Homework #9  Chapter 11
Money Growth and Inflation

Use the quantity equation for questions 1 – 6. Suppose the money supply is $200, real output is 1000 units, and the price per unit of output is $1.

1. Write down the quantity equation. What is the value of velocity? [2 pts]

2. If velocity is fixed at the value solved for above, what does the quantity theory of money suggest will happen if the money supply is increased to $400? [2 pt]

3. Is your answer in (2) consistent with the classical dichotomy? Explain. [2 pts]

4. Suppose that when the money supply is doubled from $200 to $400, real output grows a small amount (say 2%). Now what will happen to prices? Do prices more than double, less than double, or exactly double? Explain. [2 pts]
5. When inflation gets very high, people do not like to hold money because it is losing value quickly. Therefore, they spend it faster. If when the money supply is doubled, people spend money more quickly, what happens to prices? Do prices more than double, less than double, or exactly double? Explain. [2 pts]

Multiple Choice Questions [10 pts]

6. In the long run, inflation is caused by
   a. banks that have market power and refuse to lend money.
   b. governments that raise taxes so high that it increases the cost of doing business and, hence, raises prices.
   c. governments that print too much money.
   d. increase in the price of inputs, such as labor and oil.
   e. none of the above.

7. When prices rise at an extraordinarily high rate, it is called
   a. inflation.
   b. hyperinflation.
   c. deflation.
   d. hypoinflation.
   e. disinflation.

8. If the price level doubles,
   a. the quantity demanded of money falls by half.
   b. the money supply has been cut by half.
   c. nominal income is unaffected.
   d. the value of money has been cut by half.
   e. none of the above.

9. In the long run, the demand for money is most dependent upon
   a. the level of prices.
   b. the availability of credit cards.
   c. the availability of banking outlets.
   d. the interest rate.

10. The quantity theory of money concludes than an increase in the money supply causes
    a. a proportional increase in velocity.
    b. a proportional increase in prices.
    c. a proportional increase in real output.
    d. a proportional decrease in velocity.
    e. a proportional decrease in prices.
11. An example of a real variable is
   a. the nominal interest rate.
   b. the ratio of the price of Coke to the price of Pepsi.
   c. the price of corn.
   d. the dollar wage.
   e. none of the above

12. If money is neutral,
   a. an increase in the money supply does nothing.
   b. the money supply cannot be changed because it is ties to a commodity such as gold.
   c. a change in the money supply only affects real variables such as real output.
   d. a change in the money supply only affects nominal variables such as prices and dollar wages.
   e. a changed in the money supply reduces velocity proportionately; therefore there is no effect on either prices or real output.

13. If the money supply grows 5%, and real output grows 2%, price should rise by
   a. 5%.
   b. less than 5%.
   c. more than 5%.
   d. none of the above.

14. Suppose the nominal interest rate is 7%, while the money supply is growing at a rate of 5% per year. If the government increases the growth rate of the money supply from 5% to 9%, the Fisher effect suggests that, in the long run, the nominal interest rate should become
   a. 4%
   b. 9%
   c. 11%
   d. 12%
   e. 16%

15. Suppose that, because of inflation, a business in Russia must calculate, print, and mail a new price list to its customers each month. This is an example of
   a. shoeleather costs.
   b. menu costs.
   c. costs due to inflation induced tax distortions.
   d. arbitrary redistributions of wealth.
   e. costs due to confusion and inconvenience.