CHAPTER 5 Review ....

1. The rate of inflation is the:
   A) median level of prices.
   B) average level of prices.
   C) percentage change in the level of prices.
   D) measure of the overall level of prices.

2. If there are 100 transactions in a year and the average value of each transaction is $10, then if there is $200 of money in the economy, transactions velocity is ______ times per year.
   A) 0.2
   B) 2
   C) 5
   D) 10

3. The income velocity of money:
   A) is defined in the identity $MV = PY$.
   B) is defined in the identity $MV = PT$.
   C) is the same thing as the transactions velocity of money.
   D) is the same as the number of times a dollar bill changes hands.

4. The inflation tax is paid:
   A) only by the central bank.
   B) by all holders of money.
   C) only by government bond holders.
   D) equally by every household.

5. If the nominal interest rate is 1 percent and the inflation rate is 5 percent, the real interest rate is:
   A) 1 percent.
   B) 6 percent.
   C) –4 percent.
   D) –5 percent.
6. The one-to-one relation between the inflation rate and the nominal interest rate, the Fisher effect, assumes that the:
   A) money supply is constant.
   B) velocity is constant.
   C) inflation rate is constant.
   D) real interest rate is constant.

7. According to the quantity theory a 5 percent increase in money growth increases inflation by ___ percent. According to the Fisher equation a 5 percent increase in the rate of inflation increases the nominal interest rate by _____.
   A) 1; 5
   B) 5; 1
   C) 1; 1
   D) 5; 5

8. The \textit{ex ante} real interest rate is equal to the nominal interest rate:
   A) minus the inflation rate.
   B) plus the inflation rate.
   C) minus the expected inflation rate.
   D) plus the expected inflation rate.

9. A positive relationship between nominal interest rates and inflation in the United States is obvious in:
   A) both recent data and nineteenth-century data.
   B) recent data but not nineteenth-century data.
   C) nineteenth-century data but not recent data.
   D) neither nineteenth-century data nor recent data.

10. The opportunity cost of holding money is the:
    A) nominal interest rate.
    B) real interest rate.
    C) federal funds rate.
    D) prevailing Treasury bill rate.

11. If the real return on government bonds is 3 percent and the expected rate of inflation is 4 percent, then the cost of holding money is ______ percent.
    A) 1
    B) 3
    C) 4
    D) 7
12. The general demand function for real balances depends on the level of income and the:
   A) real interest rate.
   B) nominal interest rate.
   C) rate of inflation.
   D) price level.

13. If the nominal interest increases, then:
   A) the money supply increases.
   B) the money supply decreases.
   C) the demand for money increases.
   D) the demand for money decreases.

14. The costs of reprinting catalogs and price lists because of inflation are called:
   A) menu costs.
   B) shoeleather costs.
   C) variable yardstick costs.
   D) fixed costs.

15. Inflation ______ the variability of relative prices and ______ allocative efficiency.
   A) increases; increases
   B) increases; decreases
   C) decreases; decreases
   D) decreases; increases

16. The costs of unexpected inflation, but not of expected inflation, are:
   A) menu costs.
   B) the arbitrary redistribution of wealth between debtors and creditors.
   C) unintended distortions of individual tax liabilities
   D) the costs of relative price variability.

17. If nominal wages cannot be cut, then the only way to cut real wages is by:
   A) inflation.
   B) unions.
   C) legislation.
   D) productivity increases.
18. Hyperinflations ultimately are the result of excessive growth rates of the money supply; the underlying motive for the excessive money growth rates is frequently a government's:
A) desire to increase prices throughout the economy.
B) need to generate revenue to pay for spending.
C) responsibility to increase nominal interest rates by increasing expected inflation.
D) inability to conduct open-market operations.

19. Which of the following would most likely be called a hyperinflation?
A) Price increases averaged 300 percent per year.
B) The inflation rate was 10 percent per year.
C) Real GDP grew at a rate of 12 percent over a year.
D) A stock market index rose by 1,000 points over a year.

20. During hyperinflation real tax revenue of the government often drops substantially because of the:
A) delay between when a tax is levied and when it is collected.
B) significantly greater menu costs of printing tax forms.
C) additional deductions taken for increased shoelather costs.
D) greater uncertainty associated with extreme rates of inflation.

21. The major source of government revenue in most countries that are experiencing hyperinflation is:
A) customs duties.
B) income taxes.
C) seigniorage.
D) borrowing.

22. To end a hyperinflation, a government trying to reduce its reliance on seigniorage would:
A) print more money.
B) raise taxes and cut spending.
C) lower taxes and increase spending.
D) lower interest rates.

23. Devoting resources to avoiding the costs of expected inflation leads to:
A) eliminating the costs of expected inflation.
B) fewer relative price changes.
C) economic inefficiency.
D) a decrease in the transaction velocity of money.
24. If the money supply is held constant, then an increase in the nominal interest rate will ______ the demand for money and ______ the price level.
   A) increase; increase
   B) increase; decrease
   C) decrease; increase
   D) decrease; decrease

25. If the Fed announces that it will raise the money supply in the future but does not change the money supply today.
   A) both the nominal interest rate and the current price level will decrease.
   B) the nominal interest rate will increase and the current price level will decrease.
   C) the nominal interest rate will decrease and the current price level will increase.
   D) both the nominal interest rate and the current price level will increase.

26. The real return on holding money is:
   A) the real interest rate.
   B) minus the real interest rate.
   C) the inflation rate.
   D) minus the inflation rate.

27. In recent U.S. experience, inflation has:
   A) been persistent from year to year, whereas in the nineteenth century inflation had little persistence.
   B) been persistent from year to year, and this was also true in the nineteenth century.
   C) not been persistent from year to year, although it was persistent in the nineteenth century.
   D) not been persistent from year to year, and the same was true in the nineteenth century.

28. If the real interest rate and real national income are constant, according to the quantity theory and the Fisher effect, a 1 percent increase in money growth will lead to rises in:
   A) inflation of 1 percent and the nominal interest rate of less than 1 percent.
   B) inflation of 1 percent and the nominal interest rate of 1 percent.
   C) inflation of 1 percent and the nominal interest rate of more than 1 percent.
   D) both inflation and the nominal interest rate of less than 1 percent.

29. The real interest rate is equal to the:
   A) amount of interest that a lender actually receives when making a loan.
   B) nominal interest rate plus the inflation rate.
   C) nominal interest rate minus the inflation rate.
   D) nominal interest rate.
30. Percentage change in $P$ is approximately equal to the percentage change in:
   A) $M$.
   B) $M$ minus percentage change in $Y$.
   C) $M$ minus percentage change in $Y$ plus percentage change in velocity.
   D) $M$ minus percentage change in $Y$ minus percentage change in velocity.

31. If the money supply increases 12 percent, velocity decreases 4 percent, and the price level increases 5 percent, then the change in real GDP must be ______ percent.
   A) 3
   B) 4
   C) 9
   D) 11

32. According to the quantity theory of money, if money is growing at a 10 percent rate and real output is growing at a 3 percent rate, but velocity is growing at increasingly faster rates over time as a result of financial innovation, the rate of inflation must be:
   A) increasing.
   B) decreasing.
   C) 7 percent.
   D) constant.
Answer Key

1. C
2. C
3. A
4. B
5. C
6. D
7. D
8. C
9. B
10. A
11. D
12. B
13. D
14. A
15. B
16. B
17. A
18. B
19. A
20. A
21. C
22. B
23. C
24. C
25. D
26. D
27. A
28. B
29. C
30. C
31. A
32. A