer : (C)

23. Sherry says that she requires a 3% rate of interest in order to lend you some money. This implies that for Sherry the present value of \$100 to be received one year from today is

- (A) \$97.09.
- (B) \$97.
- (C) \$100.03.
- (D) \$103.

Answer : (A)

24. Harold would be equally happy with receiving \$95 today or \$100 one year from today. Harold's friend Maud would be just as happy receiving \$90 today or \$100 one year from today. Based on this information, which of the following best describes the difference between Harold and Maud?

- (A) Harold has a higher rate of time preference than Maud.
- (B) Maud has a higher rate of time preference than Harold.
- (C) Maud is poorer than Harold.
- (D) Harold is older than Maud.

Answer : (B)

25. Molly's time preference is the

- (A) amount of time that Molly spends on financial transactions.
- (B) value of her time.
- (C) rate at which Molly prefers to consume today as opposed to consuming in the future.
- (D) rate of interest she is willing to pay for a loan.

Answer : (C)

26. If you borrow \$1,000 today to be paid back one year from today at 5% interest, the payment you will have to make in one year will be

- (A) \$1,005.

(B) \$1,050.

(C) \$1,055.

(D) \$1,500.

Answer : (B)

27. Shonda says that she would need to earn 3% interest in order to lend you money which you will pay back in two years. This implies that for Shonda the present value of \$100 to be received two years from today is

(A) \$97.09.

(B) \$100.06.

(C) \$94.26.

(D) \$59.17.

Answer : (C)

28. If the interest rate is 5%, the value of \$1,000 at the end of 10 years is

(A) \$1,505.

(B) \$1,628.89.

(C) \$10,000.

(D) \$57,665.04.

Answer : (B)

TRUEFALSE

29. For a criminal justice class, you take a field trip to a prison, and while there you notice something curious. Several times you see prisoners exchanging cigarettes for other items, such as a candy bar, a magazine, a soft drink, and so on. In this circumstance, cigarettes could be considered money.

(A) True

(B) False

Answer : (A)

30. For an asset to function as money, it must be easily divisible, easily standardized, easy to carry around, physically attractive, and broadly demanded.

(A) True

(B) False

Answer : (B)

31. With measurements of monetary aggregates such as M1 and M2, the money supply is relatively easy to measure.

(A) True

(B) False

Answer : (B)

32. The higher a person's rate of time preference, the lower the interest rate needed to get them to defer their consumption to the future.

(A) True

(B) False

Answer : (B)

SHORTANSWER

33. What is meant by the phrase "double coincidence of wants" in a barter economy?**Answer :** A barter economy is one in which people trade goods for goods because there is no generally accepted medium used for money. This means that, for any transaction to occur, there must be a double coincidence of wants between the two parties. Person A must want what person B is offering in exchange, and person B must want what person A is offering in exchange; hence, a double coincidence of wants.

34. What are some of the challenges of using a commodity money in society?**Answer :** A commodity

money is when some consumable asset is used for money in a society. The primary challenge with this scenario is getting the amount of money right. Too much money, and the society will have to deal with the problem of inflation. Too little money, and the society may not be able to grow and thrive.

35. Explain why it is that money received today has greater value than money received in the future.

Answer : This idea is known as the time value of money. Money received today can be spent today, meaning that you can enjoy the benefits of consuming and using what you purchase with your money immediately. Money received in the future cannot be spent until the future, so the benefit of your purchases cannot be enjoyed until the future. People would prefer to consume today rather than in the future.