

AP[®] Exam Practice Questions

Multiple-Choice Questions

- The interest rate is
 - the opportunity cost of lending money.
 - the price borrowers pay for the use of lenders' savings.
 - a percentage of the amount saved by borrowers.
 - the rate charged by banks to hold savings for one year.
 - the amount earned by using profits to build a new factory.
- Which of the following identities is true in a simplified economy with no government and no interaction with other countries?
 - consumer spending = investment spending
 - total income = consumer spending – investment spending
 - total spending = investment spending + savings
 - investment spending = total spending – savings
 - savings = investment spending
- A budget surplus exists when the government does which of the following?
 - saves
 - collects less tax revenue than it spends
 - has a negative budget balance
 - increases the national debt
 - uses expansionary fiscal policy
- Which of the following is a task of an economy's financial system?
 - maximizing risk
 - increasing transactions costs
 - decreasing diversification
 - eliminating liquidity
 - enhancing the efficiency of financial markets
- A financial intermediary that resells shares of a stock portfolio is a
 - mutual fund.
 - pension fund.
 - loan-backed security.
 - bond broker.
 - depository institution.
- Which of the following assets is most liquid?
 - stock
 - bond
 - loan
 - mutual fund
 - cash
- When money acts as a means of holding purchasing power over time, it is serving which function?
 - medium of exchange
 - source of liquidity
 - store of value
 - unit of account
 - source of wealth
- Which of the following is an example of using money as a unit of account?
 - buying a new T-shirt
 - purchasing \$10 worth of candy
 - keeping the dollar you receive each year for your birthday for 10 years
 - putting money into your savings account
 - paying for lunch with your debit card
- Which of the following is a desirable characteristic of money?
 - fixed supply
 - large denominations
 - made of precious metal
 - widely accepted
 - backed by commodities
- Fiat money derives its value from which of the following?
 - its official status
 - the good being used as a medium of exchange
 - a promise it can be converted into something valuable
 - gold or silver
 - exchange rates
- The M1 money supply includes which of the following?
 - near-moneys
 - checkable deposits
 - savings accounts
 - time deposits
 - mutual funds
- The present value of \$1 you receive one year from now is equal to
 - $\$1(1 + r)$.
 - $\$1/(1 - r)$.
 - $\$1/(1 + r)$.
 - $\$1(1 + r^2)$.
 - $\$1(1 + r)^2$.
- If the interest rate is 2%, the amount received 1 year from now as a result of lending \$1,000 today is
 - \$980.
 - \$1,000.
 - \$1,020.
 - \$1,200.
 - \$2,000.
- The liquid assets banks keep in their vaults are known as bank
 - deposits.
 - savings.
 - reserves.
 - money.
 - returns.

15. The required reserve ratio is
- the most cash that banks are allowed to hold in their vault.
 - set by the Federal Reserve.
 - responsible for most bank runs.
 - equal to 5% of bank deposits.
 - the fraction of bank loans held as reserves.
16. If rr is the reserve requirement, the money multiplier is equal to
- rr .
 - $1-rr$.
 - $1/rr$.
 - rr^2 .
 - $1/rr^2$.
17. Which of the following is part of the money supply but not part of the monetary base?
- checkable bank deposits
 - bank reserves
 - currency in circulation
 - deposits at the Fed
 - savings accounts
18. The Federal Reserve is a(n)
- single central bank located in New York.
 - government agency overseen by the Secretary of the Treasury.
 - system of 10 regional banks.
 - institution that oversees the banking system.
 - depository institution that lends to large corporations.
19. The Federal Reserve is charged with doing all of the following EXCEPT
- providing financial services to commercial banks.
 - supervising and regulating banks.
 - maintaining the stability of the financial system.
 - conducting monetary policy.
 - insuring bank deposits.
20. Which of the following will increase the demand for money?
- a fall in the aggregate price level
 - an increase in real GDP
 - technological advances
 - open-market operations by the Fed
 - a decrease in the interest rate
21. The money supply curve is
- upward sloping.
 - vertical.
 - horizontal.
 - downward sloping.
 - U-shaped.

22. When banking regulations were changed so that banks could pay interest on checking accounts, what was the effect on interest rates and the equilibrium quantity of money?

<i>Interest rate</i>	<i>Quantity of money</i>
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|-------------|-----------|
| a. increase | decrease |
| b. decrease | increase |
| c. increase | increase |
| d. decrease | decrease |
| e. increase | no change |
23. Which of the following will shift the supply curve for loanable funds to the right?
- an increase in the rate of return on investment spending
 - an increase in the government budget deficit
 - a decrease in the national saving rate
 - an increase in expected inflation
 - capital inflows from abroad
24. Crowding out is illustrated by which of the following changes in the loanable funds market?
- a decreasing equilibrium interest rate
 - an increase in the demand for loanable funds
 - a decrease in the demand for loanable funds
 - an increase in the supply of loanable funds
 - a decrease in the supply of loanable funds
25. The supply curve for loanable funds is
- upward sloping.
 - vertical.
 - horizontal.
 - downward sloping.
 - U-shaped.

Free-Response Question

- Draw a correctly labeled graph of the market for loanable funds. On your graph, indicate each of the following:
 - the equilibrium interest rate, labeled r_1
 - the equilibrium quantity of loanable funds, labeled Q_1
 - Use your graph from (a) to show how an increase in government spending affects the loanable funds market. On the graph, indicate each of the following:
 - the new equilibrium interest rate, labeled r_2
 - the new equilibrium quantity of loanable funds, labeled Q_2
 - Explain how the new interest rate (r_2) affects the level of real GDP. (5 points)