

ECFI 540: Sample: Exam 1

1. If the Fed increases the growth rate of money at time T, and people expect that the increased growth rate will be temporary, then
 - a. interest rates rise, because the liquidity effect outweighs the expected inflation effect.
 - b. interest rates fall, because the liquidity effect outweighs the expected inflation effect.
 - c. interest rates rise, because the liquidity effect is smaller than the expected inflation effect.
 - d. interest rates fall, because the liquidity effect is smaller than the expected inflation effect.
 - e. interest rates will remain the same, because neither the bond demand nor bond supply are affected.
2. Suppose the interest rate on loans is 3.8%, while the inflation rate is expected to be 1.9% per year. The real interest rate on these loans is _____% per year.
3. Use the information below to calculate the inflation rate from 1988 to 1989. It is _____%.

<u>Year</u>	<u>CPI</u>
1987	113.6
1988	118.3
1989	124.0
1990	130.7
1991	136.2

4. After a loan is made, bankers often ask commercial borrowers to file income statements each month during which the loan is outstanding. This is an attempt to deal with the problem of
 - a. moral hazard
 - b. adverse selection
 - c. transaction costs
 - d. regulation T.
5. Over the long run, there is a _____ relationship between inflation and interest rates.
 - a. direct, or positive
 - b. inverse, or negative
 - c. random, or uncorrelated
6. Over the long run, there is a _____ relationship between inflation and the growth rate of money.
 - a. direct, or positive
 - b. inverse, or negative
 - c. random, or uncorrelated

7. In general, there is a _____ relationship between the share prices in the stock market and bond prices.
- a. direct, or positive
 - b. inverse, or negative
 - c. random, or uncorrelated
8. Overall, there is a _____ relationship between the price level and the M2 money supply.
- a. direct, or positive
 - b. inverse, or negative
 - c. random, or uncorrelated
9. In general, recessions in the US have been preceded by
- a. increases in the growth rate of the money supply.
 - b. decreases in the growth rate of the money supply.
 - c. random fluctuations in the growth rate of the money supply.
10. Joe says, "A rapid increase in the money supply will cause 3-month T-bill interest rates to fall. But an sustained increase in the *growth rate* of the money supply cause them to rise."
- a. Joe is right, most of the time.
 - b. Joe has it just backwards. The money supply increase would cause a rise, and higher money growth rate would cause a fall in interest rates.
 - c. Joe is wrong, because the Treasury determines Treasury bill rates, not the market.
11. An appreciation of the Japanese Yen from 133¥ to 100¥ per dollar would be good for American businesses that import Japanese goods and resell them to US customers.
- a. true
 - b. false
12. Of these three instruments, which usually has the lowest yield?
- a. long term AAA corporate bonds
 - b. long term Treasury bonds
 - c. long term Baa corporate bonds
 - d. long term municipal bonds
 - e. none of the above: the relationship is random
13. Suppose the GDP deflator is 183, while nominal GDP is \$9,000 billion per year. Real GDP is approximately \$_____ billion.
- a. 49
 - b. 490
 - c. 4,900
 - d. 1,647
 - e. 165

14. Suppose there is an increase in people's expectations of future real estate prices. Other things equal, this would _____ the demand for loanable funds, and _____ the interest rate.

- a. increase, increase.
- b. increase, decrease
- c. decrease, increase.
- b. decrease, decrease

15. Of the following, which is the most important function of money in an economy?

- a. Source of income
- b. Unit of account
- c. Medium of exchange
- d. Store of value

16. If Mary withdraws \$100 from her checking account, then:

- a. M1 will increase by \$100.
- b. M2 will increase by \$100.
- c. M1 will not change.
- d. M2 will fall by \$100.
- e. M1 will fall by \$100.

17. Suppose there is an expectation of an increase in the future inflation rate. Other things equal, this would _____ the supply of bonds, and _____ the demand for bonds.

- a. increase, increase.
- b. increase, decrease
- c. decrease, increase.
- b. decrease, decrease

18. Which of the following is not part of M2?

- a. Saving accounts
- b. overnight repurchase agreements (repo's)
- c. Small time deposits
- d. Institutional money market mutual funds

19. Without a medium of exchange, an economy with 800 goods will have how many separate prices? _____.

20. If market interest rates are 5%, then a \$1000 (face value) Bond with a 9% coupon rate and a maturity of two years (coupon payments after year one and year two, and the face value in year two) will have a price of about \$_____.

21. If a bond sells at a premium, so that its price exceeds its face value, then we would expect to see market interest rates _____ the coupon rate.

- a. above
- b. below
- c. equal to

22. As a bond's price increases:

- a. its yield to maturity decreases.
- b. its yield to maturity can rise, fall, or not change.
- c. its yield to maturity increases.
- d. its yield to maturity does not change.

23. A prominent economist once said, "Inflation is always and everywhere a monetary phenomenon." Accordingly, countries that have high growth rates of their money supply will have _____ inflation.

24. Suppose an 10-year, 8%, \$1000 face value coupon bond is bought for \$800. A year later it is sold for \$840. The total rate of return is _____% per year.

25. A recession usually causes a _____ in bond demand that is _____ than the change in bond supply.

- a. decrease, smaller
- b. decrease, larger
- c. increase, smaller
- d. increase, larger

26. For a coupon bond, the current yield is calculated as:

- a. The current yield is the same as the coupon rate.
- b. $\text{Coupon Payment}/\text{Face Value}$
- c. $\text{Coupon Payment}/\text{Price}$
- d. $\text{Coupon Payment}/((\text{Price} + \text{Face Value})/2)$

27. Suppose the price of bond J, a substitute for bond K, rises. This will:

- a. increase the supply of bond K and reduce the interest rate on bond K.
- b. increase the supply of bond K and increase the interest rate on bond K.
- c. increase the demand for bond K and increase the interest rate on bond K.
- d. increase the demand for bond K and decrease the interest rate on bond K.

28. An increase in the expected inflation rate will:

- a. increase the demand for bonds, decrease the supply of bonds and increase the interest rate.
- b. increase the demand for bonds, increase the supply of bonds and increase the interest rate.
- c. decrease the demand for bonds, increase the supply of bonds and increase the interest rate.
- d. decrease the demand for bonds, decrease the supply of bonds and increase the interest rate.

29. Other things equal, an increase in aggregate income and total transactions will shift the _____ for money to the _____.

- a. demand, right
- b. demand, left
- c. supply, right
- d. supply, left

30. At interest rates below the equilibrium rate of interest

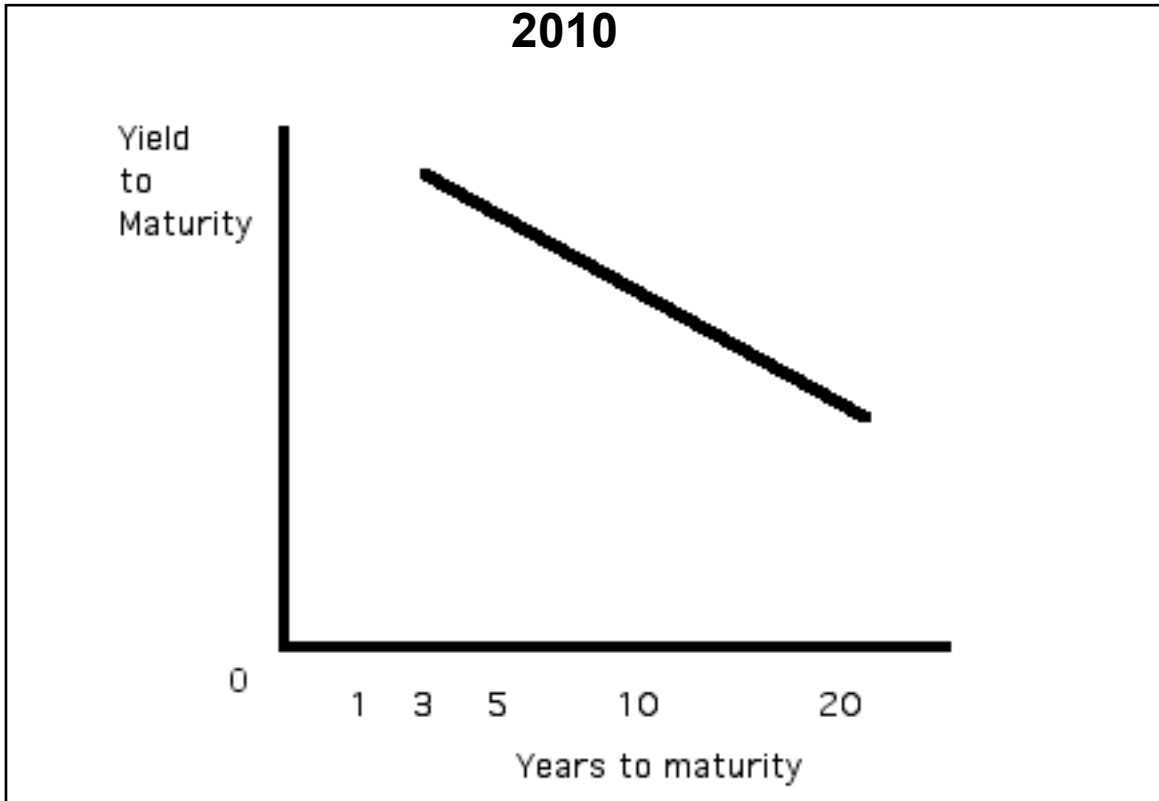
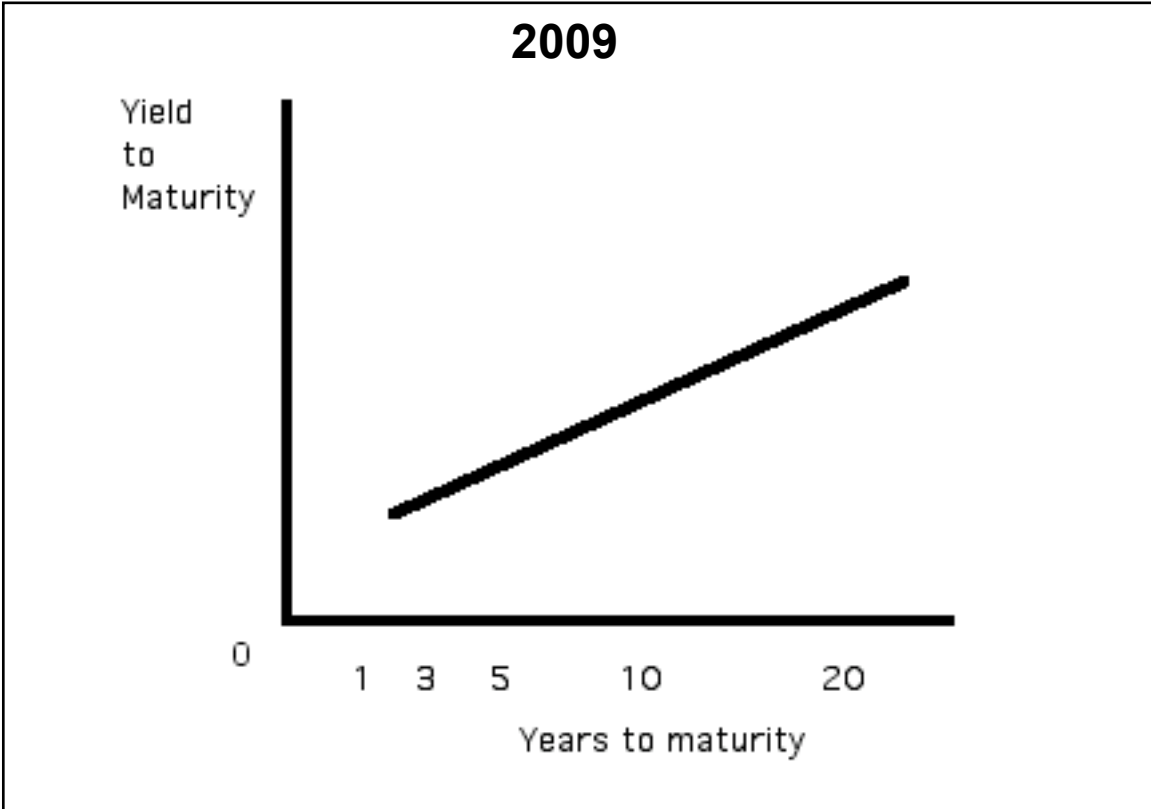
- a. there is an excess demand for bonds and the interest rate will rise.
- b. there is an excess supply of bonds and the interest rate will fall.
- c. there is an excess demand for money and the interest rate will rise.
- d. there is an excess supply of money and the interest rate will fall.

31. During recessions, aggregate income and total spending decrease. This results in a _____ in the demand for money and a _____ in the interest rate.
32. Suppose the Fed enters the money market to buy 1-month T-bills. This action will _____ the demand for 1-month T-bills and _____ the short term interest rate.
- a. increase, increase
 - b. increase, decrease
 - c. decrease, increase
 - d. decrease, decrease
 - e. not affect, not affect.
33. The risk premium on a bond is:
- a. the difference in interest rate between that bond and a municipal bond.
 - b. the difference in interest rates between that bond and a S&P 500 firm bond.
 - c. the difference in interest rate between that bond and a US government bond.
 - d. the difference in interest rate between that bond and a bank CD.
34. Municipal bonds generally have lower interest rates than US Treasury bonds because:
- a. their total issue is much lower than the total Treasury debt..
 - b. they have less risk.
 - c. they are much more liquid.
 - d. they are exempt from Federal taxes.
35. The term structure of interest rates shows:
- a. the relationship between risk and bond interest rates (yields).
 - b. the relationship between liquidity and bond interest rates (yields).
 - c. the relationship between bond interest rates (yields) and bond prices.
 - d. the relationship between time to maturity and bond interest rates (yields).
36. According to the expectations theory of the term structure, if the interest rate on a one year bond is 5% and the interest rate on a two year bond is 7%, then:
- a. the market expects the interest rate on a two year bond next year to be 6%.
 - b. the market expects the interest rate on a two year bond next year to be 9%.
 - c. the market expects the interest rate on a one year bond next year to be 6%.
 - d. the market expects the interest rate on a one year bond next year to be 9%.
 - e. the market expects the interest rate on a one year bond next year to be 12%.
37. The liquidity premium/expectations theory suggests that term-structure yield curves should usually be:
- a. downward sloping.
 - b. up-sloping to the right through year 1, then flat thereafter.
 - c. up-sloping to the right.
 - d. flat.



38. A yield curve like the one above usually appears during
- a recession, when the Fed is trying to stimulate the economy
 - a boom, when the Fed is trying to slow the economy
 - a recession, when the Fed is trying to slow the economy
 - a boom, when the Fed is trying to stimulate the economy
 - normal times, when the Fed is neutral
39. The risk premium on a bond is:
- the difference in interest rate between that bond and a municipal bond.
 - the difference in interest rate between that bond and a US government bond.
 - the difference in interest rates between that bond and a S&P 500 firm bond.
 - the difference in interest rate between that bond and a bank CD.
40. If the interest rate rises one basis point, then it has gone from 4% to
- 4.01%.
 - 4.25%.
 - 4.1%.
 - 5%.
41. Yesterday, a 300-year-old bank deposit ledger was discovered in Boston. The ledger indicated a deposit of \$100 at the Commonwealth Bank (now First of Boston Corporation) on behalf of the Narragansett Indian tribe, received for the sale of a portion of what is now Massachusetts to the Colony. Terms of the deposit were six percent, to be compounded annually. Last week, the Supreme Court ruled that the claim was indeed valid in all its particulars. What is the current value of the deposit?
\$_____.

42. U.S. Treasury Bills:
- are lacking in liquidity.
 - pay no interest and are sold at a discount.
 - have substantial default risk.
 - have a maturity of more than one year.
43. During a business cycle expansion, income is rising. This causes the _____ for money to _____.
- demand, increase
 - demand, decrease
 - supply, increase
 - supply, decrease
44. According to Keynes, if there is a shortage in the bond market, then there is a(n) _____ of money.
- shortage
 - surplus
 - equilibrium
 - either a or b or c are possible, since bonds are not substitutable for money.
45. Negative inflation, also called deflation, such as has recently occurred in Japan, can cause the real cost of borrowing to be quite different from the nominal cost. For example, the interest rate is 0.2% per year, and overall (CPI) prices are falling at the rate of 6% per year. The real rate of interest is _____% per year.
46. Argo Electronics has been de-listed. That means that the exchange no longer allows its members to trade it. This changes the _____ of the asset and will probably make its price _____.
- risk, rise
 - liquidity, fall
 - expected return, rise
 - broker's commission, fall
47. The value of Commodus World Management Systems stock will probably _____ if, other things equal, the volatility of bonds, gold and real estate were to increase.
- rise
 - fall
 - remain the same
48. Four factors influence the demand for an asset. They are
- wealth
 - expected returns
 - current yield
 - a and b but not c
 - a and c but not b



49. Suppose the yield curves for 2009 and 2010 were as indicated above. What could cause the change?

- a. The economy entered a recession between 2009 and 2010, and the Fed decreased the growth rate of money to stabilize the economy.
- b. The economy entered a recession between 2009 and 2010, and the Fed increased the growth rate of money to stabilize the economy.
- c. The economy entered a boom between 2009 and 2010, and the Fed decreased the growth rate of money to stabilize the economy.
- d. The economy entered a boom between 2009 and 2010, and the Fed increased the growth rate of money to stabilize the economy.

50. A nearby paycheck lender offers the following terms:

Availability: one week before payday

Amount Paid to Borrower: 90% of the borrower's paycheck.

Terms: Lender takes title to the borrower's paycheck, which is automatically deposited in the lender's account at payday.

Example: Joe gets \$90 for his \$100 paycheck, a week before it is due.

Assuming 52 weeks in a year, the annual interest rate for paycheck loans is _____ %