

Homework 9 – KEY

Average: 67.2 + 8pts GI bonus

Due on 26/3/2024, by 23:00

This assignment is optional but STRONGLY RECOMMENDED. If you do not submit the answers till the deadline, the score of your final exam will substitute for the score for this assignment. Submit only the correct letter for each task on eLearn under 'Quizzes' within 'COR2100-Economics and Society G7-8-9-10'. Note that the actual text of questions and answers is not supposed to appear on the eLearn quiz. You have unlimited attempts. The system is programmed to credit your last attempt. Be informed that if you submit an attempt and afterwards you re-open the quiz, you must submit your answers AGAIN. Otherwise, the system will grade the unfinished attempt with 0 (because it is the last one) and there is NOTHING I can do to fix this after the fact. Late homework or homework submitted outside eLearn cannot be accepted as this would violate SMU official policy for fairness and transparency in grading. This assignment is protected by Grade Insurance™: If the assignment's average turns out to be below 75, an equal amount of bonus points will be given to every work, for the average to become 75. Direct any homework questions to your TA.

- 1✓ Which of the following is a function of money?
- A. A standard to measure value. *[True, since it is a unit of account]*
 - B. A means of saving value over time. *[True, since money is a store of value]*
 - C. It makes it easier to trade products or services. *[True, since it is a medium of exchange]*
 - 93%D. All of the above.
- 2✓ Which of the following features of money does cryptocurrency fail to serve?
- A. Independence from political influence or manipulation. *[Crypto does not depend on any government or institution]*
 - 78%B. Predictable value. *[Nobody can control the demand of cryptocurrency, so its value can fluctuate widely]*
 - C. Non-counterfeitability. *[Cryptocurrency is harder to counterfeit than ordinary money]*
 - 11%D. Protection against inflation or deflation. *[Liquid money that changes value often, is subject to inflation and deflation]*
- 3✓ Which of the following is a function of the Central Bank?
- 89%A. It acts as the bank of other banks.
 - B. It guarantees commercial banks' profitability. *[Profit maximization of commercial banks is not the objective of any CB]*
 - C. Both A and B.
 - D. None of the above.
- 4* Which of the following population groups is LESS affected in periods of high inflation?
- A. Employees with no bargaining power over their wages. *[Their real wage will decline]*
 - 31%B. People with no cash savings. *[They will not experience decrease in their real wealth]*
 - 37%C. Firms with fixed long-term contracts with their customers. *[The real value of their revenues will drop because costs will increase but contracts will prevent them from increasing their prices]*
 - 32%D. Governments which have issued long-term bonds. *[Governments will benefit from inflation since real value of their payments will drop]*

- 5✓ Which of the following is most likely to put downward pressure to the interest rate?
- A. An increase in price level. *[People will demand more money for their transactions, which will tend to increase the interest rate]*
 - B. An increase in unemployment. *[It does not affect much the money market]*
 - C. Government transferring funds from public health to public education. *[The same amount of money will be circulated, so it does not affect money market]*
 - 91%D. **Central Bank buying large amount of bonds by firms.** *[This increases money supply, thus decreasing interest rate]*
- 6✓ What is the role of money when you use your debit card to buy a book from Bookz.com?
- A. Unit of account.
 - 86%B. **Medium of exchange.** *[Using a debit card, money will be digitally transferred from the buyer to the seller]*
 - C. Store of value.
 - D. Money has no role in this transaction. *[Money will be transferred from your account to the sellers account]*
7. Suppose that the real GDP grows by 5% and at the same time prices increase by 4%. Which of the following could have happened?
- 17%A. Unemployment declined. *[It is very likely that unemployment has decreased if now the economy is able to produce more real output]*
 - 18%B. The money supply has increased. *[It is very likely that money supply has increased if both real GDP and the price level increased at the same time]*
 - 53%C. **Both A and B.**
 - 12%D. None of the above.
8. Which of the following is accurate if prices decline by 12% on average and wages decline by 8% on average?
- A. Both entrepreneurs and workers will be better off.
 - B. Both entrepreneurs and workers will be worse off.
 - 18%C. Entrepreneurs will be better off, and workers will be worse off.
 - 64%D. **Entrepreneurs will be worse off, and workers will be better off.** *[Workers' purchasing power will increase, making them better off. Entrepreneurs will be worse off, because their revenues will decline by approximately 12% since, while their cost (wages) only by approximately 8%]*
- 9✓ Which of the following is LESS likely to be the reason why a CB executes an Open Market Purchase?
- A. To implement monetary policy. *[Possible]*
 - 84%B. **To increase the interest rate.** *[OMP involves the CB buying securities, which ceteris paribus increases M_s and lowers the interest rate]*
 - C. To increase liquidity in the economy. *[Possible]*
 - D. To boost the economy. *[Possible]*
- 10✓ Which of the following is accurate according to the Phillips relationship?
- A. Firms expand their activities hiring more workers, which makes firms decrease prices.
 - B. Firms reduce their activities firing workers, which makes firms increase their prices.
 - 80%C. **An increase in the price level incentivizes firms to hire more workers.**
 - D. An increase in price level makes firms to fire workers. *[Inflation increases firms' profit margin, thus helping them to expand their activity and hire more workers]*

11. Which of the following could offset a decrease in money supply, leaving the interest rate unchanged?

27%A. Commercial banks decide to hold more reserves. *[It further decreases money supply]*

17%B. A decrease in taxation. *[The decrease in money supply would put upward pressure to the real interest rate. A decrease in taxation may cause an increase to real GDP, which will increase the money demand, putting more upward pressure to the interest rate]*

39%C. **A decrease in real GDP.** *[If there is less output, money demand will decline as people have to transact less. Thus, the interest rate will tend to decrease further]*

17%D. All of the above.

12. Which of the following is most likely to prevent commercial banks from lending money, under the “ample reserves regime”?

16%A. Insufficient deposits. *[Commercial banks do not need deposits, since they have unlimited reserves from their CB]*

38%B. **Lack of reliable investors.** *[Commercial banks are forced by the CB to implement adequate screening when giving loans]*

10%C. A high unemployment rate. *[It does not affect banks’ ability to give loans]*

36%D. All of the above.

13. How much money can be created from a \$500 deposit, if the reserve ratio is 10%?

29%A. Around \$450.

B. Around \$900.

C. Around \$2,500.

20%D. Around \$4,500.

46%E. **Around \$5,000.**

F. Around \$9,000.

[Total money creation is $\text{deposit} \cdot \frac{1}{RR} = 500 \cdot \frac{1}{0.10} = 500 \cdot 10 = \$5,000$]

14. Which of the following is LESS likely to be a reason why a small inflation can benefit economies?

A. It stimulates economic activity.

86%B. **It leads to a more equal distribution of income.**

C. It can help unemployed people to find jobs.

D. It increases firms’ profitability.

[During a moderate inflationary period, firms’ profits increase so they tend to hire more workers and increase their production. However, income distribution distortions still worsen income inequality]

15. In 2021, El Salvador legally adopted bitcoin as a formal currency, alongside with the US dollar. Today, most transactions are still conducted in US dollars, but there are also some that are carried out in bitcoin. How did the introduction of bitcoin affect El Salvador’s money market?

14%A. Its money demand for US dollars has increased.

73%B. **Its money demand of US dollars has decreased.**

C. Its money supply of US dollars has increased.

D. Its money supply of US dollars has decreased.

[Given that some transactions are served by bitcoin, people demand less US dollars in order to maintain the same volume of spending]

16. Which of the following could have been a result of Credit Suisse's collapse in March 2023, for Switzerland's money market?
- A. Money demand decreased. *[It increased, because of uncertainty over the banking sector]*
 - 52%B. Money supply decreased.** *[Since lots of deposits were cashed because of fear, the banking system's ability to "create" money was reduced]*
 - 36%C. Both A and B.
 - D. None of the above.
17. How would a speculator react to a decrease in the interest rate?
- 31%A. She will buy bonds.
 - 61%B. She will sell bonds.**
 - C. Either A or B.
 - D. None of the above.
- [The decrease in the interest rate would increase the price of bonds, thus speculators will sell their bonds at a high price point]*
18. Which of the following best describes the term "seignorage"?
- 92%A. The gain to a government from printing money instead of borrowing or taxing.** *[Seignorage refers to government financing its expenditure through having the CB printing money]*
 - B. The profit made by a CB from conducting Open Market Operations.
 - C. The cost of regulating the banking system.
 - D. The inflation tax paid by taxpayers according to their income every year. *[Inflation tax is not paid and is not according to income]*
19. Which of the following is true for the ample-reserves regime?
- 57%A. The CB can control the real interest rate.** *[True, the CB sets the interest rate]*
 - 17%B. Commercial banks cannot satisfy the entire demand for loans for any interest rate. *[False. They can because they have ample reserves]*
 - 12%C. The CB risks losses if a loan given by a commercial bank defaults. *[False. The commercial bank risks the losses]*
 - 14%D. All of the above.
20. Which of the following is true for the scarce-reserves regime?
- 12%A. The CB can control the real interest rate. *[True, the CB controls the interest rate by setting M1]*
 - 24%B. Commercial banks cannot satisfy the entire demand for loans for any interest rate. *[True. They cannot because they do not have ample reserves]*
 - 20%C. Banks are prohibited by the CB to loan out a certain percentage of deposits. *[True. It is called the reserve ratio]*
 - 44%D. All of the above.