Name: ___________________________________ Date: ______________

1. The transactions velocity of money indicates the _____ in a given period, while the income velocity of money indicates the _____ in a given period.
   A) number of transactions; amount of income earned
   B) quantity of money used for transactions; quantity of money paid as income
   C) number of times a dollar bill changes hands; number of times a dollar bill enters someone's income
   D) volume of transactions; flow of income

2. When the demand for money parameter, *k*, is large, the velocity of money is ______ and money is changing hands ______
   A) large; frequently
   B) large; infrequently
   C) small; frequently
   D) small; infrequently

3. The demand for real money balances is generally assumed to:
   A) be exogenous.
   B) be constant.
   C) increase as real income increases.
   D) decrease as real income increases.

4. 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

5. Consider the money demand function that takes the form $(M/P)^d = kY$, where M is the quantity of money, P is the price level, k is a constant, and Y is real output. If the money supply is growing at a 10 percent rate, real output is growing at a 3 percent rate, and k is constant, what is the average inflation rate in this economy?
   A) 3 percent
   B) 7 percent
   C) 10 percent
   D) 13 percent

6. Using average rates of money growth and inflation in the United States over many decades, Friedman and Schwartz found that decades of high money growth tended to have ______ rates of inflation and decades of low money growth tended to have ______ rates of inflation.
   A) high; high
   B) high; low
   C) low; low
   D) low; high

7. 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.

8. If the real interest rate declines by 1 percent and the inflation rate increases by 2 percent, the nominal interest rate must:
   A) increase by 2 percent.
   B) increase by 1 percent.
   C) remain constant.
   D) decrease by 1 percent.

9. In the classical model, according to the quantity theory and the Fisher equation, an increase in money growth increases:
   A) output.
   B) velocity
   C) the nominal interest rate.
   D) the real interest rate.

10. Equilibrium in the market for goods and services determines the ______ interest rate and the expected rate of inflation determines the ______ interest rate.
   A) *ex ante* real; *ex ante* nominal
   B) *ex post* real; *ex post* nominal
   C) *ex ante* nominal; *ex post* real
   D) *ex post* nominal; *ex post* real

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. 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.

13. 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

14. If inflation is 6 percent and a worker receives a 4 percent nominal wage increase, then the worker's real wage:
    A) increased 4 percent.
    B) increased 2 percent.
    C) decreased 2 percent.
    D) decreased 6 percent.

15. If consumption depends positively on the level of real balances, and real balances depend negatively on the nominal interest rate in a neoclassical model, then:
    A) the classical dichotomy still holds.
    B) a rise in money growth leads to a fall in consumption and a rise in investment.
    C) a rise in money growth leads to a rise in consumption and a fall in investment.
    D) a rise in money growth leads to a rise in both consumption and investment.

16. Assume that the demand for real money balance (M/P) is $M/P = 0.6Y - 100i$, where Y is national income and i is the nominal interest rate (in percent). The real interest rate r is fixed at 3 percent by the investment and saving functions. The expected inflation rate equals the rate of nominal money growth.
    a. If Y is 1,000, M is 100, and the growth rate of nominal money is 1 percent, what must i and P be?
    b. If Y is 1,000, M is 100, and the growth rate of nominal money is 2 percent, what must i and P be?

17. The costs of expected inflation cause productive resources of an economy to be directed away from their efficient allocation. Explain how each of the following costs of expected inflation distort the allocation of productive resources:
    a. shoeleather costs
    b. menu costs
    c. the inconvenience of a changing price level