1) The major shortcoming of a barter economy is  
   A) that money loses value from inflation.  
   B) that goods and services are not traded.  
   C) the requirement of specialization and exchange.  
   D) the requirement of a double coincidence of wants.  

2) Commodity money  
   A) can be used to purchase commodities, but not services.  
   B) has little to no value independent of its use as money.  
   C) is backed by a valuable commodity such as gold.  
   D) has value independent of its use as money.  

3) In a ______ economy there are more prices than in a ______ economy.  
   A) fiat; barter  
   B) money; barter  
   C) barter; money  
   D) fiat; money
4) The statement, "My iPhone is worth $500" represents money’s function as
   A) a standard of deferred payment.       B) a medium of exchange.
   C) a store of value.                    D) a unit of account.

5) Which of the following functions of money would be most violated if inflation were high?
   A) store of value        B) unit of account
   C) certificate of gold   D) medium of exchange

6) Dollar bills in the modern economy serve as money because
   A) they are backed by the gold stored in Fort Knox.
   B) they have value as a commodity independent of their use as money.
   C) people have confidence that others will accept them as money.
   D) they can be redeemed for gold by the central bank.

7) If a person withdraws $500 from his/her savings account and puts it in his/her checking account, then M1 will ______ and M2 will ______.
   A) increase; not change
   B) not change; increase
   C) not change; not change
   D) not change; decrease
   E) increase; decrease

Scenario 13–1

<p>| | |</p>
<table>
<thead>
<tr>
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</thead>
<tbody>
<tr>
<td>Currency</td>
<td>$1,000</td>
</tr>
<tr>
<td>Checking Account Balances</td>
<td>$2,000</td>
</tr>
<tr>
<td>Savings Account Balances</td>
<td>$5,000</td>
</tr>
<tr>
<td>Small-Denomination Time Deposits</td>
<td>$6,000</td>
</tr>
<tr>
<td>Noninstitutional Money Market Fund Shares</td>
<td>$7,000</td>
</tr>
</tbody>
</table>

Consider the information above for a simple economy. Assume there are no traveler’s checks.

8) Refer to Scenario 13–1. M2 in this simple economy equals
   A) $14,000.       B) $21,000.       C) $8,000.       D) $3,000.

9) Banks can make additional loans when required reserves are
   A) less than total reserves.        B) greater than total reserves.
   C) less than total loans.          D) less than total deposits.

10) If the central bank can act as a lender of last resort during a banking panic, banks can
    A) satisfy customer withdrawal needs and eventually restore the public’s faith in the banking system.
    B) call in their loans to their customers and eventually restore the public’s faith in the banking system.
    C) borrow more and more money from the central bank, and this will lower its reserves and decrease the public’s faith in the banking system.
    D) encourage the public to borrow directly from the central bank, and this will worsen the banking panic.
11) The purchase of Treasury securities by the Federal Reserve will, in general,
   A) not change the money supply.
   B) not change the quantity of reserves held by banks.
   C) decrease the quantity of reserves held by banks.
   D) increase the quantity of reserves held by banks.

12) Suppose a bank has $100 million in checking account deposits with no excess reserves and the
    required reserve ratio is 20 percent. If the Federal Reserve reduces the required reserve ratio to 15
    percent, then the bank will now have excess reserves of
    A) $0.
    B) $20 million.
    C) $5 million.
    D) $15 million.

13) Using the quantity equation, if the velocity of money grows at 5 percent, the money supply grows
    at 10 percent, and real GDP grows at 4 percent, then the inflation rate will be
    A) 19 percent.
    B) 6 percent.
    C) 11 percent.
    D) 15 percent.

14) The quantity theory of money predicts that, in the long run, inflation results from the
    A) money supply growing at a lower rate than real GDP.
    B) velocity of money growing at a faster rate than real GDP.
    C) velocity of money growing at a lower rate than real GDP.
    D) money supply growing at a faster rate than real GDP.

15) Monetary policy refers to the actions the
    A) Federal Reserve takes to manage the money supply and interest rates to pursue its economic
        objectives.
    B) President and Congress take to manage government spending and taxes to pursue their
        economic objectives.
    C) President and Congress take to manage the money supply and interest rates to pursue their
        economic objectives.
    D) Federal Reserve takes to manage government spending and taxes to pursue its economic
        objectives.

16) An increase in the interest rate
    A) increases the opportunity cost of holding money.
    B) decreases the percentage yield of holding money.
    C) decreases the opportunity cost of holding money.
    D) increases the percentage yield of holding money.

17) An increase in the price level causes
    A) a movement up along the money demand curve.
    B) the money demand curve to shift to the left.
    C) a movement down along the money demand curve.
    D) the money demand curve to shift to the right.

18) The interest rate on a Treasury bill that you pay $980 for today that matures in one year and pays
    $1,000 is
    A) 3 percent.
    B) 4 percent.
    C) 2 percent.
    D) 1 percent.

19) For purposes of monetary policy, the Federal Reserve has targeted the interest rate known as the
    A) discount rate.
    B) prime rate.
    C) federal funds rate.
    D) Treasury bill rate.
20) The monetary policy target the Federal Reserve focuses primarily on today is the
   A) inflation rate
   B) M1.
   C) interest rate.
   D) M2.
   E) unemployment rate.
Question 2 (9 points)
1) List the Fed’s four goals of monetary policy. (4 pts)
2) List the Fed’s three main monetary policy tools. (3 pts)
3) List the Fed’s two main monetary policy targets. (2 pts)

Question 3 (11 points)
Suppose you deposit $4,000 in currency into your checking account at Bank of America. Assume that Bank of America has no excess reserves at the time you make your deposit and that the required reserve ratio is 10 percent.
1) Use a T-account to show the initial effect of this transaction on Bank of America's balance sheet. (3 pts)
2) Suppose that Bank of America makes the maximum loan they can from the funds you deposited. Use a T-account to show the initial effect on Bank of America’s balance sheet from granting the loan. Also include in this T-account the transaction from question (1). (3 pts)
3) What is the maximum increase in checking account deposits of the whole banking system that can result from your $4,000 deposit? What is the maximum increase in the money supply? Are they equal? Why? (5 pts)

Question 4 (20 points)
1) Using money supply and money demand model to verbally and graphically explain how an open market purchase of Treasury securities by the Fed would affect the equilibrium short-run money market interest rate. (10 pts)

2) Using money supply and money demand model to verbally and graphically explain how the equilibrium short-run money market interest rate would change when the economy goes into a recession and the Fed does not pursue monetary policy. (10 pts)
Question 5 (10 points)
Use Dynamic AD-AS framework to verbally and graphically show how an open market sale of Treasury securities by the Fed would be useful to fight inflation.

Question 6 (10 points)
Can the Fed target both the money supply and an interest rate at the same time? Explain your answer verbally and graphically.

Question 7 (Extra 5 points)
What is the price of a Treasury bill that pays $1,000 in one year, if its interest rate is 10 percent? What is the price of the Treasury bill if its interest rate is 8 percent?