

Week 10 Tutorial

ECON203: Macroeconomics 2

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Multiple Choice Questions

Question 1. A disadvantage of the barter system is that

- (a) no trade occurs.
- (b) people must produce all their own food, clothing, and shelter.
- (c) the opportunity to specialize is greatly reduced.
- (d) gold is the only unit of account.

Question 2. Money's primary role in the economy comes from the benefits of lowering transactions costs and allowing specialization. This function of money is called

- (a) store of value.
- (b) medium of exchange.
- (c) standard of deferred payment.
- (d) unit of account.

Question 3. In some countries, prices in stores are listed in terms of U.S. dollars, rather than in units of the local currency. That's most likely because

- (a) the country's political system is unstable.
- (b) interest rates are higher using U.S. dollars than using the local currency.
- (c) there is no other store of value.
- (d) the country has experienced high rates of inflation.

Question 4. Why do people keep currency in their pockets when bank deposits pay interest?

- (a) Because banks might steal your money.
- (b) Because currency is more liquid.
- (c) Because bank deposits lose value due to inflation.
- (d) Because bank deposits lose value due to changes in interest rates.

Question 5. Which of the following measures is the best measure of money as a medium of exchange?

- (a) M1
- (b) M2
- (c) M3
- (d) None of the above

Question 6. Which of the following statements about M1 and M2 is true?

- (a) Demand deposits are not part of M1.
- (b) M2 is more liquid than M1.
- (c) M1 is larger than M2.
- (d) Savings deposits are part of M2.

Question 7. M2 does not include

- (a) Treasury bonds.
- (b) passbook savings accounts.

- (c) small-denomination time deposits.
- (d) M1.

Question 8. Over half of U.S. currency is

- (a) held abroad.
- (b) used in the underground economy.
- (c) held by banks as reserves.
- (d) held by businesses, especially retailers, for making transactions.

Question 9. What's the most common way for a central bank to reduce the money supply?

- (a) Collect higher taxes
- (b) Sell bonds to the public
- (c) Buy bonds from the government
- (d) Buy bonds from the public

Question 10. A developing country does not have enough taxes to cover its expenditures and is unable to borrow. This government would be most likely to cover its deficit by

- (a) purchasing government bonds from the public.
- (b) selling government bonds to the public.
- (c) selling newly issued government bonds directly to the central bank.
- (d) buying newly issued government bonds directly from the central bank.

Problem Solving Questions

Question 11. All else being equal, how would each of the following affect the demand for M1? The demand for M2? Explain.

- (a) The maximum number of checks per month that can be written on money market mutual funds and money market deposit accounts is raised from three to thirty.
- (b) Home equity lines of credit that allow home-owners to write checks against the value of their homes are introduced.
- (c) The stock market crashes, and further sharp declines in the market are widely feared.
- (d) Banks introduce overdraft protection, under which funds are automatically transferred from savings to checking as needed to cover checks.
- (e) A crackdown reduces the illegal drug trades (which is carried out largely in currency).

Question 12. Assume that prices and wages adjust rapidly so that the markets for labour, goods and assets are always in equilibrium. What are the effects of each of the following on output, the real interest rate, and the current price level?

- (a) A temporary increase in government purchases.
- (b) A reduction in expected inflation.
- (c) A temporary increase in labour supply.
- (d) An increase in the interest rate paid on money.