# Econ330 – Money and Banking

# Summer 2006

# Midterm

The exam consists of 45 multiple choice questions. Please answer ALL of them.

The duration of the exam is 1 hr 15 mins. DO NOT OPEN the exams until you are told to do so and STOP writing when you are told that the exam is over. Failure to comply will result in a 10% loss in the grade.

**Do not forget to write (and bubble) your name and university ID number on the scantron.**

NO PROGRAMMABLE OR FINANCIAL CALCULATORS ARE ALLOWED. Only simple or scientific calculators can be used.

GOOD LUCK!

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

1) Which of the following statements are true?

A) A corporate bond's return becomes less uncertain as default risk increases.

B) A bond with default risk will always have a positive risk premium, and an increase in its default risk will raise the risk premium.

C) The expected return on corporate bonds decreases as default risk decreases.

D) Only A and B of the above are true statements.

2) Factors that can cause the supply curve for bonds to shift to the right include

A) an increase in expected inflation.

B) an increase in government deficits.

C) an expansion in overall economic activity.

D) all of the above.

E) only A and B of the above.

3) A lower level of income causes the demand for money to _____ and the demand curve for money to shift to the _____.

A) increase; right  B) decrease; right  C) decrease; left  D) increase; left

4) The return on a 10 percent coupon bond that initially sells at the face value of $1,000 and sells for $900 next year is

A) –10 percent.  B) 5 percent.  C) 0 percent.  D) –5 percent.

5) If the price of a consol paying $75 annually is $1000, the rate of interest is

A) 7.5 percent.  B) 10 percent.  C) 75 percent.  D) 5 percent.  E) 15 percent.

6) Which of the following is included in the M1 measure of money but is not included in the M2 measure of money?

A) Currency

B) Checkable deposits

C) Traveler's checks

D) All of the above

E) None of the above

7) If there is an excess demand for money

A) individuals sell bonds, causing the interest rate to fall.

B) individuals sell bonds, causing the interest rate to rise.

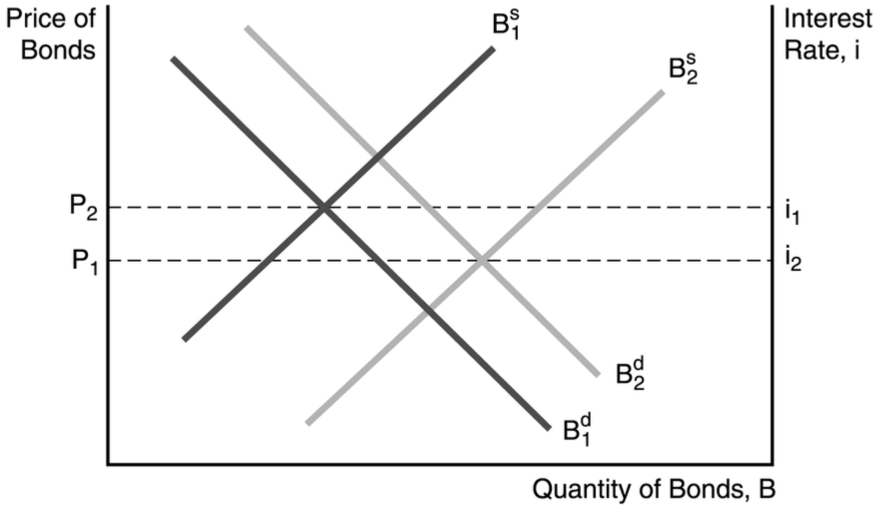
C) individuals buy bonds, causing bond prices to fall.

D) individuals buy bonds, causing interest rates to rise.

E) individuals buy bonds, causing interest rates to fall.

8) The theory of asset demand predicts that as the possibility of a default on a corporate bond increases, the expected return on the bond _____ while its relative riskiness _____.

A) falls; rises  B) falls; falls  C) rises; falls  D) rises; rises




9) In the figure above, one factor that would not have caused the supply of bonds to shift to the right is
   A) a business cycle expansion.
   B) a recession.
   C) an increase in expected inflation.
   D) an increase in government budget deficits.

10) Markets in which funds are transferred from those who have excess funds available to those who have a shortage of available funds are called
   A) financial markets.
   B) derivative exchange markets.
   C) commodity markets.
   D) fund–available markets.

11) If real GDP in 2002 is $10 trillion, and in 2003 real GDP is $9.5 trillion, then real GDP growth from 2002 to 2003 is
   A) 5%.
   B) –10%.
   C) 0%.
   D) .05%.
   E) –5%.

12) If stock prices are expected to drop dramatically, then, other things equal, the demand for stocks will _____ and that of Treasury bills will _____.
   A) increase; increase
   B) increase; decrease
   C) decrease; decrease
   D) decrease; increase

13) The risk that interest payments will not be made, or that the face value of a bond is not repaid when a bond matures is
   A) exchange rate risk.
   B) default risk.
   C) interest rate risk.
   D) inflation risk.
   E) moral hazard.

14) Which of the following $1,000 face–value securities has the lowest yield to maturity?
   A) A 15 percent coupon bond with a price of $800
   B) A 15 percent coupon bond with a price of $600
   C) A 15 percent coupon bond with a price of $1,200
   D) A 15 percent coupon bond with a price of $1,000
   E) A 15 percent coupon bond with a price of $1,500

15) If the expected path of 1–year interest rates over the next four years is 5 percent, 4 percent, 2 percent, and 1 percent, then the expectations theory predicts that today's interest rate on the four–year bond is

A) 2 percent. B) 1 percent. C) 4 percent. D) none of the above.

16) According to the expectations theory of the term structure

A) when the yield curve is downward sloping, short–term interest rates are expected to decline in the future.

B) buyers of bonds do not prefer bonds of one maturity over another.

C) when the yield curve is steeply upward sloping, short–term interest rates are expected to rise in the future.

D) all of the above.

E) only A and B of the above.

17) The risk structure of interest rates is

A) the relationship among interest rates on bonds with different maturities.

B) the relationship among interest rates of different bonds with the same maturity.

C) the relationship among the term to maturity of different bonds.

D) the structure of how interest rates move over time.

18) 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

A) free–riding. B) costly state verification.

C) moral hazard. D) adverse selection.

19) When stock prices become more volatile, the demand curve for bonds shifts to the _____ and the interest rate _____.

A) left; rises B) right; rises C) left; falls D) right; falls

20) Which of the following are true for a coupon bond?

A) When the coupon bond is priced at its face value, the yield to maturity equals the coupon rate.

B) The price of a coupon bond and the yield to maturity are negatively related.

C) The yield to maturity is greater than the coupon rate when the bond price is below the par value.

D) All of the above are true.

21) The process of calculating what dollars received in the future are worth today is called

A) calculating the yield to maturity. B) discounting the future.

C) deflating the future. D) none of the above.

22) If a $10,000 coupon bond has a coupon rate of 5 percent, then the coupon payment every year is

A) $40.

B) $600.

C) $400.

D) $140.

E) none of the above.

23) With an interest rate of 10 percent, the present value of a security that pays $1,100 next year *and* $1,460 four years from now is:

A) $2,000. B) $3,000. C) $1,000. D) $2,560.

24) According to the liquidity premium theory

A) a moderately rising yield curve indicates that short–term interest rates are not expected to change much in the future.

B) a flat yield curve indicates that short–term interest rates are expected to rise moderately in the future.

C) a steeply rising yield curve indicates that short–term interest rates are expected to remain unchanged in the future.

D) only A and B of the above are true.

25) The resources used finding buyers or sellers and negotiating price and other terms are called

A) information costs.

B) transactions costs.

C) enforcement costs.

D) pecuniary costs.

E) barter costs.

26) An increase in the expected rate of inflation causes the demand curve for bonds to _____ and the supply curve of bonds to _____.

A) fall; rise B) fall; fall C) rise; fall D) rise; rise

27) When yield curves are steeply upward sloping,

A) medium–term interest rates are above both short–term and long–term interest rates.

B) medium–term interest rates are below both short–term and long–term interest rates.

C) long–term interest rates are above short–term interest rates.

D) short–term interest rates are about the same as long–term interest rates.

E) short–term interest rates are above long–term interest rates.

28) Increasing transactions costs of selling an asset make the asset

A) more fungible.

B) more moneylike.

C) less liquid.

D) more valuable.

E) more liquid.

29) It is entirely possible that when the money supply rises, interest rates may _____ if the _____ effect is more than offset by changes in income, the price level, and expected inflation.

A) fall; risk B) rise; risk C) fall; liquidity D) rise; liquidity

30) Factors that decrease the demand for bonds include

A) an increase in the riskiness of stock prices.

B) a decrease in the inflation rate.

C) an increase in the federal government budget deficit.

D) an increase in the liquidity of stocks.

31) The current yield

A) more accurately approximates the yield to maturity when the bond's price is near par value and its maturity is long.

B) less accurately approximates the yield to maturity when the bond's price is near par value and its maturity is long.

C) more accurately approximates the yield to maturity when the bond's price is near par value and its maturity is short.

D) more accurately approximates the yield to maturity when the bond's price is far from par value and its maturity is short.

E) never provides a good approximation of current yield.

32) A loan that requires the borrower to make the same payment every period until the maturity date is called a

A) fixed-payment loan.

B) a same-payment loan.

C) discount loan.

D) simple loan.

E) none of the above.

33) If the amount payable in two years is $2420 for a simple loan at 10 percent interest, the loan amount is

A) $2400. B) $1210. C) $2200. D) $2000. E) $1000.

34) Bonds with relatively high risk of default are called

A) investment grade bonds. B) Brady bonds.

C) zero coupon bonds. D) junk bonds.

35) If income tax rates rise, then

A) the prices of municipal bonds would fall. B) the prices of Treasury bonds would rise.

C) the interest rate on municipal bonds would rise. D) the interest rate on Treasury bonds would rise.

36) Which of the following can be described as involving indirect finance?

A) A corporation issues new shares of stock.

B) People buy shares in a mutual fund.

C) A pension fund manager buys a short-term corporate security in the secondary market.

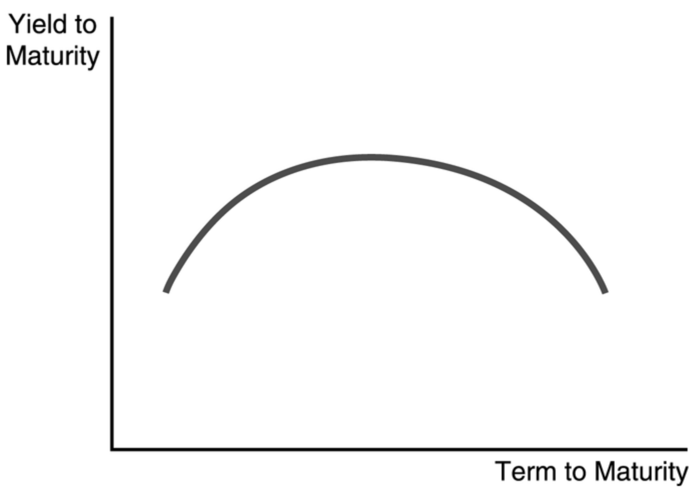
D) Both A and B of the above.

E) Both B and C of the above.

37) For a commodity to function effectively as money it must be
A) easily standardized, making it easy to ascertain its value.
B) widely accepted.
C) deteriorate quickly so that its supply does not become to large.
D) all of the above.
E) only A and B of the above.

38) Banks and other financial institutions engage in financial intermediation, which
A) involves borrowing from investors and lending to savers.
B) has no effect on economic performance.
C) can benefit economic performance.
D) can hurt the performance of the economy.
E) none of the above.

39) A common stock is a claim on a corporation's
A) earnings and assets.
B) debt.
C) employees.
D) expenses.
E) liabilities.




40) The inverted U–shaped yield curve in the figure above indicates that
A) short–term interest rates are expected to fall sharply in the near–term and rise later on.
B) short–term interest rates are expected to remain unchanged in the near–term and fall later on.
C) short–term interest rates are expected to rise in the near–term and fall later on.
D) short–term interest rates are expected to fall moderately in the near–term and rise later on.

41) When the inflation rate is expected to rise, interest rates will ____; this result has been termed the _____.

A) fall; Fisher effect

B) rise; Pigou effect

C) rise; Keynes effect

D) fall; Keynes effect

E) rise; Fisher effect

42) A corporation acquires new funds only when its securities are sold

A) in the primary market by a stock exchange broker.

B) in the secondary market by a securities dealer.

C) in the primary market by an investment bank.

D) in the secondary market by a commercial bank.

43) An increase in the riskiness of bonds relative to alternative assets causes the demand for bonds to _____ and the demand curve to shift to the _____.

A) rise; left B) fall; right C) fall; left D) rise; right

44) The yield on a discount basis of a 90–day $1,000 Treasury bill selling for $900 is

A) 40 percent. B) 25 percent. C) 10 percent. D) 20 percent.

45) For a bond selling for $4000, with a par value of $5000 and a coupon rate of 10 percent, the current yield is

A) 25 percent. B) 12.5 percent. C) 5 percent. D) 10 percent. E) 20 percent.