

9.4 Money and banking

Name: _____ Class: _____ Date: _____

Total: 25 marks

KEY WORDS liquidity • interest rate • liquidity preference
 • money supply • moral hazard

Objective

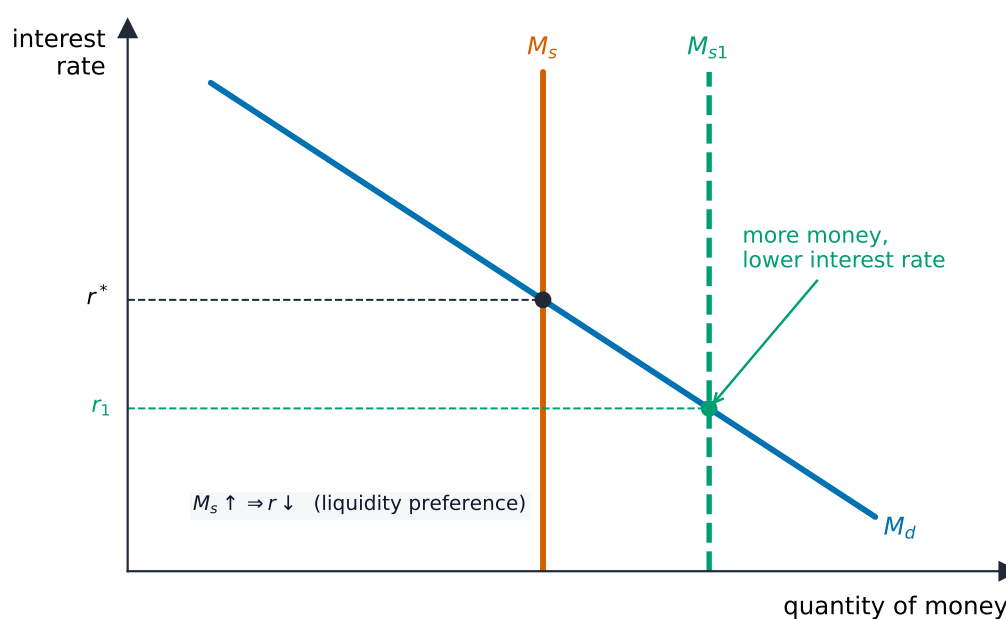
Build the skills to answer exam questions on **money and banking** – the functions of money, the role of the central and commercial banks, liquidity preference, and moral hazard.

You must be able to:

- state the four functions of money
- explain the roles of central and commercial banks
- analyse how the interest rate is set and the risk of moral hazard

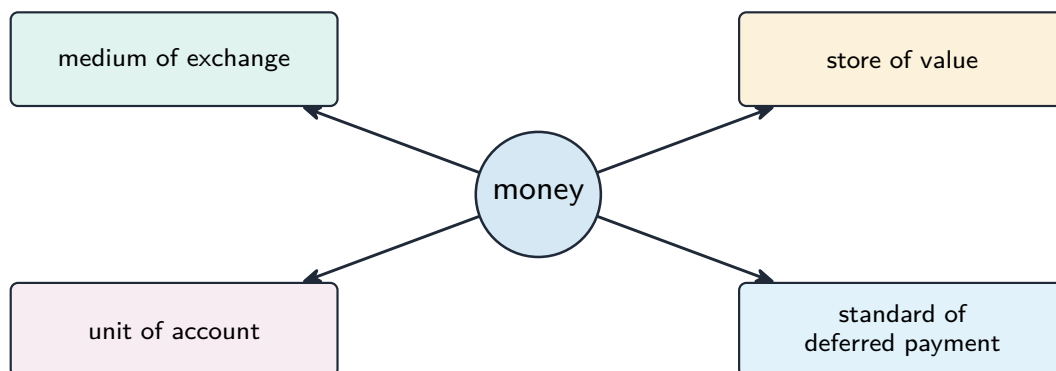
1 Key knowledge and worked examples

■ Money and the money market



A larger money supply tends to lower the interest rate

- **Four functions of money:** medium of exchange, store of value, unit of account, standard of deferred payment



The four functions of money, which a definition question expects you to name

- **Central bank** : issues notes, runs monetary policy, **lender of last resort** . **Commercial banks** create money by lending.
- **Liquidity preference** : the demand to hold money → with money supply, sets the **interest rate** .
- **Moral hazard** : banks take bigger risks if they expect a bailout.

Answer shapes: AO1 + AO2 + AO3 (analysis) + AO4 (a supported judgement *in context*).

2 Practice

2.1 State the four functions of money. [2]

2.2 Define the term *liquidity preference*. [2]

2.3 Define the term *moral hazard*. [2]

3 Exam-style questions

3.1 Which is **not** a function of money?

[1]

☐

A a medium of exchange

B a store of value

C a factor of production

D a unit of account

3.2 Explain how an increase in the money supply affects the interest rate.

[6]

3.3 Discuss whether moral hazard means governments should never rescue failing banks.[12]