MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

1) If wealth decreases, the demand for stocks _____ and that of long-term bonds _____.
   A) decreases; decreases  B) increases; decreases
   C) increases; increases  D) decreases; increases

2) If the expected return on ABC stock is unchanged and the expected return on CBS stock falls from 10 to 5 percent, then the expected return of holding CBS stock _____ relative to ABC stock and the demand for ABC stock _____.
   A) rises; rises  B) rises; falls  C) falls; rises  D) falls; falls

3) If housing prices are suddenly expected to shoot up, then, other things equal, the demand for houses will _____ and that of Treasury bills will _____.
   A) increase; increase  B) increase; decrease  C) decrease; decrease  D) decrease; increase

4) When people begin to expect a run up in large stock market, the demand curve for bonds shifts to the _____ and the interest rate _____.
   A) right; falls  B) left; rises  C) left; falls  D) right; rises

5) When stock prices become less volatile, the demand curve for bonds shifts to the _____ and the interest rate _____.
   A) left; falls  B) left; rises  C) right; rises  D) right; falls

6) When bonds become less widely traded, and as a consequence the market becomes less liquid, the demand curve for bonds shifts to the _____ and the interest rate _____.
   A) right; falls  B) right; rises  C) left; rises  D) left; falls

7) The demand curve for bonds has the usual downward slope, indicating that at _____ prices of the bond, everything else equal, the _____ is higher.
   A) higher; quantity demanded  B) higher; demand  
   C) lower; demand  D) lower; quantity demanded

8) Factors that decrease the demand for bonds include
   A) an increase in the volatility of stock prices.
   B) a decrease in the inflation rate.
   C) a decrease in the expected returns on stocks.
   D) all of the above.
   E) none of the above.
9) You would be more willing to purchase U.S. Treasury bonds, other things equal, if
   A) gold becomes more liquid.
   B) you inherit $1 million from your Uncle Harry.
   C) you expect interest rates to rise.
   D) any of the above occurs.
   E) either B or C of the above occurs.

10) Holding everything else constant,
    A) the lower the expected return to asset A relative to alternative assets, the greater will be the
        demand for asset A.
    B) if asset A’s risk rises relative to that of alternative assets, the demand will increase for asset A.
    C) the more liquid is asset A, relative to alternative assets, the greater will be the demand for
        asset A.
    D) only A and B of the above.

11) In a contracting economy with declining wealth, the demand for bonds _____ and the demand
    curve for bonds shifts to the _____.
    A) rises; right          B) rises; left          C) falls; right          D) falls; left

12) Factors that can cause the supply curve for bonds to shift to the left include
    A) an expansion in overall economic activity.
    B) an increase in government deficits.
    C) a decrease in expected inflation.
    D) only A and C of the above.

13) A decrease in the expected rate of inflation causes the demand curve for bonds to _____ and the
    supply curve of bonds to _____.
    A) rise; fall              B) fall; rise              C) fall; fall              D) rise; rise

14) During a business cycle expansion, the supply of bonds shifts to the ____ as businesses perceive
    more profitable investment opportunities, while the demand for bonds shifts to the ____ as a
    result of the increase in wealth generated by the economic expansion.
    A) left; right             B) right; left             C) left; left             D) right; right

15) Expectations of inflation have a major impact on bond prices and interest rates through the

16) A situation in which the quantity of bonds supplied exceeds the quantity of bonds demanded is
    called a condition of excess supply; because people want to sell ____ bonds than others want to
    buy, the price of bonds will _____.
    A) fewer; rise              B) more; rise              C) more; fall              D) fewer; fall
17) When prices in the stock market become less uncertain, the demand curve for bonds shifts to the_____ and the interest rate_____.
   A) right; rises    B) right; falls    C) left; rises    D) left; falls

18) In the 1990s Japan had the lowest interest rates in the world due to a combination of
   A) deflation and expansion.
   B) deflation and recession.
   C) inflation and expansion.
   D) inflation and recession.
   E) disinflation and expansion.

19) A low savings rate will______ interest rates, and_______ investment in capital goods
   A) decrease; increase
   B) decrease; decrease
   C) decrease; not affect
   D) increase; increase
   E) increase; decrease

20) In Figure 5-1, one factor that would not have caused the supply of bonds to increase (shift to the right) is
   A) a decrease in government budget deficits.
   B) a business cycle expansion.
   C) expectations of more profitable investment opportunities.
   D) an increase in expected inflation.
21) In Figure 5-1, one factor that would not have caused the demand for bonds to shift to the left is
   A) an increase in the expected rate of inflation.
   B) an increase in the riskiness of bonds relative to other assets.
   C) a decrease in the expected return on bonds relative to other assets.
   D) expectations of lower interest rates in the future.

22) In Figure 5-2, one factor that would not have caused the supply of bonds to shift to the right is
   A) an increase in expected inflation.
   B) an increase in government budget deficits.
   C) a recession.
   D) a business cycle expansion.

23) In Keynes's liquidity preference framework,
   A) the demand for money must equal the supply of bonds.
   B) an excess supply of bonds implies an excess supply of money.
   C) the demand for bonds must equal the supply of money.
   D) all of the above.
   E) none of the above.

24) A decrease in the interest rate
   A) increases the demand for money.
   B) decreases the demand for money.
   C) increases the quantity of money demanded.
   D) has no effect on the quantity of money demanded.
   E) decreases the quantity of money demanded.
25) When real income increases, the demand curve for money shifts to the _____ and the interest rate _____.
   A) left; falls  B) right; fall  C) left; rises  D) right; rises

26) In the Keynesian liquidity preference framework, a rise in the price level causes the demand for money to _____ and the demand curve to shift to the _____.
   A) decrease; left  B) increase; left  C) increase; right  D) decrease; right

27) Holding everything else equal, a decrease in the money supply causes
   A) interest rates to increase initially.
   B) bond prices to increase initially.
   C) interest rates to decline initially.
   D) both A and C of the above.
   E) both B and C of the above.

28) When the interest rate is above the equilibrium interest rate, there is an excess _____ for (of) money and the interest rate will _____.
   A) demand; rise  B) supply; rise  C) supply; fall  D) demand; fall

29) In Figure 5-3, the decrease in the interest rate from $i_1$ to $i_2$ can be explained by
   A) a decrease in money growth.  B) an increase in the expected price level.
   C) a decrease in income.  D) only A and B of the above.
Figure 5-5

30) Figure 5-5 illustrates the effect of an increased rate of money supply growth. From the figure, one can conclude that the

A) Fisher effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.

B) Fisher effect is dominated by the liquidity effect and interest rates adjust slowly to changes in expected inflation.

C) liquidity effect is dominated by the Fisher effect and interest rates adjust quickly to changes in expected inflation.

D) liquidity effect is dominated by the Fisher effect and interest rates adjust slowly to changes in expected inflation.
Figure 5-7 illustrates the effect of an increased rate of money supply growth. From the figure, one can conclude that the

- A) liquidity effect is larger than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.
- B) liquidity effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
- C) liquidity effect is larger than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
- D) liquidity effect is smaller than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.
Answer Key
Testname: PRACTICE_CH5A

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