

Name \_\_\_\_\_

ID \_\_\_\_\_

Section Number \_\_\_\_\_

**MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.**

- 1) When the Fed \_\_\_\_\_ the money stock, the money supply curve shifts to the \_\_\_\_\_ and the interest rate \_\_\_\_\_, everything else held constant. 1) \_\_\_\_\_  
A) decreases; right; rises B) decreases; left; falls  
C) increases; left; rises D) increases; right; falls
- 2) During a "flight to quality" 2) \_\_\_\_\_  
A) the spread between Treasury bonds and Baa bonds is not affected.  
B) the spread between Treasury bonds and Baa bonds decreases.  
C) the change in the spread between Treasury bonds and Baa bonds cannot be predicted.  
D) the spread between Treasury bonds and Baa bonds increases.
- 3) A consol paying \$20 annually when the interest rate is 5 percent has a price of 3) \_\_\_\_\_  
A) \$100. B) \$200. C) \$400. D) \$800.
- 4) Patrick places his pocket change into his savings bank on his desk each evening. By his actions, Patrick indicates that he believes that money is a 4) \_\_\_\_\_  
A) store of value. B) unit of account.  
C) medium of exchange. D) unit of specialization.
- 5) If a \$10,000 face-value discount bond maturing in one year is selling for \$5,000, then its yield to maturity is 5) \_\_\_\_\_  
A) 5 percent. B) 10 percent. C) 50 percent. D) 100 percent.
- 6) Which of the following are short-term financial instruments? 6) \_\_\_\_\_  
A) A repurchase agreement.  
B) A share of Walt Disney Corporation stock.  
C) A residential mortgage.  
D) A Treasury note with a maturity of four years.
- 7) An increase in the liquidity of corporate bonds will \_\_\_\_\_ the price of corporate bonds and \_\_\_\_\_ the yield of Treasury bonds, everything else held constant. 7) \_\_\_\_\_  
A) reduce; increase B) reduce; reduce  
C) increase; reduce D) increase; increase
- 8) If a security pays \$55 in one year and \$133 in three years, its present value is \$150 if the interest rate is 8) \_\_\_\_\_  
A) 5 percent. B) 10 percent. C) 12.5 percent. D) 15 percent.
- 9) A bank's net interest margin is defined by which of the following? 9) \_\_\_\_\_  
A) Yield on assets minus cost of funds. B) Interest income plus interest expense.  
C) Interest expense minus interest income. D) Yield on assets minus interest income.

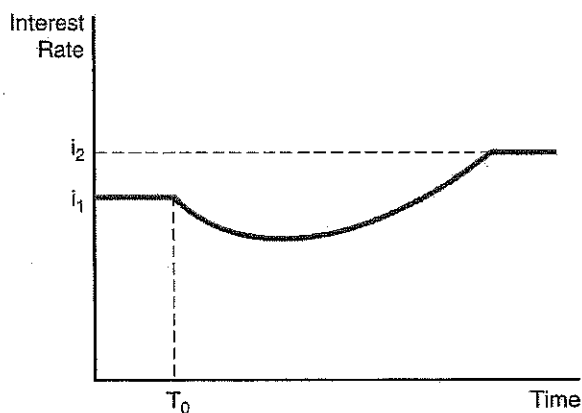
- 10) During the financial crisis, the Federal Reserve intervened in the commercial paper market by: 10) \_\_\_\_\_  
A) accepting special deposits from the Treasury and lending the money directly into the commercial paper market.  
B) creating money through their quantitative easing program and lending it in the commercial paper market.  
C) creating new regulations forcing banks to convert part of their excess reserves into commercial paper.  
D) encouraging prime MMMF to buy commercial paper.
- 11) Which was not a contributing factor to the broken investment banking model? 11) \_\_\_\_\_  
A) Excessive leverage. B) Falling home prices.  
C) Excessive due diligence. D) Mortgage securitization.
- 12) If bad credit risks are the ones who most actively seek loans and, therefore, receive them from financial intermediaries, then financial intermediaries face the problem of 12) \_\_\_\_\_  
A) moral hazard. B) free-riding.  
C) costly state verification. D) adverse selection.
- 13) When we say that money is a stock variable, we mean that 13) \_\_\_\_\_  
A) money never loses purchasing power.  
B) we must attach a time period to the measure.  
C) the quantity of money is measured at a given point in time.  
D) it is sold in the equity market.
- 14) A monetary expansion \_\_\_\_\_ stock prices due to a decrease in the \_\_\_\_\_ and an increase in the \_\_\_\_\_, everything else held constant. 14) \_\_\_\_\_  
A) reduces; current dividend; expected rate of return  
B) increases; required rate of return; future sales price  
C) increases; required rate of return; dividend growth rate  
D) reduces; future sales price; expected rate of return
- 15) The major criticism of the view that expectations are formed adaptively is that 15) \_\_\_\_\_  
A) it is easier to model adaptive expectations than it is to model rational expectations.  
B) adaptive expectations models have no predictive power.  
C) people are irrational and therefore never learn from past mistakes.  
D) this view ignores that people use more information than just past data to form their expectations.
- 16) Even economists have no single, precise definition of money because 16) \_\_\_\_\_  
A) the Federal Reserve does not employ or report different measures of the money supply.  
B) economists find disagreement interesting and refuse to agree for ideological reasons.  
C) the "moneyness" or liquidity of an asset is a matter of degree.  
D) money supply statistics are a state secret.
- 17) According to rational expectations theory, forecast errors of expectations 17) \_\_\_\_\_  
A) are unpredictable.  
B) are more likely to be positive than negative.  
C) tend to be persistently high or low.  
D) are more likely to be negative than positive.

18) In the Gordon growth model, a decrease in the required rate of return on equity \_\_\_\_\_  
 A) increases the current stock price. B) increases the future stock price.  
 C) reduces the current stock price. D) reduces the future stock price.

19) Which of the following bonds would you prefer to be buying?  
 A) A \$10,000 face-value security with a 9 percent coupon selling for \$10,000  
 B) A \$10,000 face-value security with a 10 percent coupon selling for \$9,000  
 C) A \$10,000 face-value security with a 10 percent coupon selling for \$10,000  
 D) A \$10,000 face-value security with a 7 percent coupon selling for \$10,000

20) A bank fails when its tangible equity falls below \_\_\_\_\_ percent of assets.  
 A) 0 B) 6 C) 2 D) 4

21) When yield curves are downward sloping,  
 A) long-term interest rates are above short-term interest rates.  
 B) medium-term interest rates are above both short-term and long-term interest rates.  
 C) short-term interest rates are above long-term interest rates.  
 D) short-term interest rates are about the same as long-term interest rates.



22) The figure above illustrates the effect of an increased rate of money supply growth at time period  $T_0$ . From the figure, one can conclude that the  
 A) liquidity effect is smaller than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.  
 B) liquidity effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.  
 C) liquidity effect is larger than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.  
 D) liquidity effect is larger than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.

23) If there are five goods in a barter economy, one needs to know ten prices in order to exchange one good for another. If, however, there are ten goods in a barter economy, then one needs to know \_\_\_\_\_ prices in order to exchange one good for another.  
 A) 20 B) 25 C) 30 D) 45

- 24) The \_\_\_\_\_ of the term structure of interest rates states that the interest rate on a long-term bond will equal the average of short-term interest rates that individuals expect to occur over the life of the long-term bond, and investors have no preference for short-term bonds relative to long-term bonds. 24) \_\_\_\_\_  
 A) segmented markets theory B) expectations theory  
 C) liquidity premium theory D) separable markets theory
- 25) Which of the following is not one of the characteristics of a failed bank? 25) \_\_\_\_\_  
 A) Chartered for more than 10 years. B) Large credit losses on CRE loans.  
 C) Exhibited weak underwriting standards. D) Pursued aggressive growth strategies.
- 26) An investment fund that engages in the "carry trade" looks at the slope of the yield curve to determine the \_\_\_\_\_. 26) \_\_\_\_\_  
 A) funding spread. B) interest rate risk spread.  
 C) default plus liquidity premium. D) credit spread.
- 27) Everything else held constant, if the tax-exempt status of municipal bonds were eliminated, then 27) \_\_\_\_\_  
 A) the interest rates on municipal, Treasury, and corporate bonds would all increase.  
 B) the interest rate on municipal bonds would exceed the rate on Treasury bonds.  
 C) the interest rates on municipal bonds would still be less than the interest rate on Treasury bonds.  
 D) the interest rate on municipal bonds would equal the rate on Treasury bonds.
- 28) Equity and debt instruments with maturities greater than one year are called \_\_\_\_\_ market instruments. 28) \_\_\_\_\_  
 A) benchmark B) money C) capital D) federal
- 29) Which of the following statements best explains how the use of money in an economy increases economic efficiency? 29) \_\_\_\_\_  
 A) Money cannot have an effect on economic efficiency.  
 B) Money increases economic efficiency because it decreases transactions costs.  
 C) Money increases economic efficiency because it discourages specialization.  
 D) Money increases economic efficiency because it is costless to produce.
- 30) Channeling funds from individuals with surplus funds to those desiring funds when the saver does not purchase the borrower's security is known as 30) \_\_\_\_\_  
 A) financial intermediation. B) barter.  
 C) taxation. D) redistribution.
- 31) If \$22,050 is the amount payable in two years for a \$20,000 simple loan made today, the interest rate is 31) \_\_\_\_\_  
 A) 5 percent. B) 10 percent. C) 22 percent. D) 25 percent.
- 32) The expectations theory and the segmented markets theory do not explain the facts very well, but they provide the groundwork for the most widely accepted theory of the term structure of interest rates, 32) \_\_\_\_\_  
 A) separable markets theory. B) liquidity premium theory.  
 C) the Keynesian theory. D) the asset market approach.
- 33) Assume you invest \$100 each year for 10 years in a bond fund earning a 5% annual return. How much money will be in the fund after 10 years? (The future value of an ordinary annuity). 33) \_\_\_\_\_  
 A) \$1,435.55 B) \$1,552.12 C) \$1,257.79 D) \$1,135.55

- 34) Everything else held constant, when the inflation rate is expected to rise, interest rates will \_\_\_\_\_; this result has been termed the \_\_\_\_\_. 34) \_\_\_\_\_  
 A) fall; Keynes effect B) fall; Fisher effect  
 C) rise; Keynes effect D) rise; Fisher effect
- 35) When money prices are used to facilitate comparisons of value, money is said to function as a \_\_\_\_\_ 35) \_\_\_\_\_  
 A) payments-system ruler. B) unit of account.  
 C) store of value. D) medium of exchange.
- 36) An example of the problem of \_\_\_\_\_ is when a corporation uses the funds raised from selling bonds to fund corporate expansion to pay for Caribbean cruises for all of its employees and their families. 36) \_\_\_\_\_  
 A) moral hazard B) credit risk  
 C) adverse selection D) risk sharing
- 37) Typically, borrowers have superior information relative to lenders about the potential returns and risks associated with an investment project. The difference in information is called \_\_\_\_\_ 37) \_\_\_\_\_  
 A) moral selection. B) adverse hazard  
 C) risk sharing. D) asymmetric information.
- 38) Securities are \_\_\_\_\_ for the person who buys them, but are \_\_\_\_\_ for the individual or firm that issues them. 38) \_\_\_\_\_  
 A) liabilities; assets B) assets; liabilities  
 C) nonnegotiable; negotiable D) negotiable; nonnegotiable
- 39) If a \$5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is \_\_\_\_\_ 39) \_\_\_\_\_  
 A) \$650. B) \$13. C) \$130. D) \$1,300.
- 40) Which of the following best describes Fannie Mae and Freddie Mac? 40) \_\_\_\_\_  
 A) Federally Chartered Thrift Institution B) National Bank  
 C) Government sponsored enterprise D) Special Purpose Vehicle
- 41) A bank's tier 1 capital is defined as: 41) \_\_\_\_\_  
 A) equity & retained earnings  
 B) common stock & preferred stock & earnings  
 C) tangible equity  
 D) common stock & preferred stock
- 42) Which of the following factors is not keeping interest rates low today? 42) \_\_\_\_\_  
 A) Excess cash in the corporate sector B) Federal Reserve selling bonds  
 C) Eurozone debt crisis D) Quantitative Easing
- 43) Federal funds are \_\_\_\_\_ 43) \_\_\_\_\_  
 A) funds raised by the federal government in the bond market.  
 B) loans made by banks to each other.  
 C) loans made by the Federal Reserve System to banks.  
 D) loans made by banks to the Federal Reserve System.
- 44) An increase in the time to the promised future payment \_\_\_\_\_ the present value of the payment. 44) \_\_\_\_\_  
 A) is irrelevant to B) decreases C) has no effect on D) increases

- 45) Which of the following is a long-term financial instrument? 45) \_\_\_\_\_  
A) A repurchase agreement. B) A U.S. Treasury bond.  
C) A U.S. Treasury bill. D) A negotiable certificate of deposit.
- 46) If stock prices are expected to climb next year, everything else held constant, the \_\_\_\_\_ curve 46) \_\_\_\_\_  
for bonds shifts \_\_\_\_\_ and the interest rate \_\_\_\_\_.  
A) supply; left; rises B) demand; left; falls  
C) demand; left; rises D) demand; right; rises
- 47) Using the one-period valuation model, assuming a year-end dividend of \$1.00, an expected sales 47) \_\_\_\_\_  
price of \$100, and a required rate of return of 5%, the current price of the stock would be  
A) \$110.00. B) \$101.00. C) \$100.00. D) \$96.19.
- 48) In 2012 the Federal Reserve used "Operation Twist" to push down long term interest rates. 48) \_\_\_\_\_  
"Operation Twist" is best described by which of the following?  
A) Fed sells short term bonds and buys long term bonds.  
B) The Fed issues currency and decreases bank reserves.  
C) Fed sells long term bonds today and buys them back tomorrow.  
D) Fed sells long term bonds and buys short term notes.
- 49) If the liquidity effect is smaller than the other effects, and the adjustment to expected inflation is 49) \_\_\_\_\_  
slow, then the  
A) interest rate will fall.  
B) interest rate will rise.  
C) interest rate will initially rise but eventually fall below the initial level in response to an  
increase in money growth.  
D) interest rate will initially fall but eventually climb above the initial level in response to an  
increase in money growth.
- 50) If there is an excess supply of money 50) \_\_\_\_\_  
A) individuals sell bonds, causing the interest rate to fall.  
B) individuals buy bonds, causing interest rates to fall.  
C) individuals buy bonds, causing interest rates to rise.  
D) individuals sell bonds, causing the interest rate to rise.

- 1) D
- 2) D
- 3) C
- 4) A
- 5) D
- 6) A
- 7) D
- 8) B
- 9) A
- 10) A
- 11) C
- 12) D
- 13) C
- 14) C
- 15) D
- 16) C
- 17) A
- 18) A
- 19) B
- 20) C
- 21) C
- 22) A
- 23) D
- 24) B
- 25) A
- 26) B
- 27) B
- 28) C
- 29) B
- 30) A
- 31) A
- 32) B
- 33) C
- 34) D
- 35) B
- 36) A
- 37) D
- 38) B
- 39) A
- 40) C
- 41) A
- 42) B
- 43) B
- 44) B
- 45) B
- 46) C
- 47) D
- 48) A
- 49) D
- 50) B