Chapter 27

Put into practice questions

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Which of the following statements are true and which are false? Explain your answers.

a. The precautionary demand for money is to purchase day-to-day items. FALSE
b. When the interest rate is high, demand for money is likely to be high. FALSE; it means people will want to save not hold money
c. The supply of money is assumed to be interest inelastic. TRUE
d. Excess demand for money is likely to lead to an increase in interest rates. TRUE; excess demand pulls up the price.
e. When the price of assets is high, the return on them falls. TRUE
f. Liquidity preference schedule is the supply of money. FALSE it is the demand

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In addition to interest rates, what are the influences on consumption and the influences on investment?

Consumption may be affected by:
Income
Expected future income
Consumer confidence
Stage in life cycle

Investment may be affected by:
Expectations of future earning
Business confidence

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Using diagrams outline the possible impact of a decrease in the money supply on the aggregate demand.

Money supply shifts inwards; interest rates rise; aggregate demand falls

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If the money multiplier is 5, the reserve ratio is:

Answer is : 20 per cent.

A central bank may increase the money supply:

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Answer is: by means of an open-market purchase of government bonds.

A decrease in reserve requirements ______ the money multiplier and ______ the money supply. Which of the following best completes this statement?

Answer is: increases; increases

End of chapter put into practice questions

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Using diagrams show the effect of an increase in the money supply on interest rates if the demand for money is interest elastic.

See figure 27.6. If demand is interest elastic, it is relatively flat so relatively little impact on interest rates.

Using diagrams show the effect of an increase in the money supply on interest rates if the demand for money is interest inelastic.

See figure 27.6. If demand is interest elastic, it is relatively flat so relatively large impact on interest rates.

Using diagrams show the effect of a fall in the money supply on interest rates, investment, aggregate demand, and national income and output.

See figure 27.6 but what will happen is:

- Money supply moves inwards
- Interest rates rise
- Investment falls
- Aggregate demand falls
- Prices and output fall.

Using diagrams show the intended effect of quantitative easing on national income.

Increases the money supply (see figure 27.6) and should increase aggregate demand and national income.

Using diagrams show how an increase in the money supply can lead to inflation.

See figure 27.6

Show why an increase in the money supply might not affect the interest rate.

If the demand for money is interest elastic.

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If M = £3,000bn, V = 2, T = 2,000 what is the price level?

MV=PT so 3000*2= P *2000; P=3

If M = £6,000bn, V = 2, T = 2,000 what is the price level?

MV=PT so 6000*2= P *2000; P=6

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