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Money and Banking (Trường Đại học Ngoại thương)

Chapter 1

Why Study Money, Banking, and Financial Markets?

1.1 Why Study Financial Markets?

1) Financial markets promote economic efficiency by

A) channeling funds from investors to savers.

B) creating inflation.

C) channeling funds from savers to investors.

D) reducing investment.

Answer: C

Ques Status: Previous Edition

2) Financial markets promote greater economic efficiency by channeling funds from ________ to ________.

A) investors; savers

B) borrowers; savers

C) savers; borrowers

D) savers; lenders

Answer: C

Ques Status: Previous Edition

3) Well-functioning financial markets promote

A) inflation.

B) deflation.

C) unemployment.

D) growth.

Answer: D

Ques Status: Previous Edition

4) A key factor in producing high economic growth is

A) eliminating foreign trade.

B) well-functioning financial markets.

C) high interest rates.

D) stock market volatility.

Answer: B

Ques Status: New

5) 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) commodity markets.

B) fund- available markets.

C) derivative exchange markets.

D) financial markets.

Answer: D

Ques Status: Previous Edition

6) ________ markets transfer funds from people who have an excess of available funds to people who have a shortage.
A) Commodity
B) Fund- available
C) Financial
D) Derivative exchange

Answer: C
Ques Status: Previous Edition

7) Poorly performing financial markets can be the cause of
A) wealth.
B) poverty.
C) financial stability.
D) financial expansion.

Answer: B
Ques Status: Previous Edition

8) The bond markets are important because they are
A) easily the most widely followed financial markets in the United States.
B) the markets where foreign exchange rates are determined.
C) the markets where interest rates are determined.
D) the markets where all borrowers get their funds.

Answer: C
Ques Status: Previous Edition

9) The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of $100 per year) is commonly referred to as the
A) inflation rate.
B) exchange rate.
C) interest rate.
D) aggregate price level.

Answer: C
Ques Status: Previous Edition

10) Compared to interest rates on long-term U.S. government bonds, interest rates on three -month Treasury bills fluctuate ________ and are ________ on average.
A) more; lower
B) less; lower
C) more; higher
D) less; higher

Answer: A
Ques Status: Previous Edition

11) The interest rate on Baa (medium quality) corporate bonds is ________, on average, than other interest rates, and the spread between it and other rates became ________ in the 1970s.

A) lower; smaller
B) lower; larger
C) higher; smaller
D) higher; larger

Answer: D
Ques Status: Previous Edition

12) Everything else held constant, a decline in interest rates will cause spending on housing to

A) fall.
B) remain unchanged.
C) either rise, fall, or remain the same.
D) rise.

Answer: D
Ques Status: Previous Edition

13) High interest rates might ________ purchasing a house or car but at the same time high interest rates might ________ saving.

A) discourage; encourage
B) discourage; discourage
C) encourage; encourage
D) encourage; discourage

Answer: A
Ques Status: New

14) An increase in interest rates might ________ saving because more can be earned in interest income.

A) encourage
B) discourage
C) disallow
D) invalidate

Answer: A
Ques Status: Previous Edition

15) Everything else held constant, an increase in interest rates on student loans

A) increases the cost of a college education.
B) reduces the cost of a college education.
C) has no effect on educational costs.
D) increases costs for students with no loans.

Answer: A
Ques Status: Previous Edition

16) High interest rates might cause a corporation to ________ building a new plant that would provide more jobs.

A) complete
B) consider
C) postpone
D) contemplate

Answer: C
Ques Status: Previous Edition

17) The stock market is important because it is

A) where interest rates are determined.
B) the most widely followed financial market in the United States.
C) where foreign exchange rates are determined.
D) the market where most borrowers get their funds.

Answer: B
Ques Status: Previous Edition

18) Stock prices are

A) relatively stable trending upward at a steady pace.
B) relatively stable trending downward at a moderate rate.
C) extremely volatile.
D) unstable trending downward at a moderate rate.

Answer: C
Ques Status: Revised

19) A rising stock market index due to higher share prices

A) increases people's wealth, but is unlikely to increase their willingness to spend.
B) increases people's wealth and as a result may increase their willingness to spend.
C) decreases the amount of funds that business firms can raise by selling newly- issued stock.
D) decreases people's wealth, but is unlikely to increase their willingness to spend.

Answer: B
Ques Status: Previous Edition

20) When stock prices fall

A) an individual's wealth is not affected nor is their willingness to spend.
B) a business firm will be more likely to sell stock to finance investment spending.
C) an individual's wealth may decrease but their willingness to spend is not affected.
D) an individual's wealth may decrease and their willingness to spend may decrease.

Answer: D
Ques Status: Previous Edition

21) Changes in stock prices

A) do not affect people's wealth and their willingness to spend.
B) affect firms' decisions to sell stock to finance investment spending.
C) occur in regular patterns.
D) are unimportant to decision makers.

Answer: B
Ques Status: Previous Edition

22) An increase in stock prices ________ the size of people's wealth and may ________ their willingness to spend, everything else held constant.

A) increases; increase
B) increases; decrease
C) decreases; increase
D) decreases; decrease

Answer: A
Ques Status: Previous Edition

23) Low stock market prices might ________ consumers willingness to spend and might ________ businesses willingness to undertake investment projects.

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

Answer: C
Ques Status: New

24) Fear of a major recession causes stock prices to fall, everything else held constant, which in turn causes consumer spending to

A) increase.
B) remain unchanged.
C) decrease.
D) cannot be determined.

Answer: C
Ques Status: Previous Edition

25) A share of common stock is a claim on a corporation's

A) debt.
B) liabilities.
C) expenses.
D) earnings and assets.

Answer: D
Ques Status: Revised

26) On ________, October 19, 1987, the market experienced its worst one -day drop in its entire history with the DIJA falling by more than 500 points.

A) "Terrible Tuesday"
B) "Woeful Wednesday"
C) "Freaky Friday"
D) "Black Monday"

Answer: D
Ques Status: Previous Edition

27) The decline in stock prices from 2000 through 2002
A) increased individuals' willingness to spend.
B) had no effect on individual spending.
C) reduced individuals' willingness to spend.
D) increased individual wealth.

Answer: C
Ques Status: Previous Edition

28) The Dow reached a peak of over 11,000 before the collapse of the ________ bubble in 2000.
A) housing
B) manufacturing
C) high-tech
D) banking

Answer: C
Ques Status: Previous Edition

29) What is a stock? How do stocks affect the economy?

Answer: A stock represents a share of ownership of a corporation, or a claim on a firm's earnings/assets. Stocks are part of wealth, and changes in their value affect people's willingness to spend. Changes in stock prices affect a firm's ability to raise funds, and thus their investment.
Ques Status: Previous Edition

30) Why is it important to understand the bond market?

Answer: The bond market supports economic activity by enabling the government and corporations to borrow to undertake their projects and it is the market where interest rates are determined.
Ques Status: New

1.2 Why Study Financial Institutions and Banking?

1) Channeling funds from individuals with surplus funds to those desiring funds when the saver does not purchase the borrower's security is known as
A) barter.
B) redistribution.
C) financial intermediation.
D) taxation.

Answer: C
Ques Status: Previous Edition

2) A financial crisis is
A) not possible in the modern financial environment.
B) a major disruption in the financial markets.
C) a feature of developing economies only.
D) typically followed by an economic boom.

Answer: B
Ques Status: New

3) Banks are important to the study of money and the economy because they
A) channel funds from investors to savers.
B) have been a source of rapid financial innovation.
C) are the only important financial institution in the U.S. economy.
D) create inflation.

Answer: B
Ques Status: Previous Edition

4) Financial intermediaries
A) provide a channel for linking those who want to save with those who want to invest.
B) produce nothing of value and are therefore a drain on society's resources.
C) can hurt the performance of the economy.
D) hold very little of the average American's wealth.

Answer: A
Ques Status: Revised

5) Banks, savings and loan associations, mutual savings banks, and credit unions
A) are no longer important players in financial intermediation.
B) since deregulation now provide services only to small depositors.
C) have been adept at innovating in response to changes in the regulatory environment.
D) produce nothing of value and are therefore a drain on society's resources.

Answer: C
Ques Status: Previous Edition

6) Financial institutions search for ________ has resulted in many financial innovations.
A) higher profits
B) regulations
C) respect
D) higher risk

Answer: A
Ques Status: New

7) Banks and other financial institutions engage in financial intermediation, which
A) can hurt the performance of the economy.
B) can benefit economic performance.
C) has no effect on economic performance.
D) involves borrowing from investors and lending to savers.

Answer: B
Ques Status: Previous Edition

8) Financial institutions that accept deposits and make loans are called ________.
A) exchanges
B) banks
C) over-the-counter markets
D) finance companies

Answer: B
Ques Status: Previous Edition

9) The financial intermediaries that the average person interacts with most frequently are ________.

A) exchanges
B) over-the-counter markets
C) finance companies
D) banks

Answer: D
Ques Status: Previous Edition

10) Which of the following is not a financial institution?

A) a life insurance company
B) a pension fund
C) a credit union
D) a business college

Answer: D
Ques Status: Previous Edition

11) The delivery of financial services electronically is called ________.

A) e-business
B) e-commerce
C) e-finance
D) e-possible

Answer: C
Ques Status: Previous Edition

12) What crucial role do financial intermediaries perform in an economy?

Answer: Financial intermediaries borrow funds from people who have saved and make loans to other individuals and businesses and thus improve the efficiency of the economy.
Ques Status: New

1.3 Why Study Money and Monetary Policy?

1) Money is defined as

A) bills of exchange.
B) anything that is generally accepted in payment for goods and services or in the repayment of debt.
C) a risk-free repository of spending power.
D) the unrecognized liability of governments.

Answer: B
Ques Status: Previous Edition

2) The upward and downward movement of aggregate output produced in the economy is referred to as the ________.

A) roller coaster
B) see saw
C) business cycle
D) shock wave

Answer: C
Ques Status: Previous Edition

3) Sustained downward movements in the business cycle are referred to as
A) inflation.
B) recessions.
C) economic recoveries.
D) expansions.

Answer: B
Ques Status: Previous Edition

4) During a recession, output declines resulting in
A) lower unemployment in the economy.
B) higher unemployment in the economy.
C) no impact on the unemployment in the economy.
D) higher wages for the workers.

Answer: B
Ques Status: New

5) Prior to all recessions since 1900, there has been a drop in
A) inflation.
B) the money stock.
C) the growth rate of the money stock.
D) interest rates.

Answer: C
Ques Status: Previous Edition

6) Evidence from business cycle fluctuations in the United States indicates that
A) a negative relationship between money growth and general economic activity exists.
B) recessions have been preceded by declines in share prices on the stock exchange.
C) recessions have been preceded by dollar depreciation.
D) recessions have been preceded by a decline in the growth rate of money.

Answer: D
Ques Status: Previous Edition

7) ________ theory relates changes in the quantity of money to changes in aggregate economic activity and the price level.
A) Monetary
B) Fiscal
C) Financial
D) Systemic

Answer: A
Ques Status: Previous Edition

8) A sharp increase in the growth of the money supply is likely followed by
A) a recession.
B) a depression.
C) an increase in the inflation rate.
D) no change in the economy.

Answer: C
Ques Status: Previous Edition

9) It is true that inflation is a
A) continuous increase in the money supply.
B) continuous fall in prices.
C) decline in interest rates.
D) continually rising price level.

Answer: D
Ques Status: Previous Edition

10) Which of the following is a true statement?
A) Money or the money supply is defined as Federal Reserve notes.
B) The average price of goods and services in an economy is called the aggregate price level.
C) The inflation rate is measured as the rate of change in the federal government budget deficit.
D) The aggregate price level is measured as the rate of change in the inflation rate.

Answer: B
Ques Status: Previous Edition

11) If ten years ago the prices of the items bought last month by the average consumer would have been much higher, then one can likely conclude that
A) the aggregate price level has declined during this ten-year period.
B) the average inflation rate for this ten -year period has been positive.
C) the average rate of money growth for this ten-year period has been positive.
D) the aggregate price level has risen during this ten- year period.

Answer: A
Ques Status: Previous Edition

12) From 1950-2008 the price level in the United States increased more than ________.
A) twofold
B) threefold
C) sixfold
D) ninefold

Answer: C
Ques Status: Revised

13) Complete Milton Friedman's famous statement, "Inflation is always and everywhere a ________ phenomenon."
A) recessionary
B) discretionary
C) repressionary
D) monetary

Answer: D
Ques Status: Previous Edition

14) There is a ________ association between inflation and the growth rate of money ________.
A) positive; demand
B) positive; supply
C) negative; demand
D) negative; supply

Answer: B
Ques Status: New

15) Evidence from the United States and other foreign countries indicates that

A) there is a strong positive association between inflation and growth rate of money over long periods of time.

B) there is little support for the assertion that "inflation is always and everywhere a monetary phenomenon."

C) countries with low monetary growth rates tend to experience higher rates of inflation, all else being constant.

D) money growth is clearly unrelated to inflation.

Answer: A

Ques Status: Previous Edition

16) Countries that experience very high rates of inflation may also have

A) balanced budgets.

B) rapidly growing money supplies.

C) falling money supplies.

D) constant money supplies.

Answer: B

Ques Status: Revised

17) Between 1950 and 1980 in the U.S., interest rates trended upward. During this same time period,

A) the rate of money growth declined.

B) the rate of money growth increased.

C) the government budget deficit (expressed as a percentage of GNP) trended downward.

D) the aggregate price level declined quite dramatically.

Answer: B

Ques Status: Previous Edition

18) The management of money and interest rates is called ________ policy and is conducted by a nation's ________ bank.

A) monetary; superior

B) fiscal; superior

C) fiscal; central

D) monetary; central

Answer: D

Ques Status: Previous Edition

19) The organization responsible for the conduct of monetary policy in the United States is the

A) Comptroller of the Currency.

B) U.S. Treasury.

C) Federal Reserve System.

D) Bureau of Monetary Affairs.

Answer: C

Ques Status: Previous Edition

20) ________ policy involves decisions about government spending and taxation.
A) Monetary
B) Fiscal
C) Financial
D) Systemic

Answer: B
Ques Status: Previous Edition

21) When tax revenues are greater than government expenditures, the government has a budget ________.
A) crisis
B) deficit
C) surplus
D) revision

Answer: C
Ques Status: Previous Edition

22) A budget ________ occurs when government expenditures exceed tax revenues for a particular time period.
A) deficit
B) surplus
C) surge
D) surfeit

Answer: A
Ques Status: New

23) Budgets deficits can be a concern because they might
A) ultimately lead to higher inflation.
B) lead to lower interest rates.
C) lead to a slower rate of money growth.
D) lead to higher bond prices.

Answer: A
Ques Status: Previous Edition

24) Budget deficits are important because deficits
A) cause bank failures.
B) always cause interest rates to fall.
C) can result in higher rates of monetary growth.
D) always cause prices to fall.

Answer: C
Ques Status: Previous Edition

25) What happens to economic growth and unemployment during a business cycle recession? What is the relationship between the money growth rate and a business cycle recession?

Answer: During a recession, output declines and unemployment increases. Prior to every recession in the U.S. the money growth rate has declined, however, not every decline is followed by a recession.
Ques Status: Previous Edition

1.4 Why Study International Finance?

1) American companies can borrow funds
A) only in U.S. financial markets.
B) only in foreign financial markets.
C) in both U.S. and foreign financial markets.
D) only from the U.S. government.

Answer: C
Ques Status: New

2) The price of one country's currency in terms of another country's currency is called the
A) exchange rate.
B) interest rate.
C) Dow Jones industrial average.
D) prime rate.

Answer: A
Ques Status: Previous Edition

3) The market where one currency is converted into another currency is called the ________ market.
A) stock
B) bond
C) derivatives
D) foreign exchange

Answer: D
Ques Status: Previous Edition

4) Everything else constant, a stronger dollar will mean that
A) vacationing in England becomes more expensive.
B) vacationing in England becomes less expensive.
C) French cheese becomes more expensive.
D) Japanese cars become more expensive.

Answer: B
Ques Status: Previous Edition

5) Which of the following is most likely to result from a stronger dollar?
A) U.S. goods exported aboard will cost less in foreign countries, and so foreigners will buy more of them.
B) U.S. goods exported aboard will cost more in foreign countries and so foreigners will buy more of them.
C) U.S. goods exported abroad will cost more in foreign countries, and so foreigners will buy fewer of them.
D) Americans will purchase fewer foreign goods.

Answer: C
Ques Status: Previous Edition

6) Everything else held constant, a weaker dollar will likely hurt
   A) textile exporters in South Carolina.
   B) wheat farmers in Montana that sell domestically.
   C) automobile manufacturers in Michigan that use domestically produced inputs.
   D) furniture importers in California.

Answer: D
Ques Status: Previous Edition

7) Everything else held constant, a stronger dollar benefits ________ and hurts ________.
   A) American businesses; American consumers
   B) American businesses; foreign businesses
   C) American consumers; American businesses
   D) foreign businesses; American consumers

Answer: C
Ques Status: Previous Edition

8) From 1980 to early 1985 the dollar ________ in value, thereby benefiting American ________.
   A) appreciated; consumers
   B) appreciated, businesses
   C) depreciated; consumers
   D) depreciated, businesses

Answer: A
Ques Status: Previous Edition

9) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,
   A) fewer Britons traveled to the United States in 1985.
   B) Britons imported more wine from California in 1985.
   C) Americans exported more wheat to England in 1985.
   D) more Britons traveled to the United States in 1985.

Answer: A
Ques Status: Previous Edition

10) When in 1985 a British pound cost approximately $1.30, a Shetland sweater that cost 100 British pounds would have cost $130. With a weaker dollar, the same Shetland sweater would have cost
   A) less than $130.
   B) more than $130.
   C) $130, since the exchange rate does not affect the prices that American consumers pay for foreign goods.
   D) $130, since the demand for Shetland sweaters will decrease to prevent an increase in price due to the stronger dollar.

Answer: B
Ques Status: Previous Edition

11) Everything else held constant, a decrease in the value of the dollar relative to all foreign currencies means that the price of foreign goods purchased by Americans

A) increases

B) decreases.

C) remains unchanged.

D) either increases, decreases, or remains unchanged.

Answer: A

Ques Status: Previous Edition

12) American farmers who sell beef to Europe benefit most from

A) a decrease in the dollar price of euros.

B) an increase in the dollar price of euros.

C) a constant dollar price for euros.

D) a European ban on imports of American beef.

Answer: B

Ques Status: Previous Edition

13) If the price of a euro (the European currency) increases from $1.00 to $1.10, then, everything else held constant,

A) a European vacation becomes less expensive.

B) a European vacation becomes more expensive.

C) the cost of a European vacation is not affected.

D) foreign travel becomes impossible.

Answer: B

Ques Status: Previous Edition

14) Everything else held constant, Americans who love French wine benefit most from

A) a decrease in the dollar price of euros.

B) an increase in the dollar price of euros.

C) a constant dollar price for euros.

D) a ban on imports from Europe.

Answer: A

Ques Status: Previous Edition

15) From 1980- 1985, the dollar strengthened in value against other currencies. Who was helped and who was hurt by this strong dollar?

Answer: American consumers benefitted because imports were cheaper and consumers could purchase more. American businesses and workers in those businesses were hurt as domestic and foreign sales of American products fell.

Ques Status: New

1.5 Appendix: Defining Aggregate Output, Income, the Price Level, and the Inflation Rate

1) The most comprehensive measure of aggregate output is
A) gross domestic product.
B) net national product.
C) the stock value of the industrial 500.
D) national income.

Answer: A
Ques Status: Previous Edition

2) The gross domestic product is the
A) the value of all wealth in an economy.
B) the value of all goods and services sold to other nations in a year.
C) the market value of all final goods and services produced in an economy in a year.
D) the market value of all intermediate goods and services produced in an economy in a year.

Answer: C
Ques Status: Previous Edition

3) Which of the following items are not counted in U.S. GDP?
A) your purchase of a new Ford Mustang
B) your purchase of new tires for your old car
C) GM's purchase of tires for new cars
D) a foreign consumer's purchase of a new Ford Mustang

Answer: C
Ques Status: New

4) If an economy has aggregate output of $20 trillion, then aggregate income is
A) $10 trillion.
B) $20 trillion.
C) $30 trillion.
D) $40 trillion.

Answer: B
Ques Status: Previous Edition

5) When the total value of final goods and services is calculated using current prices, the resulting measure is referred to as
A) real GDP.
B) the GDP deflator.
C) nominal GDP.
D) the index of leading indicators.

Answer: C
Ques Status: Previous Edition

6) Nominal GDP is output measured in ________ prices while real GDP is output measured in ________ prices.

A) current; current
B) current; fixed
C) fixed; fixed
D) fixed; current

Answer: B
Ques Status: New

7) GDP measured with constant prices is referred to as

A) real GDP.
B) nominal GDP.
C) the GDP deflator.
D) industrial production.

Answer: A
Ques Status: Previous Edition

8) If your nominal income in 2002 was $50,000, and prices doubled between 2002 and 2008, to have the same real income, your nominal income in 2008 must be

A) $50,000.
B) $75,000.
C) $90,000.
D) $100,000.

Answer: D
Ques Status: Revised

9) If your nominal income in 1998 is $50,000, and prices increase by 50% between 1998 and 2008, then to have the same real income, your nominal income in 2008 must be

A) $50,000.
B) $75,000.
C) $100,000.
D) $150,000.

Answer: B
Ques Status: Revised

10) To convert a nominal GDP to a real GDP, you would use

A) the PCE deflator.
B) the CPI measure.
C) the GDP deflator.
D) the PPI measure.

Answer: C
Ques Status: New

11) If nominal GDP in 2001 is $9 trillion, and 2001 real GDP in 1996 prices is $6 trillion, the GDP deflator price index is

A) 7.
B) 100.
C) 150.
D) 200.

Answer: C
Ques Status: Previous Edition

12) When prices are measured in terms of fixed (base-year) prices they are called ________ prices.

A) nominal
B) real
C) inflated
D) aggregate

Answer: B
Ques Status: Previous Edition

13) The measure of the aggregate price level that is most frequently reported in the media is the ________.

A) GDP deflator
B) producer price index
C) consumer price index
D) household price index

Answer: C
Ques Status: Previous Edition

14) To calculate the growth rate of a variable, you will

A) calculate the percentage change from one time period to the next.
B) calculate the difference between the two variables.
C) add the ending value to the beginning value.
D) divide the increase by the number of time periods.

Answer: A
Ques Status: New

15) If real GDP grows from $10 trillion in 2002 to $10.5 trillion in 2003, the growth rate for real GDP is

A) 5%.
B) 10%.
C) 50%.
D) 0.5%.

Answer: A
Ques Status: Previous Edition

16) 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) 0.5%.
B) 5%.
C) 0%.
D) - 5%.

Answer: D
Ques Status: Previous Edition

17) If the aggregate price level at time t is denoted by Pt, the inflation rate from time t - 1 to t is defined as

A) t = (Pt - Pt - 1)/Pt - 1.
B) t = (Pt + 1 - Pt - 1) /Pt - 1.
C) t = (Pt + 1 - Pt) /Pt.
D) t = (Pt - Pt - 1) /Pt.

Answer: A
Ques Status: Previous Edition

18) If the price level increases from 200 in year 1 to 220 in year 2, the rate of inflation from year 1 to year 2 is

A) 20%.
B) 10%.
C) 11%.
D) 120%.

Answer: B
Ques Status: Previous Edition

19) If the CPI is 120 in 1996 and 180 in 2002, then between 1996 and 2002, prices have increased by

A) 180%.
B) 80%.
C) 60%.
D) 50%.

Answer: D
Ques Status: Previous Edition

20) If the CPI in 2004 is 200, and in 2005 the CPI is 180, the rate of inflation from 2004 to 2005 is

A) 20%.
B) 10%.
C) 0%.
D) - 10%.

Answer: D
Ques Status: Previous Edition

Chapter 2

An Overview of the Financial System

2.1 Function of Financial Markets

1) Every financial market has the following characteristic:
A) It determines the level of interest rates.
B) It allows common stock to be traded.
C) It allows loans to be made.
D) It channels funds from lenders- savers to borrowers-spenders.

Answer: D
Ques Status: Previous Edition

2) Financial markets have the basic function of
A) getting people with funds to lend together with people who want to borrow funds.
B) assuring that the swings in the business cycle are less pronounced.
C) assuring that governments need never resort to printing money.
D) providing a risk-free repository of spending power.

Answer: A
Ques Status: Previous Edition

3) Financial markets improve economic welfare because
A) they channel funds from investors to savers.
B) they allow consumers to time their purchase better.
C) they weed out inefficient firms.
D) eliminate the need for indirect finance.

Answer: B
Ques Status: Previous Edition

4) Well-functioning financial markets
A) cause inflation.
B) eliminate the need for indirect finance.
C) cause financial crises.
D) produce an efficient allocation of capital.

Answer: D
Ques Status: Previous Edition

5) A breakdown of financial markets can result in
A) financial stability.
B) rapid economic growth.
C) political instability.
D) stable prices.

Answer: C
Ques Status: Previous Edition

6) The principal lender- savers are
A) governments.
B) businesses.
C) households.
D) foreigners.
Answer: C
Ques Status: New

7) Which of the following can be described as direct finance?
A) You take out a mortgage from your local bank.
B) You borrow $2500 from a friend.
C) You buy shares of common stock in the secondary market.
D) You buy shares in a mutual fund.
Answer: B
Ques Status: Previous Edition

8) Assume that you borrow $2000 at 10% annual interest to finance a new business project. For this loan to be profitable, the minimum amount this project must generate in annual earnings is
A) $400.
B) $201.
C) $200.
D) $199.
Answer: B
Ques Status: Previous Edition

9) You can borrow $5000 to finance a new business venture. This new venture will generate annual earnings of $251. The maximum interest rate that you would pay on the borrowed funds and still increase your income is
A) 25%.
B) 12.5%.
C) 10%.
D) 5%.
Answer: D
Ques Status: Previous Edition

10) Which of the following can be described as involving direct 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) An insurance company buys shares of common stock in the over- the-counter markets.
Answer: A
Ques Status: Previous Edition

11) Which of the following can be described as involving direct finance?
A) A corporation takes out loans from a bank.
B) People buy shares in a mutual fund.
C) A corporation buys a short-term corporate security in a secondary market.
D) People buy shares of common stock in the primary markets.
Answer: D
Ques Status: Previous Edition

12) Which of the following can be described as involving indirect finance?
   A) You make a loan to your neighbor.
   B) A corporation buys a share of common stock issued by another corporation in the primary market.
   C) You buy a U.S. Treasury bill from the U.S. Treasury.
   D) You make a deposit at a bank.

Answer: D
Ques Status: Previous Edition

13) Which of the following can be described as involving indirect finance?
   A) You make a loan to your neighbor.
   B) You buy shares in a mutual fund.
   C) You buy a U.S. Treasury bill from the U.S. Treasury.
   D) A corporation buys a short- term security issued by another corporation in the primary market.

Answer: B
Ques Status: Previous Edition

14) Securities are ________ for the person who buys them, but are ________ for the individual or firm that issues them.
   A) assets; liabilities
   B) liabilities; assets
   C) negotiable; nonnegotiable
   D) nonnegotiable; negotiable

Answer: A
Ques Status: Previous Edition

15) With ________ finance, borrowers obtain funds from lenders by selling them securities in the financial markets.
   A) active
   B) determined
   C) indirect
   D) direct

Answer: D
Ques Status: Previous Edition

16) With direct finance funds are channeled through the financial market from the ________ directly to the ________.
   A) savers, spenders
   B) spenders, investors
   C) borrowers, savers
   D) investors, savers

Answer: A
Ques Status: Previous Edition

17) Distinguish between direct finance and indirect finance. Which of these is the most important source of funds for corporations in the United States?

Answer: With direct finance, funds flow directly from the lender/saver to the borrower. With indirect finance, funds flow from the lender/saver to a financial intermediary who then channels the funds to the borrower/investor. Financial intermediaries (indirect finance) are the major source of funds for corporations in the U.S.

Ques Status: Previous Edition

2.2 Structure of Financial Markets

1) Which of the following statements about the characteristics of debt and equity is false?

A) They can both be long- term financial instruments.
B) They can both be short-term financial instruments.
C) They both involve a claim on the issuer's income.
D) They both enable a corporation to raise funds.

Answer: B
Ques Status: Previous Edition

2) Which of the following statements about the characteristics of debt and equities is true?

A) They can both be long- term financial instruments.
B) Bond holders are residual claimants.
C) The income from bonds is typically more variable than that from equities.
D) Bonds pay dividends.

Answer: A
Ques Status: Previous Edition

3) Which of the following statements about financial markets and securities is true?

A) A bond is a long-term security that promises to make periodic payments called dividends to the firm's residual claimants.
B) A debt instrument is intermediate term if its maturity is less than one year.
C) A debt instrument is intermediate term if its maturity is ten years or longer.
D) The maturity of a debt instrument is the number of years (term) to that instrument's expiration date.

Answer: D
Ques Status: Previous Edition

4) Which of the following is an example of an intermediate- term debt?

A) A thirty-year mortgage.
B) A sixty-month car loan.
C) A six month loan from a finance company.
D) A Treasury bond.

Answer: B
Ques Status: Previous Edition

5) If the maturity of a debt instrument is less than one year, the debt is called ________.
A) short-term
B) intermediate-term
C) long-term
D) prima- term

Answer: A
Ques Status: Previous Edition

6) Long-term debt has a maturity that is ________.
A) between one and ten years.
B) less than a year.
C) between five and ten years.
D) ten years or longer.

Answer: D
Ques Status: Previous Edition

7) When I purchase ________, I own a portion of a firm and have the right to vote on issues important to the firm and to elect its directors.
A) bonds
B) bills
C) notes
D) stock

Answer: D
Ques Status: Previous Edition

8) Equity holders are a corporation's ________. That means the corporation must pay all of its debt holders before it pays its equity holders.
A) debtors
B) brokers
C) residual claimants
D) underwriters

Answer: C
Ques Status: Previous Edition

9) Which of the following benefit directly from any increase in the corporation's profitability?
A) a bond holder
B) a commercial paper holder
C) a shareholder
D) a T-bill holder

Answer: C
Ques Status: New

10) A financial market in which previously issued securities can be resold is called a ________ market.
A) primary
B) secondary
C) tertiary
D) used securities

Answer: B
Ques Status: Previous Edition

11) An important financial institution that assists in the initial sale of securities in the primary market is the

A) investment bank.
B) commercial bank.
C) stock exchange.
D) brokerage house.

Answer: A
Ques Status: Previous Edition

12) When an investment bank ________ securities, it guarantees a price for a corporation's securities and then sells them to the public.

A) underwrites
B) undertakes
C) overwrites
D) overtakes

Answer: A
Ques Status: Previous Edition

13) Which of the following is not a secondary market?

A) foreign exchange market
B) futures market
C) options market
D) IPO market

Answer: D
Ques Status: New

14) ________ work in the secondary markets matching buyers with sellers of securities.

A) Dealers
B) Underwriters
C) Brokers
D) Claimants

Answer: C
Ques Status: Previous Edition

15) A corporation acquires new funds only when its securities are sold in the

A) primary market by an investment bank.
B) primary market by a stock exchange broker.
C) secondary market by a securities dealer.
D) secondary market by a commercial bank.

Answer: A
Ques Status: Previous Edition

16) A corporation acquires new funds only when its securities are sold in the

A) secondary market by an investment bank.
B) primary market by an investment bank.
C) secondary market by a stock exchange broker.
D) secondary market by a commercial bank.

Answer: B
Ques Status: Previous Edition

17) An important function of secondary markets is to
A) make it easier to sell financial instruments to raise funds.
B) raise funds for corporations through the sale of securities.
C) make it easier for governments to raise taxes.
D) create a market for newly constructed houses.

Answer: A
Ques Status: Previous Edition

18) Secondary markets make financial instruments more
A) solid.
B) vapid.
C) liquid.
D) risky.

Answer: C
Ques Status: Previous Edition

19) A liquid asset is
A) an asset that can easily and quickly be sold to raise cash.
B) a share of an ocean resort.
C) difficult to resell.
D) always sold in an over-the-counter market.

Answer: A
Ques Status: New

20) The higher a security's price in the secondary market the ________ funds a firm can raise by selling securities in the ________ market.
A) more; primary
B) more; secondary
C) less; primary
D) less; secondary

Answer: A
Ques Status: Previous Edition

21) When secondary market buyers and sellers of securities meet in one central location to conduct trades the market is called a(n)
A) exchange.
B) over-the-counter market.
C) common market.
D) barter market.

Answer: A
Ques Status: New

22) Forty or so dealers establish a "market" in these securities by standing ready to buy and sell them.
A) Secondary stocks
B) Surplus stocks
C) U.S. government bonds
D) Common stocks

Answer: C
Ques Status: Previous Edition

23) Which of the following statements about financial markets and securities is true?
A) Many common stocks are traded over-the-counter, although the largest corporations usually have their shares traded at organized stock exchanges such as the New York Stock Exchange.
B) As a corporation gets a share of the broker's commission, a corporation acquires new funds whenever its securities are sold.
C) Capital market securities are usually more widely traded than shorter -term securities and so tend to be more liquid.
D) Because of their short- terms to maturity, the prices of money market instruments tend to fluctuate wildly.

Answer: A
Ques Status: Previous Edition

24) A financial market in which only short-term debt instruments are traded is called the ________ market.
A) bond
B) money
C) capital
D) stock

Answer: B
Ques Status: Previous Edition

25) Equity instruments are traded in the ________ market.
A) money
B) bond
C) capital
D) commodities

Answer: C
Ques Status: Previous Edition

26) Corporations receive funds when their stock is sold in the primary market. Why do corporations pay attention to what is happening to their stock in the secondary market?

Answer: The existence of the secondary market makes their stock more liquid and the price in the secondary market sets the price that the corporation would receive if they choose to sell more stock in the primary market.
Ques Status: Previous Edition

27) Describe the two methods of organizing a secondary market.

Answer: A secondary market can be organized as an exchange where buyers and sellers meet in one central location to conduct trades. An example of an exchange is the New York Stock Exchange. A secondary market can also be organized as an over -the-counter market. In this type of market, dealers in different locations buy and sell securities to anyone who comes to them and is willing to accept their prices. An example of an over -the- counter market is the federal funds market.
Ques Status: New

2.3 Financial Market Instruments

1) Prices of money market instruments undergo the least price fluctuations because of
   A) the short terms to maturity for the securities.
   B) the heavy regulations in the industry.
   C) the price ceiling imposed by government regulators.
   D) the lack of competition in the market.

Answer: A
Ques Status: New

2) U.S. Treasury bills pay no interest but are sold at a ________. That is, you will pay a lower purchase price than the amount you receive at maturity.
   A) premium
   B) collateral
   C) default
   D) discount

Answer: D
Ques Status: Previous Edition

3) U.S. Treasury bills are considered the safest of all money market instruments because there is no risk of ________.
   A) defeat
   B) default
   C) desertion
   D) demarcation

Answer: B
Ques Status: Previous Edition

4) A debt instrument sold by a bank to its depositors that pays annual interest of a given amount and at maturity pays back the original purchase price is called
   A) commercial paper.
   B) a negotiable certificate of deposit.
   C) a municipal bond.
   D) federal funds.

Answer: B
Ques Status: Revised

5) A short-term debt instrument issued by well- known corporations is called
   A) commercial paper.
   B) corporate bonds.
   C) municipal bonds.
   D) commercial mortgages.

Answer: A
Ques Status: New

6) ________ are short-term loans in which Treasury bills serve as collateral.
A) Repurchase agreements
B) Negotiable certificates of deposit
C) Federal funds
D) U.S. government agency securities

Answer: A
Ques Status: New

7) Collateral is ________ the lender receives if the borrower does not pay back the loan.
A) a liability
B) an asset
C) a present
D) an offering

Answer: B
Ques Status: Previous Edition

8) Federal funds are
A) funds raised by the federal government in the bond market.
B) loans made by the Federal Reserve System to banks.
C) loans made by banks to the Federal Reserve System.
D) loans made by banks to each other.

Answer: D
Ques Status: Previous Edition

9) The British Banker's Association average of interbank rates for dollar deposits in the London market is called the
A) Libor rate.
B) federal funds rate.
C) prime rate.
D) Treasury Bill rate.

Answer: A
Ques Status: New

10) Which of the following are short-term financial instruments?
A) A repurchase agreement.
B) A share of Walt Disney Corporation stock.
C) A Treasury note with a maturity of four years.
D) A residential mortgage.

Answer: A
Ques Status: Revised

11) Which of the following instruments are traded in a money market?
A) State and local government bonds.
B) U.S. Treasury bills.
C) Corporate bonds.
D) U.S. government agency securities.

Answer: B
Ques Status: Previous Edition

12) Which of the following instruments are traded in a money market?
A) Bank commercial loans.
B) Commercial paper.
C) State and local government bonds.
D) Residential mortgages.

Answer: B
Ques Status: Revised

13) Which of the following instruments is not traded in a money market?
A) Residential mortgages.
B) U.S. Treasury Bills.
C) Negotiable bank certificates of deposit.
D) Commercial paper.

Answer: A
Ques Status: Revised

14) Bonds issued by state and local governments are called ________ bonds.
A) corporate
B) Treasury
C) municipal
D) commercial

Answer: C
Ques Status: Previous Edition

15) Equity and debt instruments with maturities greater than one year are called ________ market instruments.
A) capital
B) money
C) federal
D) benchmark

Answer: A
Ques Status: New

16) Which of the following is a long-term financial instrument?
A) A negotiable certificate of deposit.
B) A repurchase agreement.
C) A U.S. Treasury bond.
D) A U.S. Treasury bill.

Answer: C
Ques Status: Revised

17) Which of the following instruments are traded in a capital market?
A) U.S. Government agency securities.
B) Negotiable bank CDs.
C) Repurchase agreements.
D) U.S. Treasury bills.

Answer: A
Ques Status: Revised

18) Which of the following instruments are traded in a capital market?
A) Corporate bonds.
B) U.S. Treasury bills.
C) Negotiable bank CDs.
D) Repurchase agreements.

Answer: A
Ques Status: Revised

19) Which of the following are not traded in a capital market?
A) U.S. government agency securities.
B) State and local government bonds.
C) Repurchase agreements.
D) Corporate bonds.

Answer: C
Ques Status: Previous Edition

2.4 Internationalization of Financial Markets

1) Equity of U.S. companies can be purchased by
A) U.S. citizens only.
B) foreign citizens only.
C) U.S. citizens and foreign citizens.
D) U.S. mutual funds only.

Answer: C
Ques Status: New

2) One reason for the extraordinary growth of foreign financial markets is
A) decreased trade.
B) increases in the pool of savings in foreign countries.
C) the recent introduction of the foreign bond.
D) slower technological innovation in foreign markets.

Answer: B
Ques Status: Revised

3) Bonds that are sold in a foreign country and are denominated in the country's currency in which they are sold are known as
A) foreign bonds.
B) Eurobonds.
C) equity bonds.
D) country bonds.

Answer: A
Ques Status: Previous Edition

4) Bonds that are sold in a foreign country and are denominated in a currency other than that of the country in which it is sold are known as
A) foreign bonds.
B) Eurobonds.
C) equity bonds.
D) country bonds.

Answer: B
Ques Status: Previous Edition

5) If Microsoft sells a bond in London and it is denominated in dollars, the bond is a ________.
A) Eurobond
B) foreign bond
C) British bond
D) currency bond

Answer: A
Ques Status: Previous Edition

6) U.S. dollar deposits in foreign banks outside the U.S. or in foreign branches of U.S. banks are called ________.
A) Atlantic dollars
B) Eurodollars
C) foreign dollars
D) outside dollars

Answer: B
Ques Status: Previous Edition

7) Distinguish between a foreign bond and a Eurobond.

Answer: A foreign bond is sold in a foreign country and priced in that country's currency. A Eurobond is sold in a foreign country and priced in a currency that is not that country's currency.
Ques Status: New

2.5 Function of Financial Intermediaries: Indirect Finance

1) The process of indirect finance using financial intermediaries is called
A) direct lending.
B) financial intermediation.
C) resource allocation.
D) financial liquidation.

Answer: B
Ques Status: Previous Edition

2) In the United States, loans from ________ are far ________ important for corporate finance than are securities markets.
A) government agencies; more
B) government agencies; less
C) financial intermediaries; more
D) financial intermediaries; less

Answer: C
Ques Status: Previous Edition

3) The time and money spent in carrying out financial transactions are called
A) economies of scale.
B) financial intermediation.
C) liquidity services.
D) transaction costs.

Answer: D
Ques Status: New

4) Economies of scale enable financial institutions to
A) reduce transactions costs.
B) avoid the asymmetric information problem.
C) avoid adverse selection problems.
D) reduce moral hazard.

Answer: A
Ques Status: Previous Edition

5) An example of economies of scale in the provision of financial services is
A) investing in a diversified collection of assets.
B) providing depositors with a variety of savings certificates.
C) spreading the cost of borrowed funds over many customers.
D) spreading the cost of writing a standardized contract over many borrowers.

Answer: D
Ques Status: Previous Edition

6) Financial intermediaries provide customers with liquidity services. Liquidity services
A) make it easier for customers to conduct transactions.
B) allow customers to have a cup of coffee while waiting in the lobby.
C) are a result of the asymmetric information problem.
D) are another term for asset transformation.

Answer: A
Ques Status: New

7) The process where financial intermediaries create and sell low-risk assets and use the proceeds to purchase riskier assets is known as
A) risk sharing.
B) risk aversion.
C) risk neutrality.
D) risk selling.

Answer: A
Ques Status: Previous Edition

8) The process of asset transformation refers to the conversion of
A) safer assets into risky assets.
B) safer assets into safer liabilities.
C) risky assets into safer assets.
D) risky assets into risky liabilities.

Answer: C
Ques Status: Previous Edition

9) Reducing risk through the purchase of assets whose returns do not always move together is
A) diversification.
B) intermediation.
C) intervention.
D) discounting.

Answer: A
Ques Status: Previous Edition

10) The concept of diversification is captured by the statement
A) don't look a gift horse in the mouth.
B) don't put all your eggs in one basket.
C) it never rains, but it pours.
D) make hay while the sun shines.

Answer: B
Ques Status: Previous Edition

11) Risk sharing is profitable for financial institutions due to
A) low transactions costs.
B) asymmetric information.
C) adverse selection.
D) moral hazard.

Answer: A
Ques Status: Previous Edition

12) 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
A) moral selection.
B) risk sharing.
C) asymmetric information.
D) adverse hazard

Answer: C
Ques Status: Revised

13) 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) moral hazard.
B) adverse selection.
C) free-riding.
D) costly state verification.

Answer: B
Ques Status: Previous Edition

14) The problem created by asymmetric information before the transaction occurs is called ________, while the problem created after the transaction occurs is called ________.
A) adverse selection; moral hazard
B) moral hazard; adverse selection
C) costly state verification; free-riding
D) free-riding; costly state verification

Answer: A
Ques Status: Previous Edition

15) Adverse selection is a problem associated with equity and debt contracts arising from
    A) the lender's relative lack of information about the borrower's potential returns and risks of his investment activities.
    B) the lender's inability to legally require sufficient collateral to cover a 100% loss if the borrower defaults.
    C) the borrower's lack of incentive to seek a loan for highly risky investments.
    D) the borrower's lack of good options for obtaining funds.

Answer: A
Ques Status: Previous Edition

16) 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.
    A) adverse selection
    B) moral hazard
    C) risk sharing
    D) credit risk

Answer: B
Ques Status: Previous Edition

17) Studies of the major developed countries show that when businesses go looking for funds to finance their activities they usually obtain these funds from
    A) government agencies.
    B) equities markets.
    C) financial intermediaries.
    D) bond markets.

Answer: C
Ques Status: Previous Edition

18) The countries that have made the least use of securities markets are ________ and ________; in these two countries finance from financial intermediaries has been almost ten times greater than that from securities markets.
    A) Germany; Japan
    B) Germany; Great Britain
    C) Great Britain; Canada
    D) Canada; Japan

Answer: A
Ques Status: Previous Edition

19) Although the dominance of ________ over ________ is clear in all countries, the relative importance of bond versus stock markets differs widely.
    A) financial intermediaries; securities markets
    B) financial intermediaries; government agencies
    C) government agencies; financial intermediaries
    D) government agencies; securities markets

Answer: A
Ques Status: Previous Edition

20) Because there is an imbalance of information in a lending situation, we must deal with the problems of adverse selection and moral hazard. Define these terms and explain how financial intermediaries can reduce these problems.

Answer: Adverse selection is the asymmetric information problem that exists before the transaction occurs. For lenders, it is the difficulty in judging a good credit risk from a bad credit risk. Moral hazard is the asymmetric information problem that exists after the transaction occurs. For lenders, it is the difficulty in making sure the borrower uses the funds appropriately. Financial intermediaries can reduce adverse selection through intensive screening and can reduce moral hazard by monitoring the borrower.

Ques Status: Previous Edition

2.6 Types of Financial Intermediaries

1) Financial institutions that accept deposits and make loans are called ________ institutions.
A) investment
B) contractual savings
C) depository
D) underwriting

Answer: C
Ques Status: Previous Edition

2) Thrift institutions include
A) banks, mutual funds, and insurance companies.
B) savings and loan associations, mutual savings banks, and credit unions.
C) finance companies, mutual funds, and money market funds.
D) pension funds, mutual funds, and banks.

Answer: B
Ques Status: Previous Edition

3) Which of the following is a depository institution?
A) A life insurance company
B) A credit union
C) A pension fund
D) A mutual fund

Answer: B
Ques Status: Previous Edition

4) Which of the following is a depository institution?
A) A life insurance company
B) A mutual savings bank
C) A pension fund
D) A finance company

Answer: B
Ques Status: Previous Edition

5) Which of the following financial intermediaries is not a depository institution?
A) A savings and loan association
B) A commercial bank
C) A credit union
D) A finance company

Answer: D
Ques Status: Previous Edition

6) The primary assets of credit unions are
A) municipal bonds.
B) business loans.
C) consumer loans.
D) mortgages.

Answer: C
Ques Status: Previous Edition

7) The primary liabilities of a commercial bank are
A) bonds.
B) mortgages.
C) deposits.
D) commercial paper.

Answer: C
Ques Status: Previous Edition

8) The primary liabilities of depository institutions are
A) premiums from policies.
B) shares.
C) deposits.
D) bonds.

Answer: C
Ques Status: Previous Edition

9) ________ institutions are financial intermediaries that acquire funds at periodic intervals on a contractual basis.
A) Investment
B) Contractual savings
C) Thrift
D) Depository

Answer: B
Ques Status: Previous Edition

10) Which of the following is a contractual savings institution?
A) A life insurance company
B) A credit union
C) A savings and loan association
D) A mutual fund

Answer: A
Ques Status: Previous Edition

11) Contractual savings institutions include
A) mutual savings banks.
B) money market mutual funds.
C) commercial banks.
D) life insurance companies.

Answer: D
Ques Status: Previous Edition

12) Which of the following are not contractual savings institutions?
A) Life insurance companies
B) Credit unions
C) Pension funds
D) State and local government retirement funds

Answer: B
Ques Status: Previous Edition

13) Which of the following is not a contractual savings institution?
A) A life insurance company
B) A pension fund
C) A savings and loan association
D) A fire and casualty insurance company

Answer: C
Ques Status: Previous Edition

14) The primary assets of a pension fund are
A) money market instruments.
B) corporate bonds and stock.
C) consumer and business loans.
D) mortgages.

Answer: B
Ques Status: Previous Edition

15) Which of the following are investment intermediaries?
A) Life insurance companies
B) Mutual funds
C) Pension funds
D) State and local government retirement funds

Answer: B
Ques Status: Previous Edition

16) An investment intermediary that lends funds to consumers is
A) a finance company.
B) an investment bank.
C) a finance fund.
D) a consumer company.

Answer: A
Ques Status: New

17) The primary assets of a finance company are
A) municipal bonds.
B) corporate stocks and bonds.
C) consumer and business loans.
D) mortgages.

Answer: C
Ques Status: Previous Edition

18) ________ are financial intermediaries that acquire funds by selling shares to many individuals and using the proceeds to purchase diversified portfolios of stocks and bonds.
A) Mutual funds
B) Investment banks
C) Finance companies
D) Credit unions

Answer: A
Ques Status: New

19) Money market mutual fund shares function like
A) checking accounts that pay interest.
B) bonds.
C) stocks.
D) currency.

Answer: A
Ques Status: Previous Edition

20) An important feature of money market mutual fund shares is
A) deposit insurance.
B) the ability to write checks against shareholdings.
C) the ability to borrow against shareholdings.
D) claims on shares of corporate stock.

Answer: B
Ques Status: Previous Edition

21) The primary assets of money market mutual funds are
A) stocks.
B) bonds.
C) money market instruments.
D) deposits.

Answer: C
Ques Status: Previous Edition

22) An investment bank helps ________ issue securities.
A) a corporation
B) the United States government
C) the SEC
D) foreign governments

Answer: A
Ques Status: New

23) An investment bank purchases securities from a corporation at a predetermined price and then resells them in the market. This process is called
A) underwriting.
B) underhanded.
C) understanding.
D) undertaking.

Answer: A
Ques Status: New

2.7 Regulation of the Financial System

1) Which of the following is not a goal of financial regulation?
A) Ensuring the soundness of the financial system
B) Reducing moral hazard
C) Reducing adverse selection
D) Ensuring that investors never suffer losses

Answer: D
Ques Status: Previous Edition

2) Increasing the amount of information available to investors helps to reduce the problems of ________ and ________ in the financial markets.
A) adverse selection; moral hazard
B) adverse selection; risk sharing
C) moral hazard; transactions costs
D) adverse selection; economies of scale

Answer: A
Ques Status: New

3) A goal of the Securities and Exchange Commission is to reduce problems arising from
A) competition.
B) banking panics.
C) risk.
D) asymmetric information.

Answer: D
Ques Status: Previous Edition

4) The purpose of the disclosure requirements of the Securities and Exchange Commission is to
A) increase the information available to investors.
B) prevent bank panics.
C) improve monetary control.
D) protect investors against financial losses.

Answer: A
Ques Status: Previous Edition

5) Government regulations to reduce the possibility of financial panic include all of the following except

A) transactions costs.
B) restrictions on assets and activities.
C) disclosure.
D) deposit insurance.

Answer: A
Ques Status: New

6) Which of the following do not provide charters?

A) The Office of the Comptroller of the Currency
B) The Federal Reserve System
C) The National Credit Union Administration
D) State banking and insurance commissions

Answer: B
Ques Status: Previous Edition

7) A restriction on bank activities that was repealed in 1999 was

A) the prohibition of the payment of interest on checking deposits.
B) restrictions on credit terms.
C) minimum down payments on loans to purchase securities.
D) separation of commercial banking from the securities industries.

Answer: D
Ques Status: Revised

8) In order to reduce risk and increase the safety of financial institutions, commercial banks and other depository institutions are prohibited from

A) owning municipal bonds.
B) making real estate loans.
C) making personal loans.
D) owning common stock.

Answer: D
Ques Status: Previous Edition

9) The primary purpose of deposit insurance is to

A) improve the flow of information to investors.
B) prevent banking panics.
C) protect bank shareholders against losses.
D) protect bank employees from unemployment.

Answer: B
Ques Status: Previous Edition

10) The agency that was created to protect depositors after the banking failures of 1930 -1933 is the

A) Federal Reserve System.
B) Federal Deposit Insurance Corporation.
C) Treasury Department.
D) Office of the Comptroller of the Currency.

Answer: B
Ques Status: Previous Edition

11) Savings and loan associations are regulated by the
A) Federal Reserve System.
B) Securities and Exchange Commission.
C) Office of the Comptroller of the Currency.
D) Office of Thrift Supervision.

Answer: D
Ques Status: Previous Edition

12) The regulatory agency that sets reserve requirements for all banks is
A) the Federal Reserve System.
B) the Federal Deposit Insurance Corporation.
C) the Office of Thrift Supervision.
D) the Securities and Exchange Commission.

Answer: A
Ques Status: New

13) Asymmetric information is a universal problem. This would suggest that financial regulations
A) in industrial countries are an unqualified failure.
B) differ significantly around the world.
C) in industrialized nations are similar.
D) are unnecessary.

Answer: C
Ques Status: Previous Edition

14) How do regulators help to ensure the soundness of financial intermediaries?

Answer: Regulators restrict who can set up a financial intermediary, conduct regular examinations, restrict assets, and provide insurance to help ensure the soundness of financial intermediaries.
Ques Status: Previous Edition

Chapter 3

What Is Money?

3.1 Meaning of Money

1) To an economist, ________ is anything that is generally accepted in payment for goods and services or in the repayment of debt.
   A) wealth
   B) income
   C) money
   D) credit

   Answer: C
   Ques Status: Previous Edition

2) Money is
   A) anything that is generally accepted in payment for goods and services or in the repayment of debt.
   B) a flow of earnings per unit of time.
   C) the total collection of pieces of property that are a store of value.
   D) always based on a precious metal like gold or silver.

   Answer: A
   Ques Status: Previous Edition

3) Currency includes
   A) paper money and coins.
   B) paper money, coins, and checks.
   C) paper money and checks.
   D) paper money, coins, checks, and savings deposits.

   Answer: A
   Ques Status: Previous Edition

4) Even economists have no single, precise definition of money because
   A) money supply statistics are a state secret.
   B) the Federal Reserve does not employ or report different measures of the money supply.
   C) the "moneyness" or liquidity of an asset is a matter of degree.
   D) economists find disagreement interesting and refuse to agree for ideological reasons.

   Answer: C
   Ques Status: Revised

5) The total collection of pieces of property that serve to store value is a person's
   A) wealth.
   B) income.
   C) money.
   D) credit.

   Answer: A
   Ques Status: New

6) A person's house is part of her
A) money.
B) income.
C) liabilities.
D) wealth.

Answer: D
Ques Status: Previous Edition

7) ________ is used to make purchases while ________ is the total collection of pieces of property that serve to store value.
A) Money; income
B) Wealth; income
C) Income; money
D) Money; wealth

Answer: D
Ques Status: Previous Edition

8) ________ is a flow of earnings per unit of time.
A) Income
B) Money
C) Wealth
D) Currency

Answer: A
Ques Status: Previous Edition

9) An individual's annual salary is her
A) money.
B) income.
C) wealth.
D) liabilities.

Answer: B
Ques Status: Previous Edition

10) When we say that money is a stock variable, we mean that
A) the quantity of money is measured at a given point in time.
B) we must attach a time period to the measure.
C) it is sold in the equity market.
D) money never loses purchasing power.

Answer: A
Ques Status: New

11) The difference between money and income is that
A) money is a flow and income is a stock.
B) money is a stock and income is a flow.
C) there is no difference money and income are both stocks.
D) there is no difference money and income are both flows.

Answer: B
Ques Status: Previous Edition

12) Which of the following is a true statement?
A) Money and income are flow variables.
B) Money is a flow variable.
C) Income is a flow variable.
D) Money and income are stock variables.

Answer: C
Ques Status: Revised

13) Which of the following statements uses the economists' definition of money?
A) I plan to earn a lot of money over the summer.
B) Betsy is rich she has a lot of money.
C) I hope that I have enough money to buy my lunch today.
D) The job with New Company gave me the opportunity to earn more money.

Answer: C
Ques Status: Previous Edition

3.2 Functions of Money

1) Of money's three functions, the one that distinguishes money from other assets is its function as a
A) store of value.
B) unit of account.
C) standard of deferred payment.
D) medium of exchange.

Answer: D
Ques Status: Previous Edition

2) If peanuts serve as a medium of exchange, a unit of account, and a store of value, then peanuts are
A) bank deposits.
B) reserves.
C) money.
D) loanable funds.

Answer: C
Ques Status: Previous Edition

3) ________ are the time and resources spent trying to exchange goods and services.
A) Bargaining costs.
B) Transaction costs.
C) Contracting costs.
D) Barter costs.

Answer: B
Ques Status: Previous Edition

4) Compared to an economy that uses a medium of exchange, in a barter economy
A) transaction costs are higher.
B) transaction costs are lower.
C) liquidity costs are higher.
D) liquidity costs are lower.

Answer: A
Ques Status: Previous Edition

5) When compared to exchange systems that rely on money, disadvantages of the barter system include:
A) the requirement of a double coincidence of wants.
B) lowering the cost of exchanging goods over time.
C) lowering the cost of exchange to those who would specialize.
D) encouraging specialization and the division of labor.

Answer: A
Ques Status: Previous Edition

6) The conversion of a barter economy to one that uses money
A) increases efficiency by reducing the need to exchange goods and services.
B) increases efficiency by reducing the need to specialize.
C) increases efficiency by reducing transactions costs.
D) does not increase economic efficiency.

Answer: C
Ques Status: Previous Edition

7) Which of the following statements best explains how the use of money in an economy increases economic efficiency?
A) Money increases economic efficiency because it is costless to produce.
B) Money increases economic efficiency because it discourages specialization.
C) Money increases economic efficiency because it decreases transactions costs.
D) Money cannot have an effect on economic efficiency.

Answer: C
Ques Status: Previous Edition

8) When economists say that money promotes ________, they mean that money encourages specialization and the division of labor.
A) bargaining
B) contracting
C) efficiency
D) greed

Answer: C
Ques Status: Previous Edition

9) Money ________ transaction costs, allowing people to specialize in what they do best.
A) reduces
B) increases
C) enhances
D) eliminates

Answer: A
Ques Status: Previous Edition

10) For a commodity to function effectively as money it must be
A) easily standardized, making it easy to ascertain its value.
B) difficult to make change.
C) deteriorate quickly so that its supply does not become too large.
D) hard to carry around.

Answer: A
Ques Status: Previous Edition

11) All of the following are necessary criteria for a commodity to function as money except
A) it must deteriorate quickly.
B) it must be divisible.
C) it must be easy to carry.
D) it must be widely accepted.

Answer: A
Ques Status: New

12) Whatever a society uses as money, the distinguishing characteristic is that it must
A) be completely inflation proof.
B) be generally acceptable as payment for goods and services or in the repayment of debt.
C) contain gold.
D) be produced by the government.

Answer: B
Ques Status: Previous Edition

13) All but the most primitive societies use money as a medium of exchange, implying that
A) the use of money is economically efficient.
B) barter exchange is economically efficient.
C) barter exchange cannot work outside the family.
D) inflation is not a concern.

Answer: A
Ques Status: Previous Edition

14) Kevin purchasing concert tickets with his debit card is an example of the ________ function of money.
A) medium of exchange
B) unit of account
C) store of value
D) specialization

Answer: A
Ques Status: Previous Edition

15) When money prices are used to facilitate comparisons of value, money is said to function as a
A) unit of account.
B) medium of exchange.
C) store of value.
D) payments- system ruler.

Answer: A
Ques Status: Previous Edition

16) A problem with barter exchange when there are many goods is that in a barter system
A) transactions costs are minimized.
B) there exists a multiple number of prices for each good.
C) there is only one store of value.
D) exchange of services is impossible.

Answer: B
Ques Status: Previous Edition

17) In a barter economy the number of prices in an economy with N goods is
A) [N(N - 1)]/2.
B) N(N/2).
C) 2N.
D) N(N/2) - 1.

Answer: A
Ques Status: Previous Edition

18) 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

Answer: D
Ques Status: Previous Edition

19) If there are four goods in a barter economy, then one needs to know ________ prices in order to exchange one good for another.
A) 8
B) 6
C) 5
D) 4

Answer: B
Ques Status: Previous Edition

20) Because it is a unit of account, money
A) increases transaction costs.
B) reduces the number of prices that need to be calculated.
C) does not earn interest.
D) discourages specialization.

Answer: B
Ques Status: Previous Edition

21) Dennis notices that jackets are on sale for $99. In this case money is functioning as a ________.
A) medium of exchange
B) unit of account
C) store of value
D) payments-system ruler

Answer: B
Ques Status: Previous Edition

22) As a store of value, money
A) does not earn interest.
B) cannot be a durable asset.
C) must be currency.
D) is a way of saving for future purchases.

Answer: D
Ques Status: Revised

23) 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
A) medium of exchange.
B) unit of account.
C) store of value.
D) unit of specialization.

Answer: C
Ques Status: Revised

24) ________ is the relative ease and speed with which an asset can be converted into a medium of exchange.
A) Efficiency
B) Liquidity
C) Deflation
D) Specialization

Answer: B
Ques Status: Previous Edition

25) Increasing transactions costs of selling an asset make the asset
A) more valuable.
B) more liquid.
C) less liquid.
D) more moneylike.

Answer: C
Ques Status: Previous Edition

26) Since it does not have to be converted into anything else to make purchases, ________ is the most liquid asset.
A) money
B) stock
C) artwork
D) gold

Answer: A
Ques Status: New

27) Of the following assets, the least liquid is
A) stocks.
B) traveler's checks.
C) checking deposits.
D) a house.

Answer: D
Ques Status: Previous Edition

28) Ranking assets from most liquid to least liquid, the correct order is
A) savings bonds; house; currency.
B) currency; savings bonds; house.
C) currency; house; savings bonds.
D) house; savings bonds; currency.

Answer: B
Ques Status: Previous Edition

29) People hold money even during inflationary episodes when other assets prove to be better stores of value. This can be explained by the fact that money is
A) extremely liquid.
B) a unique good for which there are no substitutes.
C) the only thing accepted in economic exchange.
D) backed by gold.

Answer: A
Ques Status: Previous Edition

30) If the price level doubles, the value of money
A) doubles.
B) more than doubles, due to scale economies.
C) rises but does not double, due to diminishing returns.
D) falls by 50 percent.

Answer: D
Ques Status: Previous Edition

31) A fall in the level of prices
A) does not affect the value of money.
B) has an uncertain effect on the value of money.
C) increases the value of money.
D) reduces the value of money.

Answer: C
Ques Status: Previous Edition

32) A hyperinflation is
A) a period of extreme inflation generally greater than 50% per month.
B) a period of anxiety caused by rising prices.
C) an increase in output caused by higher prices.
D) impossible today because of tighter regulations.

Answer: A
Ques Status: New

33) During hyperinflations,
A) the value of money rises rapidly.
B) money no longer functions as a good store of value and people may resort to barter transactions on a much larger scale.
C) middle-class savers benefit as prices rise.
D) money's value remains fixed to the price level; that is, if prices double so does the value of money.

Answer: B
Ques Status: Previous Edition

34) Because inflation in Germany after World War I sometimes exceeded 1,000 % per month, one can conclude that the German economy suffered from

A) deflation.
B) disinflation.
C) hyperinflation.
D) superdeflation.

Answer: C
Ques Status: Revised

35) If merchants in the country Zed choose to close their doors, preferring to be stuck with rotting merchandise rather than worthless currency, then one can conclude that Zed is experiencing a

A) superdeflation.
B) hyperdeflation.
C) disinflation.
D) hyperinflation.

Answer: D
Ques Status: Previous Edition

36) Explain how cigarettes could be called "money" in prisoner- of-war camps of World War II.

Answer: The cigarettes performed the three functions of money. They served as the medium of exchange because individuals did exchange items for cigarettes. They served as a unit of account because prices were quoted in terms of the number of cigarettes required for the exchange. They served as a store of value because an individual would be willing to save their cigarettes even if they did not smoke because they believed that they could exchange the cigarettes for something that they did want at some time in the future.
Ques Status: Previous Edition

3.3 Evolution of the Payments System

1) The payments system is

A) the method of conducting transactions in the economy.
B) used by union officials to set salary caps.
C) an illegal method of rewarding contracts.
D) used by your employer to determine salary increases.

Answer: A
Ques Status: New

2) As the payments system evolves from barter to a monetary system,

A) commodity money is likely to precede the use of paper currency.
B) transaction costs increase.
C) the number of prices that need to be calculated increase rather dramatically.
D) specialization decreases.

Answer: A
Ques Status: Previous Edition

3) A disadvantage of ________ is that it is very heavy and hard to transport from one place to another.
   A) commodity money
   B) fiat money
   C) electronic money
   D) paper money

Answer: A
Ques Status: Previous Edition

4) Paper currency that has been declared legal tender but is not convertible into coins or precious metals is called ________ money.
   A) commodity
   B) fiat
   C) electronic
   D) funny

Answer: B
Ques Status: Previous Edition

5) When paper currency is decreed by governments as legal tender, legally it must be ________.
   A) paper currency backed by gold
   B) a precious metal such as gold or silver
   C) accepted as payment for debts
   D) convertible into an electronic payment

Answer: C
Ques Status: Previous Edition

6) The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of the fact that
   A) paper is more costly to produce than precious metals.
   B) precious metals were not generally acceptable.
   C) precious metals were difficult to carry and transport.
   D) paper money is less accepted than checks.

Answer: C
Ques Status: Previous Edition

7) Compared to checks, paper currency and coins have the major drawbacks that they
   A) are easily stolen.
   B) are hard to counterfeit.
   C) are not the most liquid assets.
   D) must be backed by gold.

Answer: A
Ques Status: Previous Edition

8) Introduction of checks into the payments system reduced the costs of exchanging goods and services. Another advantage of checks is that

A) they provide convenient receipts for purchases.

B) they can never be stolen.

C) they are more widely accepted than currency.

D) the funds from a deposited check are available for use immediately.

Answer: A

Ques Status: New

9) The evolution of the payments system from barter to precious metals, then to fiat money, then to checks can best be understood as a consequence of

A) government regulations designed to improve the efficiency of the payments system.

B) government regulations designed to promote the safety of the payments system.

C) innovations that reduced the costs of exchanging goods and services.

D) competition among firms to make it easier for customers to purchase their products.

Answer: C

Ques Status: Previous Edition

10) Compared to an electronic payments system, a payments system based on checks has the major drawback that

A) checks are less costly to process.

B) checks take longer to process, meaning that it may take several days before the depositor can get her cash.

C) fraud may be more difficult to commit when paper receipts are eliminated.

D) legal liability is more clearly defined.

Answer: B

Ques Status: Previous Edition

11) Which of the following sequences accurately describes the evolution of the payments system?

A) Barter, coins made of precious metals, paper currency, checks, electronic funds transfers

B) Barter, coins made of precious metals, checks, paper currency, electronic funds transfers

C) Barter, checks, paper currency, coins made of precious metals, electronic funds transfers

D) Barter, checks, paper currency, electronic funds transfers

Answer: A

Ques Status: Previous Edition

12) During the past two decades an important characteristic of the modern payments system has been the rapidly increasing use of

A) checks and decreasing use of currency.

B) electronic fund transfers.

C) commodity monies.

D) fiat money.

Answer: B

Ques Status: Previous Edition

13) Which of the following is not a form of e-money?
A) a debit card
B) a credit card
C) a stored-value card
D) a smart card

Answer: B
Ques Status: Previous Edition

14) A smart card is the equivalent of
A) cash.
B) savings bonds.
C) savings deposits.
D) certificates of deposit.

Answer: A
Ques Status: Previous Edition

15) An electronic payments system has not completely replaced the paper payments system because of all of the following reasons except
A) expensive equipment is necessary to set up the system.
B) security concerns.
C) privacy concerns.
D) transportation costs.

Answer: D
Ques Status: Revised

16) In explaining the evolution of money
A) government regulation is the most important factor.
B) commodity money, because it is valued more highly, tends to drive out paper money.
C) new forms of money evolve to lower transaction costs.
D) paper money is always backed by gold and therefore more desirable than checks.

Answer: C
Ques Status: Previous Edition

17) What factors have slowed down the movement to a system where all payments are made electronically?

Answer: The equipment necessary to set up the system is expensive, security of the information, and privacy concerns are issues that need to be addressed before an electronic payments system will be widely accepted.
Ques Status: Previous Edition

3.4 Measuring Money

1) Recent financial innovation makes the Federal Reserve's job of conducting monetary policy
A) easier, since the Fed now knows what to consider money.
B) more difficult, since the Fed now knows what to consider money.
C) easier, since the Fed no longer knows what to consider money.
D) more difficult, since the Fed no longer knows what to consider money.

Answer: D
Ques Status: Previous Edition

2) Defining money becomes ________ difficult as the pace of financial innovation ________.

A) less; quickens

B) more; quickens

C) more; slows

D) more; stops

Answer: B

Ques Status: Previous Edition

3) Monetary aggregates are

A) measures of the money supply reported by the Federal Reserve.

B) measures of the wealth of individuals.

C) never redefined since "money" never changes.

D) reported by the Treasury Department annually.

Answer: A

Ques Status: New

4) ________ is the narrowest monetary aggregate that the Fed reports.

A) M0

B) M1

C) M2

D) M3

Answer: B

Ques Status: Previous Edition

5) The currency component includes paper money and coins held in ________.

A) bank vaults

B) ATMs

C) the hands of the nonbank public

D) the central bank

Answer: C

Ques Status: Previous Edition

6) The components of the U.S. M1 money supply are demand and checkable deposits plus

A) currency.

B) currency plus savings deposits.

C) currency plus travelers checks.

D) currency plus travelers checks plus money market deposits.

Answer: C

Ques Status: Previous Edition

7) The M1 measure of money includes

A) small denomination time deposits.

B) traveler's checks.

C) money market deposit accounts.

D) money market mutual fund shares.

Answer: B

Ques Status: Previous Edition

8) Which of the following is not included in the measure of M1?
A) NOW accounts.
B) Demand deposits.
C) Currency.
D) Savings deposits.
Answer: D
Ques Status: Previous Edition

9) Which of the following is not included in the M1 measure of money but is included in the M2 measure of money?
A) Currency
B) Traveler's checks
C) Demand deposits
D) Small-denomination time deposits
Answer: D
Ques Status: Previous Edition

10) Which of the following is included in both M1 and M2?
A) Currency
B) Savings deposits
C) Small-denomination time deposits
D) Money market deposit accounts
Answer: A
Ques Status: Previous Edition

11) Which of the following is not included in the monetary aggregate M2?
A) Currency
B) Savings bonds
C) Traveler's checks
D) Checking deposits
Answer: B
Ques Status: Previous Edition

12) Which of the following is included in M2 but not in M1?
A) NOW accounts
B) Demand deposits
C) Currency
D) Money market mutual fund shares (retail)
Answer: D
Ques Status: Previous Edition

13) Of the following, the largest is
A) money market deposit accounts.
B) demand deposits.
C) M1.
D) M2.
Answer: D
Ques Status: Previous Edition

14) If an individual redeems a U.S. savings bond for currency
A) M1 stays the same and M2 decreases.
B) M1 increases and M2 increases.
C) M1 increases and M2 stays the same.
D) M1 stays the same and M2 stays the same.

Answer: B
Ques Status: Previous Edition

15) If an individual moves money from a small -denomination time deposit to a demand deposit account,
A) M1 increases and M2 stays the same.
B) M1 stays the same and M2 increases.
C) M1 stays the same and M2 stays the same.
D) M1 increases and M2 decreases.

Answer: A
Ques Status: Previous Edition

16) If an individual moves money from a demand deposit account to a money market deposit account,
A) M1 decreases and M2 stays the same.
B) M1 stays the same and M2 increases.
C) M1 stays the same and M2 stays the same.
D) M1 increases and M2 decreases.

Answer: A
Ques Status: Previous Edition

17) If an individual moves money from a savings deposit account to a money market deposit account,
A) M1 decreases and M2 stays the same.
B) M1 stays the same and M2 increases.
C) M1 stays the same and M2 stays the same.
D) M1 increases and M2 decreases.

Answer: C
Ques Status: Previous Edition

18) If an individual moves money from currency to a demand deposit account,
A) M1 decreases and M2 stays the same.
B) M1 stays the same and M2 increases.
C) M1 stays the same and M2 stays the same.
D) M1 increases and M2 stays the same.

Answer: C
Ques Status: Previous Edition

19) If an individual moves money from a money market deposit account to currency,
A) M1 increases and M2 stays the same.
B) M1 stays the same and M2 increases.
C) M1 stays the same and M2 stays the same.
D) M1 increases and M2 decreases.

Answer: A
Ques Status: Previous Edition

20) Small- denomination time deposits refer to certificates of deposit with a denomination of less than ________.
A) $1,000
B) $10,000
C) $100,000
D) $1,000,000

Answer: C
Ques Status: Previous Edition

21) Which of the following statements accurately describes the two measures of the money supply?
A) The two measures do not move together, so they cannot be used interchangeably by policymakers.
B) The two measures' movements closely parallel each other, even on a month -to-month basis.
C) Short-run movements in the money supply are extremely reliable.
D) M2 is the narrowest measure the Fed reports.

Answer: A
Ques Status: Previous Edition

22) The decade during which the growth rates of monetary aggregates diverged the most is
A) the 1960s.
B) the 1970s.
C) the 1980s.
D) the 1990s.

Answer: D
Ques Status: Previous Edition

23) Why are most of the U.S. dollars held outside of the United States?

Answer: Concern about high inflation eroding the value of their own currency causes many people in foreign countries to hold U.S. dollars as a hedge against inflation risk.
Ques Status: Previous Edition

3.5 How Reliable are the Money Data?

1) The Fed revises its estimates of the monetary aggregates, sometimes by large amounts, because
A) large depository institutions need only report their deposits infrequently.
B) weekly monetary data need to be adjusted for the "weekend effect."
C) monthly monetary data need to be adjusted for the "payday effect."
D) seasonal adjustments become more precise only as more data becomes available.

Answer: D
Ques Status: Previous Edition

2) The Fed estimates initial monetary aggregate reports because ________ depository institutions report the amount of their deposits infrequently.
A) all
B) small
C) large
D) state

Answer: B
Ques Status: Previous Edition

3) The increase in holiday spending is not the same every year causing the Fed's adjustment for ________ to be revised as more data becomes available.

A) seasonal variation
B) reporting discrepancy
C) market churning
D) transactions discrepancy

Answer: A
Ques Status: Previous Edition

4) An examination of revised money supply statistics, when compared to the initial statistics, suggests that the initial statistics

A) are pretty good.
B) do not provide a good guide to short- run movements in the money supply.
C) provide a poor guide of monetary policy because they are usually underestimates of the revised statistics.
D) provide a good guide of monetary policy, though they are usually underestimates of the revised statistics.

Answer: B
Ques Status: Previous Edition

5) Generally, the initial money supply data reported by the Fed

A) is not a reliable guide to the short- run behavior of the money supply.
B) is not a reliable guide to the long- run behavior of the money supply.
C) is a reliable guide to the short-run behavior of the money supply.
D) usually underestimate the revised statistics.

Answer: A
Ques Status: Revised

6) The initial money supply data reported by the Fed are not a reliable guide to short -run movements in the money supply such as a ________, but are reasonably reliable for longer periods such as a ________.

A) month; year
B) day; month
C) year; decade
D) decade; century

Answer: A
Ques Status: New

Chapter 4

Understanding Interest Rates

4.1 Measuring Interest Rates

1) The concept of ________ is based on the common -sense notion that a dollar paid to you in the future is less valuable to you than a dollar today.
    A) present value
    B) future value
    C) interest
    D) deflation

Answer: A
Ques Status: Previous Edition

2) The present value of an expected future payment ________ as the interest rate increases.
    A) falls
    B) rises
    C) is constant
    D) is unaffected

Answer: A
Ques Status: Previous Edition

3) An increase in the time to the promised future payment ________ the present value of the payment.
    A) decreases
    B) increases
    C) has no effect on
    D) is irrelevant to

Answer: A
Ques Status: Previous Edition

4) With an interest rate of 6 percent, the present value of $100 next year is approximately
    A) $106.
    B) $100.
    C) $94.
    D) $92.

Answer: C
Ques Status: Previous Edition

5) If a security pays $55 in one year and $133 in three years, its present value is $150 if the interest rate is
    A) 5 percent.
    B) 10 percent.
    C) 12.5 percent.
    D) 15 percent.

Answer: B
Ques Status: Previous Edition

6) To claim that a lottery winner who is to receive $1 million per year for twenty years has won $20 million ignores the process of
A) face value.
B) par value.
C) deflation.
D) discounting the future.

Answer: D
Ques Status: Revised

7) A credit market instrument that provides the borrower with an amount of funds that must be repaid at the maturity date along with an interest payment is known as a
A) simple loan.
B) fixed-payment loan.
C) coupon bond.
D) discount bond.

Answer: A
Ques Status: Previous Edition

8) A credit market instrument that requires the borrower to make the same payment every period until the maturity date is known as a
A) simple loan.
B) fixed- payment loan.
C) coupon bond.
D) discount bond.

Answer: B
Ques Status: Previous Edition

9) Which of the following are true of fixed payment loans?
A) The borrower repays both the principal and interest at the maturity date.
B) Installment loans and mortgages are frequently of the fixed payment type.
C) The borrower pays interest periodically and the principal at the maturity date.
D) Commercial loans to businesses are often of this type.

Answer: B
Ques Status: Previous Edition

10) A fully amortized loan is another name for
A) a simple loan.
B) a fixed-payment loan.
C) a commercial loan.
D) an unsecured loan.

Answer: B
Ques Status: Previous Edition

11) A credit market instrument that pays the owner a fixed coupon payment every year until the maturity date and then repays the face value is called a
A) simple loan.
B) fixed-payment loan.
C) coupon bond.
D) discount bond.

Answer: C
Ques Status: Previous Edition

12) A ________ pays the owner a fixed coupon payment every year until the maturity date, when the ________ value is repaid.
A) coupon bond; discount
B) discount bond; discount
C) coupon bond; face
D) discount bond; face

Answer: C
Ques Status: Previous Edition

13) The ________ is the final amount that will be paid to the holder of a coupon bond.
A) discount value
B) coupon value
C) face value
D) present value

Answer: C
Ques Status: Previous Edition

14) When talking about a coupon bond, face value and ________ mean the same thing.
A) par value
B) coupon value
C) amortized value
D) discount value

Answer: A
Ques Status: New

15) The dollar amount of the yearly coupon payment expressed as a percentage of the face value of the bond is called the bond's
A) coupon rate.
B) maturity rate.
C) face value rate.
D) payment rate.

Answer: A
Ques Status: New

16) If a $5,000 coupon bond has a coupon rate of 13 percent, then the coupon payment every year is
A) $650.
B) $1,300.
C) $130.
D) $13.

Answer: A
Ques Status: Previous Edition

17) An $8,000 coupon bond with a $400 coupon payment every year has a coupon rate of
A) 5 percent.
B) 8 percent.
C) 10 percent.
D) 40 percent.

Answer: A
Ques Status: Previous Edition

18) All of the following are examples of coupon bonds except
A) Corporate bonds
B) U.S. Treasury bills
C) U.S. Treasury notes
D) U.S. Treasury bonds

Answer: B
Ques Status: Previous Edition

19) A bond that is bought at a price below its face value and the face value is repaid at a maturity date is called a
A) simple loan.
B) fixed- payment loan.
C) coupon bond.
D) discount bond.

Answer: D
Ques Status: Previous Edition

20) A ________ is bought at a price below its face value, and the ________ value is repaid at the maturity date.
A) coupon bond; discount
B) discount bond; discount
C) coupon bond; face
D) discount bond; face

Answer: D
Ques Status: Previous Edition

21) A discount bond
A) pays the bondholder a fixed amount every period and the face value at maturity.
B) pays the bondholder the face value at maturity.
C) pays all interest and the face value at maturity.
D) pays the face value at maturity plus any capital gain.

Answer: B
Ques Status: Previous Edition

22) Examples of discount bonds include
A) U.S. Treasury bills.
B) corporate bonds.
C) U.S. Treasury notes.
D) municipal bonds.

Answer: A
Ques Status: Previous Edition

23) Which of the following are true for discount bonds?
A) A discount bond is bought at par.
B) The purchaser receives the face value of the bond at the maturity date.
C) U.S. Treasury bonds and notes are examples of discount bonds.
D) The purchaser receives the par value at maturity plus any capital gains.

Answer: B
Ques Status: Previous Edition

24) The interest rate that equates the present value of payments received from a debt instrument with its value today is the
A) simple interest rate.
B) current yield.
C) yield to maturity.
D) real interest rate.

Answer: C
Ques Status: Previous Edition

25) Economists consider the ________ to be the most accurate measure of interest rates.
A) simple interest rate.
B) current yield.
C) yield to maturity.
D) real interest rate.

Answer: C
Ques Status: Previous Edition

26) For simple loans, the simple interest rate is ________ the yield to maturity.
A) greater than
B) less than
C) equal to
D) not comparable to

Answer: C
Ques Status: Previous Edition

27) If the amount payable in two years is $2420 for a simple loan at 10 percent interest, the loan amount is
A) $1000.
B) $1210.
C) $2000.
D) $2200.

Answer: C
Ques Status: Previous Edition

28) For a 3-year simple loan of $10,000 at 10 percent, the amount to be repaid is
A) $10,030.
B) $10,300.
C) $13,000.
D) $13,310.

Answer: D
Ques Status: Previous Edition

29) If $22,050 is the amount payable in two years for a $20,000 simple loan made today, the interest rate is

A) 5 percent.
B) 10 percent.
C) 22 percent.
D) 25 percent.

Answer: A
Ques Status: Previous Edition

30) If a security pays $110 next year and $121 the year after that, what is its yield to maturity if it sells for $200?

A) 9 percent
B) 10 percent
C) 11 percent
D) 12 percent

Answer: B
Ques Status: Previous Edition

31) The present value of a fixed- payment loan is calculated as the ________ of the present value of all cash flow payments.

A) sum
B) difference
C) multiple
D) log

Answer: A
Ques Status: New

32) 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 positively related.
C) The yield to maturity is greater than the coupon rate when the bond price is above the par value.
D) The yield is less than the coupon rate when the bond price is below the par value.

Answer: A
Ques Status: Previous Edition

33) The price of a coupon bond and the yield to maturity are ________ related; that is, as the yield to maturity ________, the price of the bond ________.

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

Answer: D
Ques Status: Previous Edition

34) The yield to maturity is ________ than the ________ rate when the bond price is ________ its face value.

A) greater; coupon; above
B) greater; coupon; below
C) greater; perpetuity; above
D) less; perpetuity; below

Answer: B
Ques Status: Previous Edition

35) A $10,000 8 percent coupon bond that sells for $10,000 has a yield to maturity of

A) 8 percent.
B) 10 percent.
C) 12 percent.
D) 14 percent.

Answer: A
Ques Status: Previous Edition

36) Which of the following $1,000 face-value securities has the highest yield to maturity?

A) A 5 percent coupon bond selling for $1,000
B) A 10 percent coupon bond selling for $1,000
C) A 12 percent coupon bond selling for $1,000
D) A 12 percent coupon bond selling for $1,100

Answer: C
Ques Status: Previous Edition

37) Which of the following $5,000 face-value securities has the highest to maturity?

A) A 6 percent coupon bond selling for $5,000
B) A 6 percent coupon bond selling for $5,500
C) A 10 percent coupon bond selling for $5,000
D) A 12 percent coupon bond selling for $4,500

Answer: D
Ques Status: Previous Edition

38) Which of the following $1,000 face-value securities has the highest yield to maturity?

A) A 5 percent coupon bond with a price of $600
B) A 5 percent coupon bond with a price of $800
C) A 5 percent coupon bond with a price of $1,000
D) A 5 percent coupon bond with a price of $1,200

Answer: A
Ques Status: Previous Edition

39) Which of the following $1,000 face-value securities has the lowest yield to maturity?

A) A 5 percent coupon bond selling for $1,000
B) A 10 percent coupon bond selling for $1,000
C) A 15 percent coupon bond selling for $1,000
D) A 15 percent coupon bond selling for $900

Answer: A
Ques Status: Previous Edition

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

Answer: A
Ques Status: Previous Edition

41) A coupon bond that has no maturity date and no repayment of principal is called a
A) consol.
B) cabinet.
C) Treasury bill.
D) Treasury note.

Answer: A
Ques Status: New

42) The price of a consol equals the coupon payment
A) times the interest rate.
B) plus the interest rate.
C) minus the interest rate.
D) divided by the interest rate.

Answer: D
Ques Status: Previous Edition

43) The interest rate on a consol equals the
A) price times the coupon payment.
B) price divided by the coupon payment.
C) coupon payment plus the price.
D) coupon payment divided by the price.

Answer: D
Ques Status: Previous Edition

44) A consol paying $20 annually when the interest rate is 5 percent has a price of
A) $100.
B) $200.
C) $400.
D) $800.

Answer: C
Ques Status: Previous Edition

45) If a perpetuity has a price of $500 and an annual interest payment of $25, the interest rate is
A) 2.5 percent.
B) 5 percent.
C) 7.5 percent.
D) 10 percent.

Answer: B
Ques Status: Revised

46) The yield to maturity for a perpetuity is a useful approximation for the yield to maturity on long-term coupon bonds. It is called the ________ when approximating the yield for a coupon bond.

A) current yield
B) discount yield
C) future yield
D) star yield

Answer: A
Ques Status: New

47) The yield to maturity for a one-year discount bond equals the increase in price over the year, divided by the

A) initial price.
B) face value.
C) interest rate.
D) coupon rate.

Answer: A
Ques Status: Previous Edition

48) If a $10,000 face -value discount bond maturing in one year is selling for $5,000, then its yield to maturity is

A) 5 percent.
B) 10 percent.
C) 50 percent.
D) 100 percent.

Answer: D
Ques Status: Previous Edition

49) If a $5,000 face- value discount bond maturing in one year is selling for $5,000, then its yield to maturity is

A) 0 percent.
B) 5 percent.
C) 10 percent.
D) 20 percent.

Answer: A
Ques Status: Previous Edition

50) A discount bond selling for $15,000 with a face value of $20,000 in one year has a yield to maturity of

A) 3 percent.
B) 20 percent.
C) 25 percent.
D) 33.3 percent.

Answer: D
Ques Status: Previous Edition

51) The yield to maturity for a discount bond is ________ related to the current bond price.
A) negatively
B) positively
C) not
D) directly

Answer: A
Ques Status: New

52) In Japan in 1998 and in the U.S. in 2008, interest rates were negative for a short period of time because investors found it convenient to hold six-month bills as a store of value because
A) of the high inflation rate.
B) these bills sold at a discount from face value.
C) the bills were denominated in small amounts and could be stored electronically.
D) the bills were denominated in large amounts and could be stored electronically.

Answer: D
Ques Status: Revised

53) If the interest rate is 5%, what is the present value of a security that pays you $1, 050 next year and $1,102.50 two years from now? If this security sold for $2200, is the yield to maturity greater or less than 5%? Why?

Answer: PV = $1,050/(1. + .05) + $1,102.50/(1 + 0.5)2
PV = $2,000
If this security sold for $2200, the yield to maturity is less than 5%. The lower the interest rate the higher the present value.
Ques Status: Previous Edition

4.2 The Distinction Between Interest Rates and Returns

1) The ________ is defined as the payments to the owner plus the change in a security's value expressed as a fraction of the security's purchase price.
A) yield to maturity
B) current yield
C) rate of return
D) yield rate

Answer: C
Ques Status: Previous Edition

2) Which of the following are true concerning the distinction between interest rates and returns?
A) The rate of return on a bond will not necessarily equal the interest rate on that bond.
B) The return can be expressed as the difference between the current yield and the rate of capital gains.
C) The rate of return will be greater than the interest rate when the price of the bond falls between time t and time t + 1.
D) The return can be expressed as the sum of the discount yield and the rate of capital gains.

Answer: A
Ques Status: Previous Edition

3) The sum of the current yield and the rate of capital gain is called the
A) rate of return.
B) discount yield.
C) pertuity yield.
D) par value.

Answer: A
Ques Status: New

4) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $1,200 next year?
A) 5 percent
B) 10 percent
C) -5 percent
D) 25 percent

Answer: D
Ques Status: Previous Edition

5) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $900 next year?
A) 5 percent
B) 10 percent
C) -5 percent
D) -10 percent

Answer: C
Ques Status: Previous Edition

6) The return on a 5 percent coupon bond that initially sells for $1,000 and sells for $950 next year is
A) - 10 percent.
B) - 5 percent.
C) 0 percent.
D) 5 percent.

Answer: C
Ques Status: Previous Edition

7) Suppose you are holding a 5 percent coupon bond maturing in one year with a yield to maturity of 15 percent. If the interest rate on one-year bonds rises from 15 percent to 20 percent over the course of the year, what is the yearly return on the bond you are holding?
A) 5 percent
B) 10 percent
C) 15 percent
D) 20 percent

Answer: C
Ques Status: Previous Edition

8) If the interest rates on all bonds rise from 5 to 6 percent over the course of the year, which bond would you prefer to have been holding?

A) A bond with one year to maturity
B) A bond with five years to maturity
C) A bond with ten years to maturity
D) A bond with twenty years to maturity

Answer: A
Ques Status: Previous Edition

9) An equal decrease in all bond interest rates

A) increases the price of a five-year bond more than the price of a ten-year bond.
B) increases the price of a ten- year bond more than the price of a five -year bond.
C) decreases the price of a five-year bond more than the price of a ten- year bond.
D) decreases the price of a ten-year bond more than the price of a five- year bond.

Answer: B
Ques Status: Previous Edition

10) An equal increase in all bond interest rates

A) increases the return to all bond maturities by an equal amount.
B) decreases the return to all bond maturities by an equal amount.
C) has no effect on the returns to bonds.
D) decreases long-term bond returns more than short- term bond returns.

Answer: D
Ques Status: Previous Edition

11) Which of the following are generally true of bonds?

A) The only bond whose return equals the initial yield to maturity is one whose time to maturity is the same as the holding period.
B) A rise in interest rates is associated with a fall in bond prices, resulting in capital gains on bonds whose terms to maturity are longer than the holding periods.
C) The longer a bond's maturity, the smaller is the size of the price change associated with an interest rate change.
D) Prices and returns for short-term bonds are more volatile than those for longer -term bonds.

Answer: A
Ques Status: Previous Edition

12) Which of the following are generally true of all bonds?

A) The longer a bond's maturity, the greater is the rate of return that occurs as a result of the increase in the interest rate.
B) Even though a bond has a substantial initial interest rate, its return can turn out to be negative if interest rates rise.
C) Prices and returns for short-term bonds are more volatile than those for longer term bonds.
D) A fall in interest rates results in capital losses for bonds whose terms to maturity are longer than the holding period.

Answer: B
Ques Status: Previous Edition

13) The riskiness of an asset's returns due to changes in interest rates is
A) exchange-rate risk.
B) price risk.
C) asset risk.
D) interest- rate risk.

Answer: D
Ques Status: Previous Edition

14) Interest- rate risk is the riskiness of an asset's returns due to
A) interest- rate changes.
B) changes in the coupon rate.
C) default of the borrower.
D) changes in the asset's maturity.

Answer: A
Ques Status: Previous Edition

15) Prices and returns for ________ bonds are more volatile than those for ________ bonds, everything else held constant.
A) long-term; long-term
B) long-term; short-term
C) short-term; long-term
D) short-term; short-term

Answer: B
Ques Status: Previous Edition

16) There is ________ for any bond whose time to maturity matches the holding period.
A) no interest-rate risk
B) a large interest-rate risk
C) rate-of-return risk
D) yield-to- maturity risk

Answer: A
Ques Status: New

17) Your favorite uncle advises you to purchase long-term bonds because their interest rate is 10%. Should you follow his advice?

Answer: It depends on where you think interest rates are headed in the future. If you think interest rates will be going up, you should not follow your uncle's advice because you would then have to discount your bond if you needed to sell it before the maturity date. Long- term bonds have a greater interest- rate risk.
Ques Status: Previous Edition

4.3 The Distinction Between Real and Nominal Interest Rates

1) The ________ interest rate is adjusted for expected changes in the price level.
A) ex ante real
B) ex post real
C) ex post nominal
D) ex ante nominal

Answer: A
Ques Status: New

2) The ________ interest rate more accurately reflects the true cost of borrowing.

A) nominal
B) real
C) discount
D) market

Answer: B
Ques Status: Previous Edition

3) The nominal interest rate minus the expected rate of inflation

A) defines the real interest rate.
B) is a less accurate measure of the incentives to borrow and lend than is the nominal interest rate.
C) is a less accurate indicator of the tightness of credit market conditions than is the nominal interest rate.
D) defines the discount rate.

Answer: A
Ques Status: Previous Edition

4) When the ________ interest rate is low, there are greater incentives to ________ and fewer incentives to ________.

A) nominal; lend; borrow
B) real; lend; borrow
C) real; borrow; lend
D) market; lend; borrow

Answer: C
Ques Status: Previous Edition

5) The interest rate that describes how well a lender has done in real terms after the fact is called the

A) ex post real interest rate.
B) ex ante real interest rate.
C) ex post nominal interest rate.
D) ex ante nominal interest rate.

Answer: A
Ques Status: New

6) The ________ states that the nominal interest rate equals the real interest rate plus the expected rate of inflation.

A) Fisher equation
B) Keynesian equation
C) Monetarist equation
D) Marshall equation

Answer: A
Ques Status: Previous Edition

7) If the nominal rate of interest is 2 percent, and the expected inflation rate is -10 percent, the real rate of interest is
   A) 2 percent.
   B) 8 percent.
   C) 10 percent.
   D) 12 percent.

Answer: D
Ques Status: Previous Edition

8) In which of the following situations would you prefer to be the lender?
   A) The interest rate is 9 percent and the expected inflation rate is 7 percent.
   B) The interest rate is 4 percent and the expected inflation rate is 1 percent.
   C) The interest rate is 13 percent and the expected inflation rate is 15 percent.
   D) The interest rate is 25 percent and the expected inflation rate is 50 percent.

Answer: B
Ques Status: Previous Edition

9) In which of the following situations would you prefer to be the borrower?
   A) The interest rate is 9 percent and the expected inflation rate is 7 percent.
   B) The interest rate is 4 percent and the expected inflation rate is 1 percent.
   C) The interest rate is 13 percent and the expected inflation rate is 15 percent.
   D) The interest rate is 25 percent and the expected inflation rate is 50 percent.

Answer: D
Ques Status: Revised

10) If you expect the inflation rate to be 15 percent next year and a one - year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
   A) 7 percent.
   B) 22 percent.
   C) - 15 percent.
   D) - 8 percent.

Answer: D
Ques Status: Previous Edition

11) If you expect the inflation rate to be 12 percent next year and a one - year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
   A) - 5 percent.
   B) - 2 percent.
   C) 2 percent.
   D) 12 percent.

Answer: A
Ques Status: Previous Edition

12) If you expect the inflation rate to be 4 percent next year and a one year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is
A) - 3 percent.
B) - 2 percent.
C) 3 percent.
D) 7 percent.

Answer: C
Ques Status: Previous Edition

13) The interest rate on Treasury Inflation Protected Securities is a direct measure of
A) the real interest rate.
B) the nominal interest rate.
C) the rate of inflation.
D) the rate of deflation.

Answer: A
Ques Status: Previous Edition

14) Assuming the same coupon rate and maturity length, the difference between the yield on a Treasury Inflation Protected Security and the yield on a nonindexed Treasury security provides insight into
A) the nominal interest rate.
B) the real interest rate.
C) the nominal exchange rate.
D) the expected inflation rate.

Answer: D
Ques Status: Previous Edition

15) Assuming the same coupon rate and maturity length, when the interest rate on a Treasury Inflation Protected Security is 3 percent, and the yield on a nonindexed Treasury bond is 8 percent, the expected rate of inflation is
A) 3 percent.
B) 5 percent.
C) 8 percent.
D) 11 percent.

Answer: B
Ques Status: Previous Edition

16) Would it make sense to buy a house when mortgage rates are 14% and expected inflation is 15%? Explain your answer.

Answer: Even though the nominal rate for the mortgage appears high, the real cost of borrowing the funds is - 1%. Yes, under this circumstance it would be reasonable to make this purchase.
Ques Status: Previous Edition

4.4 Web Appendix: Measuring Interest-Rate Risk: Duration

1) Duration is
   A) an asset's term to maturity.
   B) the time until the next interest payment for a coupon bond.
   C) the average lifetime of a debt security's stream of payments.
   D) the time between interest payments for a coupon bond.

Answer: C
Ques Status: Previous Edition

2) Comparing a discount bond and a coupon bond with the same maturity,
   A) the coupon bond has the greater effective maturity.
   B) the discount bond has the greater effective maturity.
   C) the effective maturity cannot be calculated for a coupon bond.
   D) the effective maturity cannot be calculated for a discount bond.

Answer: B
Ques Status: Previous Edition

3) The duration of a coupon bond increases
   A) the longer is the bond's term to maturity.
   B) when interest rates increase.
   C) the higher the coupon rate on the bond.
   D) the higher the bond price.

Answer: A
Ques Status: Previous Edition

4) All else equal, when interest rates ________, the duration of a coupon bond ________.
   A) rise; falls
   B) rise; increases
   C) falls; falls
   D) falls; does not change

Answer: A
Ques Status: New

5) All else equal, the ________ the coupon rate on a bond, the ________ the bond's duration.
   A) higher; longer
   B) higher; shorter
   C) lower; shorter
   D) greater; longer

Answer: B
Ques Status: Previous Edition

6) If a financial institution has 50% of its portfolio in a bond with a five-year duration and 50% of its portfolio in a bond with a seven-year duration, what is the duration of the portfolio?
   A) 12 years
   B) 7 years
   C) 6 years
   D) 5 years

Answer: C
Ques Status: Previous Edition

7) An asset's interest rate risk ________ as the duration of the asset ________.

A) increases; decreases

B) decreases; decreases

C) decreases; increases

D) remains constant; increases

Answer: B

Ques Status: Previous Edition

Chapter 5

The Behavior of Interest Rates

5.1 Determinants of Asset Demand

1) Pieces of property that serve as a store of value are called
A) assets.
B) units of account.
C) liabilities.
D) borrowings.

Answer: A
Ques Status: New

2) Of the four factors that influence asset demand, which factor will cause the demand for all assets to increase when it increases, everything else held constant?
A) wealth
B) expected returns
C) risk
D) liquidity

Answer: A
Ques Status: Previous Edition

3) If wealth increases, the demand for stocks ________ and that of long-term bonds ________, everything else held constant.
A) increases; increases
B) increases; decreases
C) decreases; decreases
D) decreases; increases

Answer: A
Ques Status: Previous Edition

4) Everything else held constant, a decrease in wealth
A) increases the demand for stocks.
B) increases the demand for bonds.
C) reduces the demand for silver.
D) increases the demand for gold.

Answer: C
Ques Status: Revised

5) An increase in an asset's expected return relative to that of an alternative asset, holding everything else constant, ________ the quantity demanded of the asset.
A) increases
B) decreases
C) has no effect on
D) erases

Answer: A
Ques Status: New

6) Everything else held constant, if the expected return on ABC stock rises from 5 to 10 percent and the expected return on CBS stock is unchanged, then the expected return of holding CBS stock ________ relative to ABC stock and the demand for CBS stock ________.

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

Answer: D
Ques Status: Previous Edition

7) Everything else held constant, if the expected return on U.S. Treasury bonds falls from 10 to 5 percent and the expected return on GE stock rises from 7 to 8 percent, then the expected return of holding GE stock ________ relative to U.S. Treasury bonds and the demand for GE stock ________.

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

Answer: A
Ques Status: Previous Edition

8) If housing prices are expected to increase, then, other things equal, the demand for houses will ________ and that of Treasury bills will ________.

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

Answer: B
Ques Status: Revised

9) 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

Answer: D
Ques Status: Previous Edition

10) Everything else held constant, if the expected return on RST stock declines from 12 to 9 percent and the expected return on XYZ stock declines from 8 to 7 percent, then the expected return of holding RST stock ________ relative to XYZ stock and demand for XYZ stock ________.

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

Answer: C
Ques Status: Previous Edition

11) Everything else held constant, if the expected return on U.S. Treasury bonds falls from 8 to 7 percent and the expected return on corporate bonds falls from 10 to 8 percent, then the expected return of corporate bonds ________ relative to U.S. Treasury bonds and the demand for corporate bonds ________.

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

Answer: D
Ques Status: Previous Edition

12) An increase in the expected rate of inflation will ________ the expected return on bonds relative to the that on ________ assets, everything else held constant.

A) reduce; financial
B) reduce; real
C) raise; financial
D) raise; real

Answer: B
Ques Status: Previous Edition

13) If fluctuations in interest rates become smaller, then, other things equal, the demand for stocks ________ and the demand for long- term bonds ________.

A) increases; increases
B) increases; decreases
C) decreases; decreases
D) decreases; increases

Answer: D
Ques Status: Previous Edition

14) If the price of gold becomes less volatile, then, other things equal, the demand for stocks will ________ and the demand for antiques will ________.

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

Answer: C
Ques Status: Previous Edition

15) If brokerage commissions on bond sales decrease, then, other things equal, the demand for bonds will ________ and the demand for real estate will ________.

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

Answer: B
Ques Status: Previous Edition

16) If gold becomes acceptable as a medium of exchange, the demand for gold will ________ and the demand for bonds will ________, everything else held constant.
A) decrease; decrease
B) decrease; increase
C) increase; increase
D) increase; decrease

Answer: D
Ques Status: Previous Edition

17) The demand for Picasso paintings rises (holding everything else equal) when
A) stocks become easier to sell.
B) people expect a boom in real estate prices.
C) Treasury securities become riskier.
D) people expect gold prices to rise.

Answer: C
Ques Status: Revised

18) The demand for silver decreases, other things equal, when
A) the gold market is expected to boom.
B) the market for silver becomes more liquid.
C) wealth grows rapidly.
D) interest rates are expected to rise.

Answer: A
Ques Status: Revised

19) You would be less willing to purchase U.S. Treasury bonds, other things equal, if
A) you inherit $1 million from your Uncle Harry.
B) you expect interest rates to fall.
C) gold becomes more liquid.
D) stock prices are expected to fall.

Answer: C
Ques Status: Revised

20) You would be more willing to buy AT&T bonds (holding everything else constant) if
A) the brokerage commissions on bond sales become cheaper.
B) interest rates are expected to rise.
C) your wealth has decreased.
D) you expect diamonds to appreciate in value.

Answer: A
Ques Status: Revised

21) The demand for gold increases, other things equal, when
A) the market for silver becomes more liquid.
B) interest rates are expected to rise.
C) interest rates are expected to fall.
D) real estate prices are expected to increase.

Answer: B
Ques Status: Revised

22) Holding everything else constant,
A) if asset A's risk rises relative to that of alternative assets, the demand will increase for asset A.
B) the more liquid is asset A, relative to alternative assets, the greater will be the demand for asset A.
C) the lower the expected return to asset A relative to alternative assets, the greater will be the demand for asset A.
D) if wealth increases, demand for asset A increases and demand for alternative assets decreases.

Answer: B
Ques Status: Previous Edition

23) Holding all other factors constant, the quantity demanded of an asset is
A) positively related to wealth.
B) negatively related to its expected return relative to alternative assets.
C) positively related to the risk of its returns relative to alternative assets.
D) negatively related to its liquidity relative to alternative assets.

Answer: A
Ques Status: New

24) Everything else held constant, would an increase in volatility of stock prices have any impact on the demand for rare coins? Why or why not?

Answer: Yes, it would cause the demand for rare coins to increase. The increased volatility of stock prices means that there is relatively more risk in owning stock than there was previously and so the demand for an alternative asset, rare coins, would increase.
Ques Status: Previous Edition

5.2 Supply and Demand in the Bond Market

1) In the bond market, the bond demanders are the ________ and the bond suppliers are the ________.
A) lenders; borrowers
B) lenders; advancers
C) borrowers; lenders
D) borrowers; advancers

Answer: A
Ques Status: New

2) The demand curve for bonds has the usual downward slope, indicating that at ________ prices of the bond, everything else equal, the ________ is higher.
A) higher; demand
B) higher; quantity demanded
C) lower; demand
D) lower; quantity demanded

Answer: D
Ques Status: Previous Edition

3) The supply curve for bonds has the usual upward slope, indicating that as the price ________, ceteris paribus, the ________ increases.
A) falls; supply
B) falls; quantity supplied
C) rises; supply
D) rises; quantity supplied

Answer: D
Ques Status: Previous Edition

4) In the bond market, the market equilibrium shows the market- clearing ________ and market- clearing ________.
A) price; deposit
B) interest rate; deposit
C) price; interest rate
D) interest rate; premium

Answer: C
Ques Status: Previous Edition

5) When the price of a bond is above the equilibrium price, there is an excess ________ bonds and price will ________.
A) demand for; rise
B) demand for; fall
C) supply of; fall
D) supply of; rise

Answer: C
Ques Status: Previous Edition

6) When the price of a bond is ________ the equilibrium price, there is an excess demand for bonds and price will ________.
A) above; rise
B) above; fall
C) below; fall
D) below; rise

Answer: D
Ques Status: Previous Edition

7) When the interest rate on a bond is above the equilibrium interest rate, in the bond market there is excess ________ and the interest rate will ________.
A) demand; rise
B) demand; fall
C) supply; fall
D) supply; rise

Answer: B
Ques Status: Previous Edition

8) When the interest rate on a bond is ________ the equilibrium interest rate, in the bond market there is excess ________ and the interest rate will ________.
A) above; demand; rise
B) above; demand; fall
C) below; supply; fall
D) above; supply; rise

Answer: B
Ques Status: Previous Edition

9) A situation in which the quantity of bonds supplied exceeds the quantity of bonds demanded is called a condition of excess supply; because people want to sell ________ bonds than others want to buy, the price of bonds will ________.
A) fewer; fall
B) fewer; rise
C) more; fall
D) more; rise

Answer: C
Ques Status: Previous Edition

10) If the price of bonds is set ________ the equilibrium price, the quantity of bonds demanded exceeds the quantity of bonds supplied, a condition called excess ________.
A) above; demand
B) above; supply
C) below; demand
D) below; supply

Answer: C
Ques Status: Previous Edition

5.3 Changes in Equilibrium Interest Rates

1) A movement along the bond demand or supply curve occurs when ________ changes.
A) bond price
B) income
C) wealth
D) expected return

Answer: A
Ques Status: Previous Edition

2) When the price of a bond decreases, all else equal, the bond demand curve ________.
A) shifts right
B) shifts left
C) does not shift
D) inverts

Answer: C
Ques Status: Previous Edition

3) During business cycle expansions when income and wealth are rising, the demand for bonds ________ and the demand curve shifts to the ________, everything else held constant.

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

Answer: C
Ques Status: Previous Edition

4) Everything else held constant, when households save less, wealth and the demand for bonds ________ and the bond demand curve shifts ________.

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

Answer: D
Ques Status: Previous Edition

5) Everything else held constant, if interest rates are expected to fall in the future, the demand for long-term bonds today ________ and the demand curve shifts to the ________.

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

Answer: A
Ques Status: Previous Edition

6) Holding the expected return on bonds constant, an increase in the expected return on common stocks would ________ the demand for bonds, shifting the demand curve to the ________.

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

Answer: A
Ques Status: Previous Edition

7) Everything else held constant, an increase in expected inflation, lowers the expected return on ________ compared to ________ assets.

A) bonds; financial
B) bonds; real
C) physical; financial
D) physical; real

Answer: B
Ques Status: Previous Edition

8) Everything else held constant, 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; right
B) rise; left
C) fall; right
D) fall; left

Answer: D
Ques Status: Previous Edition

9) Everything else held constant, when stock prices become less volatile, the demand curve for bonds shifts to the ________ and the interest rate ________.

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

Answer: D
Ques Status: Previous Edition

10) Everything else held constant, when stock prices become ________ volatile, the demand curve for bonds shifts to the ________ and the interest rate ________.

A) more; right; rises
B) more; right; falls
C) less; left; falls
D) less; left; does not change

Answer: B
Ques Status: Previous Edition

11) Everything else held constant, an increase in the liquidity of bonds results in a ________ in demand for bonds and the demand curve shifts to the ________.

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

Answer: A
Ques Status: Previous Edition

12) Everything else held constant, when bonds become less widely traded, and as a consequence the market becomes less liquid, the demand curve for bonds shifts to the ________ and the interest rate ________.

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

Answer: D
Ques Status: Previous Edition

13) The reduction of brokerage commissions for trading common stocks that occurred in 1975 caused the demand for bonds to ________ and the demand curve to shift to the ________.

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

Answer: B
Ques Status: Previous Edition

14) Factors that decrease the demand for bonds include

A) an increase in the volatility of stock prices.
B) a decrease in the expected returns on stocks.
C) a decrease in the inflation rate.
D) a decrease in the riskiness of stocks.

Answer: D
Ques Status: Previous Edition

15) During a recession, the supply of bonds ________ and the supply curve shifts to the ________, everything else held constant.

A) increases; left
B) increases; right
C) decreases; left
D) decreases; right

Answer: C
Ques Status: Previous Edition

16) In a business cycle expansion, the ________ of bonds increases and the ________ curve shifts to the ________ as business investments are expected to be more profitable.

A) supply; supply; right
B) supply; supply; left
C) demand; demand; right
D) demand; demand; left

Answer: A
Ques Status: New

17) When the expected inflation rate increases, the real cost of borrowing ________ and bond supply ________, everything else held constant.

A) increases; increases
B) increases; decreases
C) decreases; increases
D) decreases; decreases

Answer: C
Ques Status: Previous Edition

18) An increase in the expected inflation rate causes the supply of bonds to ________ and the supply curve to shift to the ________, everything else held constant.

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

Answer: B
Ques Status: Previous Edition

19) Higher government deficits ________ the supply of bonds and shift the supply curve to the ________, everything else held constant.

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

Answer: B
Ques Status: Previous Edition

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

A) an expansion in overall economic activity.
B) a decrease in expected inflation.
C) a decrease in government deficits.
D) a business cycle recession.

Answer: A
Ques Status: Previous Edition

21) When the inflation rate is expected to increase, the ________ for bonds falls, while the ________ curve shifts to the right, everything else held constant.

A) demand; demand
B) demand; supply
C) supply; demand
D) supply; supply

Answer: B
Ques Status: Previous Edition

22) When the expected inflation rate increases, the demand for bonds ________, the supply of bonds ________, and the interest rate ________, everything else held constant.

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

Answer: D
Ques Status: Previous Edition

23) Everything else held constant, when the inflation rate is expected to rise, interest rates will ________; this result has been termed the ________.

A) fall; Keynes effect

B) fall; Fisher effect

C) rise; Keynes effect

D) rise; Fisher effect

Answer: D

Ques Status: Previous Edition

24) The economist Irving Fisher, after whom the Fisher effect is named, explained why interest rates ________ as the expected rate of inflation ________, everything else held constant.

A) rise; increases

B) rise; stabilizes

C) fall; stabilizes

D) fall; increases

Answer: A

Ques Status: Previous Edition

25) Everything else held constant, during a business cycle expansion, the supply of bonds shifts to the ________ as businesses perceive more profitable investment opportunities, while the demand for bonds shifts to the ________ as a result of the increase in wealth generated by the economic expansion.

A) right; left

B) right; right

C) left; left

D) left; right

Answer: B

Ques Status: Previous Edition

26) When the economy slips into a recession, normally the demand for bonds ________, the supply of bonds ________, and the interest rate ________, everything else held constant.

A) increases; increases; rises

B) decreases; decreases; falls

C) increases; decreases; falls

D) decreases; increases; rises

Answer: B

Ques Status: Previous Edition

27) When an economy grows out of a recession, normally the demand for bonds ________ and the supply of bonds ________, everything else held constant.

A) increases; increases

B) increases; decreases

C) decreases; decreases

D) decreases; increases

Answer: A

Ques Status: Previous Edition

28) Deflation causes the demand for bonds to ________, the supply of bonds to ________, and bond prices to ________, everything else held constant.

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

Answer: B
Ques Status: Previous Edition

29) In the 1990s Japan had the lowest interest rates in the world due to a combination of

A) inflation and recession.
B) deflation and expansion.
C) inflation and expansion.
D) deflation and recession.

Answer: D
Ques Status: Previous Edition

30) When the interest rate changes,

A) the demand curve for bonds shifts to the right.
B) the demand curve for bonds shifts to the left.
C) the supply curve for bonds shifts to the right.
D) it is because either the demand or the supply curve has shifted.

Answer: D
Ques Status: Previous Edition

31) The interest rate falls when either the demand for bonds ________ or the supply of bonds ________.

A) increases; increases
B) increases; decreases
C) decreases; decreases
D) decreases; increases

Answer: B
Ques Status: Revised

32) When the government has a surplus, as occurred in the late 1990s, the ________ curve of bonds shifts to the ________, everything else held constant.

A) supply; right
B) supply; left
C) demand; right
D) demand; left

Answer: B
Ques Status: Previous Edition

33) A decrease in the brokerage commissions in the housing market from 6% to 5% of the sales price will shift the ________ curve for bonds to the ________, everything else held constant.
A) demand; right
B) demand; left
C) supply; right
D) supply; left

Answer: B
Ques Status: Previous Edition

34) When rare coin prices become volatile, the ________ curve for bonds shifts to the ________, everything else held constant.
A) demand; right
B) demand; left
C) supply; right
D) supply; left

Answer: A
Ques Status: Previous Edition

35) If people expect real estate prices to increase significantly, the ________ curve for bonds will shift to the ________, everything else held constant.
A) demand; right
B) demand; left
C) supply; left
D) supply; right

Answer: B
Ques Status: Previous Edition

36) Everything else held constant, when prices in the art market become more uncertain,
A) the demand curve for bonds shifts to the left and the interest rate rises.
B) the demand curve for bonds shifts to the left and the interest rate falls.
C) the demand curve for bonds shifts to the right and the interest rate falls.
D) the supply curve for bonds shifts to the right and the interest rate falls.

Answer: C
Ques Status: Previous Edition

37) Everything else held constant, when real estate prices are expected to decrease
A) the demand curve for bonds shifts to the left and the interest rate rises.
B) the demand curve for bonds shifts to the left and the interest rate falls.
C) the demand curve for bonds shifts to the right and the interest rate falls.
D) the supply curve for bonds shifts to the right and the interest rate falls.

Answer: C
Ques Status: New

38) Everything else held constant, when the government has higher budget deficits
A) the demand curve for bonds shifts to the left and the interest rate rises.
B) the demand curve for bonds shifts to the left and the interest rate falls.
C) the supply curve for bonds shifts to the right and the interest rate falls.
D) the supply curve for bonds shifts to the right and the interest rate rises.

Answer: D
Ques Status: New

39) If stock prices are expected to climb next year, everything else held constant, the ________ curve for bonds shifts ________ and the interest rate ________.

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

Answer: A
Ques Status: New

40) If prices in the bond market become more volatile, everything else held constant, the demand curve for bonds shifts ________ and interest rates ________.

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

Answer: A
Ques Status: New

41) If brokerage commissions on stocks fall, everything else held constant, the demand for bonds ________, the price of bonds ________, and the interest rate ________.

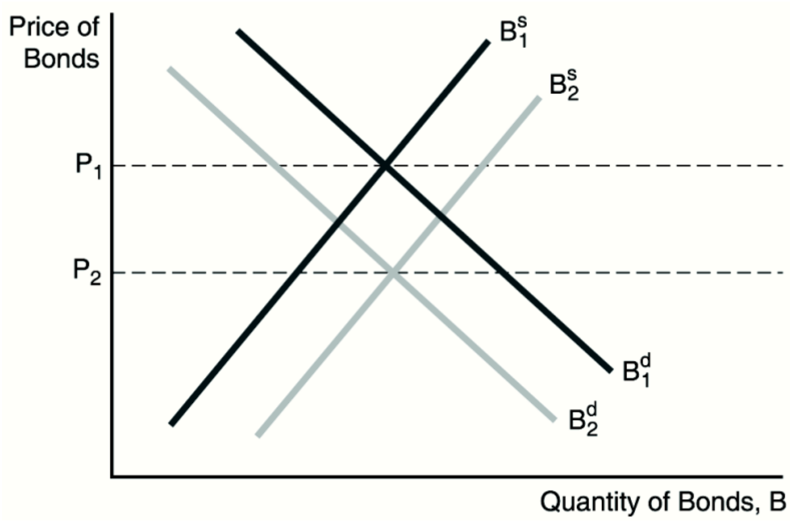
A) decreases; decreases; increases
B) decreases; decreases; decreases
C) increases; decreases; increases
D) increases; increases; increases

Answer: A
Ques Status: New

42) If the expected return on bonds increases, all else equal, the demand for bonds increases, the price of bonds ________, and the interest rate ________.

A) increases; decreases
B) increases; increases
C) decreases; decreases
D) decreases; increases

Answer: A
Ques Status: New



43) In the figure above, a factor that could cause the supply of bonds to shift to the right is:

A) a decrease in government budget deficits.
B) a decrease in expected inflation.
C) a recession.
D) a business cycle expansion.

Answer: D
Ques Status: Previous Edition

44) In the figure above, a factor that could cause the demand for bonds to decrease (shift to the left) is:

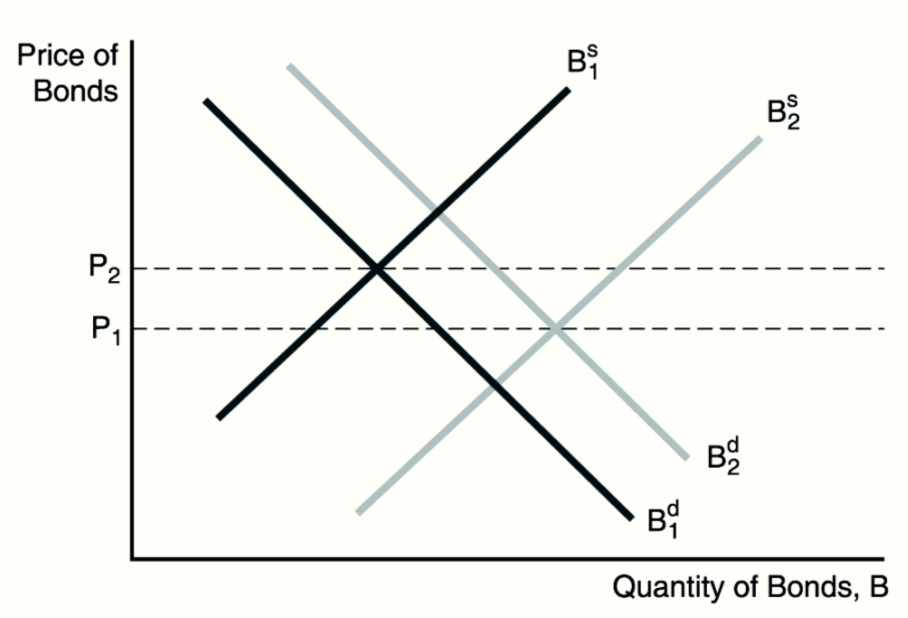
A) an increase in the expected return on bonds relative to other assets.
B) a decrease in the expected return on bonds relative to other assets.
C) an increase in wealth.
D) a reduction in the riskiness of bonds relative to other assets.

Answer: B
Ques Status: Previous Edition

45) In the figure above, the price of bonds would fall from P 1 to P2

A) inflation is expected to increase in the future.
B) interest rates are expected to fall in the future.
C) the expected return on bonds relative to other assets is expected to increase in the future.
D) the riskiness of bonds falls relative to other assets.

Answer: A
Ques Status: Previous Edition



46) In the figure above, a factor that could cause the supply of bonds to increase (shift to the right) is:

A) a decrease in government budget deficits.
B) a decrease in expected inflation.
C) expectations of more profitable investment opportunities.
D) a business cycle recession.

Answer: C
Ques Status: Previous Edition

47) In the figure above, a factor that could cause the demand for bonds to shift to the right is:

A) an increase in the riskiness of bonds relative to other assets.
B) an increase in the expected rate of inflation.
C) expectations of lower interest rates in the future.
D) a decrease in wealth.

Answer: C
Ques Status: Revised

48) In the figure above, the price of bonds would fall from P2 to P1 if

A) there is a business cycle recession.
B) there is a business cycle expansion.
C) inflation is expected to increase in the future.
D) inflation is expected to decrease in the future.

Answer: B
Ques Status: Previous Edition

49) What is the impact on interest rates when the Federal Reserve decreases the money supply by selling bonds to the public?

Answer: Bond supply increases and the bond supply curve shifts to the right. The new equilibrium bond price is lower and thus interest rates will increase.
Ques Status: Previous Edition

50) Use demand and supply analysis to explain why an expectation of Fed rate hikes would cause Treasury prices to fall.

Answer: The expected return on bonds would decrease relative to other assets resulting in a decrease in the demand for bonds. The leftward shift of the bond demand curve results in a new lower equilibrium price for bonds.

Ques Status: Previous Edition

5.4 Supply and Demand in the Market for Money: The Liquidity Preference Framework

1) In Keynes's liquidity preference framework, individuals are assumed to hold their wealth in two forms:

A) real assets and financial assets.
B) stocks and bonds.
C) money and bonds.
D) money and gold.

Answer: C
Ques Status: Previous Edition

2) In Keynes's liquidity preference framework,

A) the demand for bonds must equal the supply of money.
B) the demand for money must equal the supply of bonds.
C) an excess demand of bonds implies an excess demand for money.
D) an excess supply of bonds implies an excess demand for money.

Answer: D
Ques Status: Previous Edition

3) In Keynes's liquidity preference framework, if there is excess demand for money, there is

A) excess demand for bonds.
B) equilibrium in the bond market.
C) excess supply of bonds.
D) too much money.

Answer: C
Ques Status: Revised

4) The bond supply and demand framework is easier to use when analyzing the effects of changes in ________, while the liquidity preference framework provides a simpler analysis of the effects from changes in income, the price level, and the supply of ________.

A) expected inflation; bonds
B) expected inflation; money
C) government budget deficits; bonds
D) government budget deficits; money

Answer: B
Ques Status: Previous Edition

5) Keynes assumed that money has ________ rate of return.
A) a positive
B) a negative
C) a zero
D) an increasing

Answer: C
Ques Status: Previous Edition

6) In his Liquidity Preference Framework, Keynes assumed that money has a zero rate of return; thus,
A) when interest rates rise, the expected return on money falls relative to the expected return on bonds, causing the demand for money to fall.
B) when interest rates rise, the expected return on money falls relative to the expected return on bonds, causing the demand for money to rise.
C) when interest rates fall, the expected return on money falls relative to the expected return on bonds, causing the demand for money to fall.
D) when interest rates fall, the expected return on money falls relative to the expected return on bonds, causing the demand for money to rise.

Answer: A
Ques Status: Previous Edition

7) In Keynes's liquidity preference framework, as the expected return on bonds increases (holding everything else unchanged), the expected return on money ________, causing the demand for ________ to fall.
A) falls; bonds
B) falls; money
C) rises; bonds
D) rises; money

Answer: B
Ques Status: Previous Edition

8) The opportunity cost of holding money is
A) the level of income.
B) the price level.
C) the interest rate.
D) the discount rate.

Answer: C
Ques Status: Previous Edition

9) An increase in the interest rate
A) increases the demand for money.
B) increases the quantity of money demanded.
C) decreases the demand for money.
D) decreases the quantity of money demanded.

Answer: D
Ques Status: Previous Edition

10) If there is an excess supply of money
   A) individuals sell bonds, causing the interest rate to rise.
   B) individuals sell bonds, causing the interest rate to fall.
   C) individuals buy bonds, causing interest rates to fall.
   D) individuals buy bonds, causing interest rates to rise.

Answer: C
Ques Status: Previous Edition

11) When the interest rate is above the equilibrium interest rate, there is an excess ________ money and the interest rate will ________.
   A) demand for; rise
   B) demand for; fall
   C) supply of; fall
   D) supply of; rise

Answer: C
Ques Status: Previous Edition

12) In the market for money, an interest rate below equilibrium results in an excess ________ money and the interest rate will ________.
   A) demand for; rise
   B) demand for; fall
   C) supply of; fall
   D) supply of; rise

Answer: A
Ques Status: Previous Edition

5.5 Changes in Equilibrium Interest Rates in the Liquidity Preference Framework

1) In the Keynesian liquidity preference framework, an increase in the interest rate causes the demand curve for money to ________, everything else held constant.
   A) shift right
   B) shift left
   C) stay where it is
   D) invert

Answer: C
Ques Status: Previous Edition

2) A lower level of income causes the demand for money to ________ and the interest rate to ________, everything else held constant.
   A) decrease; decrease
   B) decrease; increase
   C) increase; decrease
   D) increase; increase

Answer: A
Ques Status: Previous Edition

3) When real income ________, the demand curve for money shifts to the ________ and the interest rate ________, everything else held constant.

A) falls; right; rises

B) rises; right; rises

C) falls; left; rises

D) rises; left; rises

Answer: B

Ques Status: Previous Edition

4) A business cycle expansion increases income, causing money demand to ________ and interest rates to ________, everything else held constant.

A) increase; increase

B) increase; decrease

C) decrease; decrease

D) decrease; increase

Answer: A

Ques Status: Previous Edition

5) In the Keynesian liquidity preference framework, a rise in the price level causes the demand for money to ________ and the demand curve to shift to the ________, everything else held constant.

A) increase; left

B) increase; right

C) decrease; left

D) decrease; right

Answer: B

Ques Status: Previous Edition

6) When the price level ________, the demand curve for money shifts to the ________ and the interest rate ________, everything else held constant.

A) falls; left; falls

B) rises; right; falls

C) falls; left; rises

D) rises; right; rises

Answer: D

Ques Status: Previous Edition

7) A rise in the price level causes the demand for money to ________ and the interest rate to ________, everything else held constant.

A) decrease; decrease

B) decrease; increase

C) increase; decrease

D) increase; increase

Answer: D

Ques Status: Previous Edition

8) When the price level falls, the ________ curve for nominal money ________, and interest rates ________, everything else held constant.
A) demand; decreases; fall
B) demand; increases; rise
C) supply; increases; rise
D) supply; decreases; fall

Answer: A
Ques Status: Previous Edition

9) A decline in the expected inflation rate causes the demand for money to ________ and the demand curve to shift to the ________, everything else held constant.
A) decrease; right
B) decrease; left
C) increase; right
D) increase; left

Answer: B
Ques Status: Previous Edition

10) When the Fed decreases the money stock, the money supply curve shifts to the ________ and the interest rate ________, everything else held constant.
A) right; rises
B) right; falls
C) left; falls
D) left; rises

Answer: D
Ques Status: Previous Edition

11) When the Fed ________ the money stock, the money supply curve shifts to the ________ and the interest rate ________, everything else held constant.
A) decreases; right; rises
B) increases; right; falls
C) decreases; left; falls
D) increases; left; rises

Answer: B
Ques Status: Previous Edition

12) ________ in the money supply creates excess ________ money, causing interest rates to ________, everything else held constant.
A) A decrease; demand for; rise
B) An increase; demand for; fall
C) An increase; supply of; rise
D) A decrease; supply of; fall

Answer: A
Ques Status: Previous Edition

13) ________ in the money supply creates excess demand for ________, causing interest rates to ________, everything else held constant.

A) An increase; money; rise

B) An increase; bonds; fall

C) A decrease; bonds; rise

D) A decrease; money; fall

Answer: B

Ques Status: Previous Edition

14) When the price level falls, the ________ curve for nominal money ________, and interest rates ________, everything else held constant.

A) demand; decreases; fall

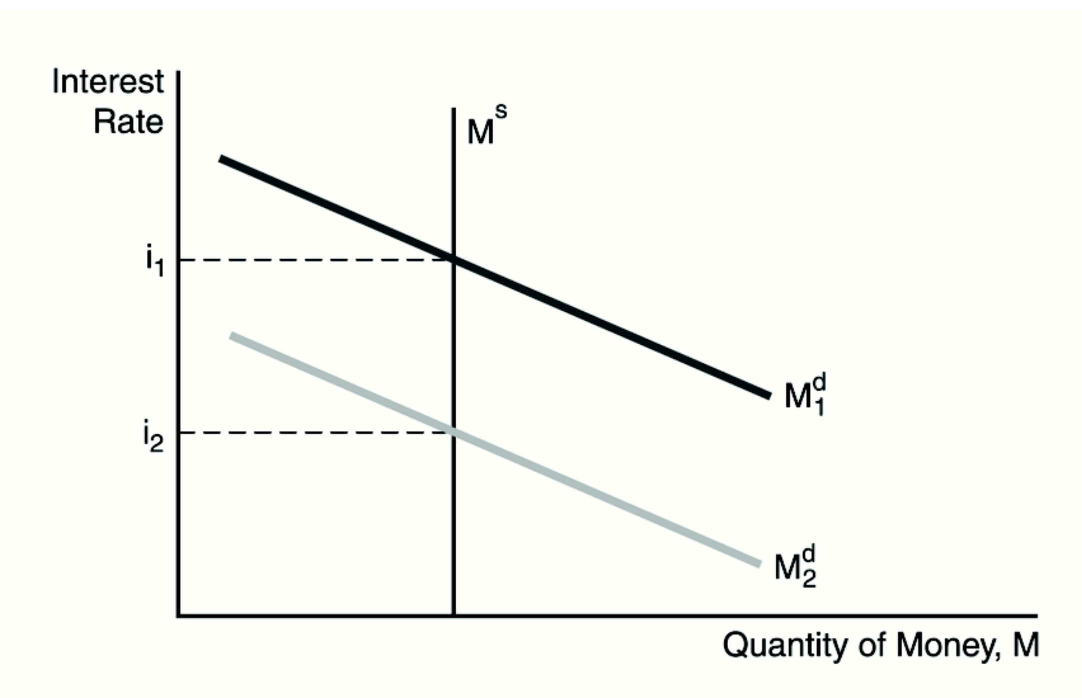
B) demand; increases; rise

C) supply; increases; rise

D) supply; decreases; fall

Answer: A

Ques Status: Previous Edition



15) In the figure above, one factor not responsible for the decline in the demand for money is

A) a decline the price level.

B) a decline in income.

C) an increase in income.

D) a decline in the expected inflation rate.

Answer: C

Ques Status: Previous Edition

16) In the figure above, the decrease in the interest rate from i 1 to i2 can be explained by

A) a decrease in money growth.

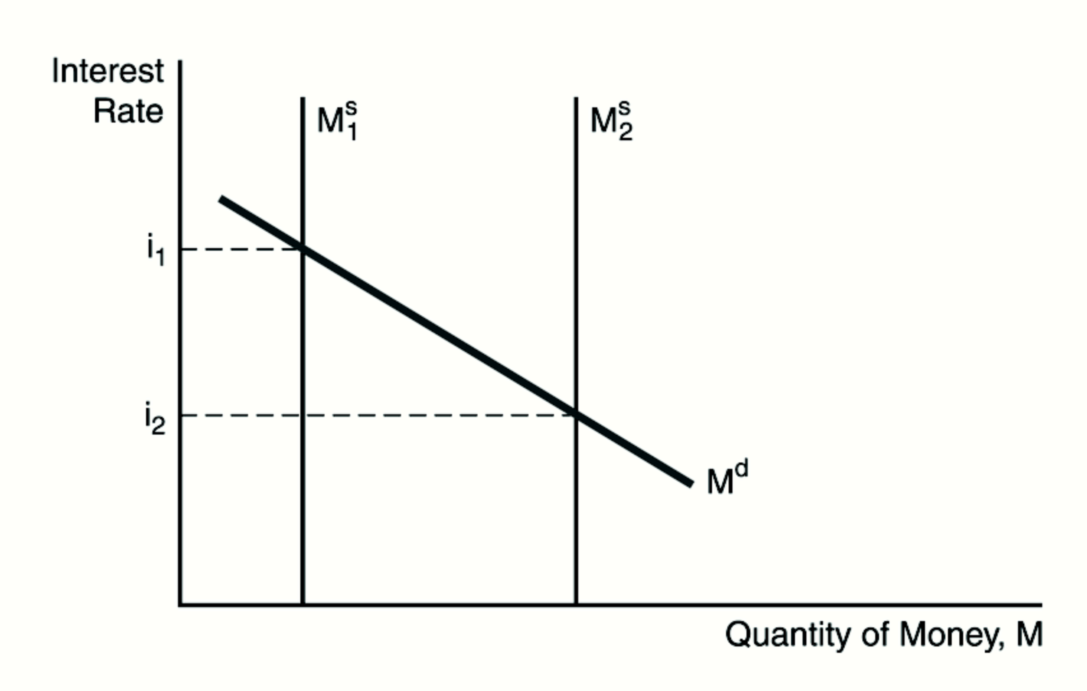
B) a decline in the expected price level.

C) an increase in income.

D) an increase in the expected price level.

Answer: B

Ques Status: Previous Edition



17) In the figure above, the factor responsible for the decline in the interest rate is

A) a decline the price level.
B) a decline in income.
C) an increase in the money supply.
D) a decline in the expected inflation rate.

Answer: C
Ques Status: Previous Edition

18) In the figure above, the decrease in the interest rate from i 1 to i2 can be explained by

A) a decrease in money growth.
B) an increase in money growth.
C) a decline in the expected price level.
D) an increase in income.

Answer: B
Ques Status: Previous Edition

19) Milton Friedman called the response of lower interest rates resulting from an increase in the money supply the ________ effect.

A) liquidity
B) price level
C) expected-inflation
D) income

Answer: A
Ques Status: New

20) Of the four effects on interest rates from an increase in the money supply, the initial effect is, generally, the

A) income effect.
B) liquidity effect.
C) price level effect.
D) expected inflation effect.

Answer: B
Ques Status: Previous Edition

21) In the liquidity preference framework, a one- time increase in the money supply results in a price level effect. The maximum impact of the price level effect on interest rates occurs

A) at the moment the price level hits its peak (stops rising) because both the price level and expected inflation effects are at work.
B) immediately after the price level begins to rise, because both the price level and expected inflation effects are at work.
C) at the moment the expected inflation rate hits its peak.
D) at the moment the inflation rate hits it peak.

Answer: A
Ques Status: Previous Edition

22) Of the four effects on interest rates from an increase in the money supply, the one that works in the opposite direction of the other three is the

A) liquidity effect.
B) income effect.
C) price level effect.
D) expected inflation effect.

Answer: A
Ques Status: Previous Edition

23) It is 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; liquidity
B) fall; risk
C) rise; liquidity
D) rise; risk

Answer: C
Ques Status: Revised

24) When the growth rate of the money supply increases, interest rates end up being permanently lower if

A) the liquidity effect is larger than the other effects.
B) there is fast adjustment of expected inflation.
C) there is slow adjustment of expected inflation.
D) the expected inflation effect is larger than the liquidity effect.

Answer: A
Ques Status: Previous Edition

25) When the growth rate of the money supply is increased, interest rates will fall immediately if the liquidity effect is ________ than the other money supply effects and there is ________ adjustment of expected inflation.

A) larger; fast
B) larger; slow
C) smaller; slow
D) smaller; fast

Answer: B
Ques Status: Previous Edition

26) If the Fed wants to permanently lower interest rates, then it should raise the rate of money growth if
A) there is fast adjustment of expected inflation.
B) there is slow adjustment of expected inflation.
C) the liquidity effect is smaller than the expected inflation effect.
D) the liquidity effect is larger than the other effects.

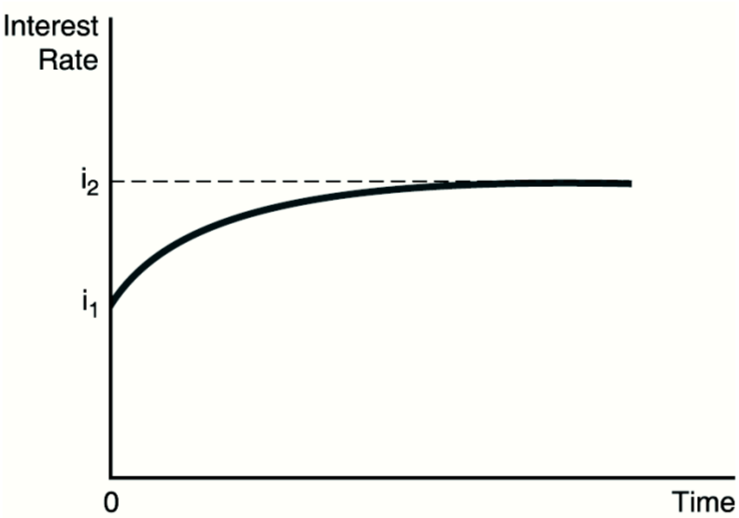
Answer: D
Ques Status: Previous Edition

27) If the liquidity effect is smaller than the other effects, and the adjustment to expected inflation is slow, then the
A) interest rate will fall.
B) interest rate will rise.
C) interest rate will initially fall but eventually climb above the initial level in response to an increase in money growth.
D) interest rate will initially rise but eventually fall below the initial level in response to an increase in money growth.

Answer: C
Ques Status: Previous Edition

28) If the liquidity effect is smaller than the other effects, and the adjustment to expected inflation is immediate, then the
A) interest rate will fall.
B) interest rate will rise.
C) interest rate will fall immediately below the initial level when the money supply grows.
D) interest rate will rise immediately above the initial level when the money supply grows.

Answer: D
Ques Status: Previous Edition

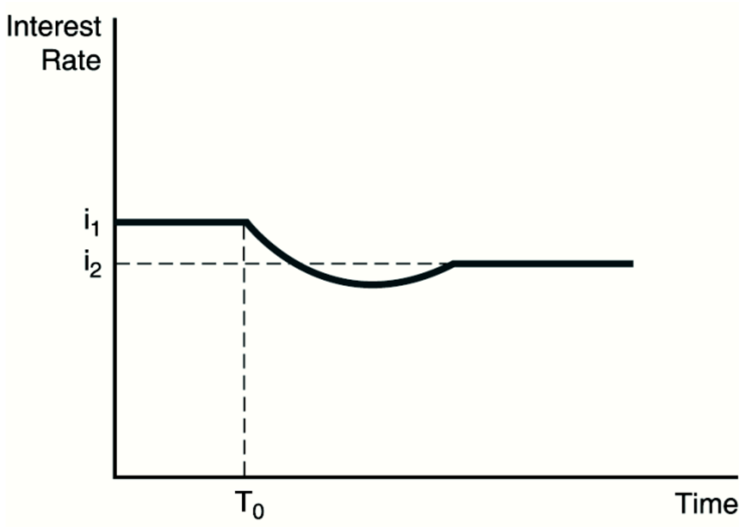


29) In the figure above, illustrates the effect of an increased rate of money supply growth at time period 0. From the figure, one can conclude that the
A) liquidity effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
B) liquidity effect is larger 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 slowly to changes in expected inflation.
D) liquidity effect is smaller than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.

Answer: A
Ques Status: Previous Edition

30) In the figure above, illustrates the effect of an increased rate of money supply growth at time period 0. From the figure, one can conclude that the
A) Fisher effect is dominated by the liquidity effect and interest rates adjust slowly to changes in expected inflation.
B) liquidity effect is dominated by the Fisher effect and interest rates adjust slowly to changes in expected inflation.
C) liquidity effect is dominated by the Fisher effect and interest rates adjust quickly to changes in expected inflation.
D) Fisher effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.

Answer: C
Ques Status: Previous Edition



31) The figure above illustrates the effect of an increased rate of money supply growth at time period T0 . From the figure, one can conclude that the

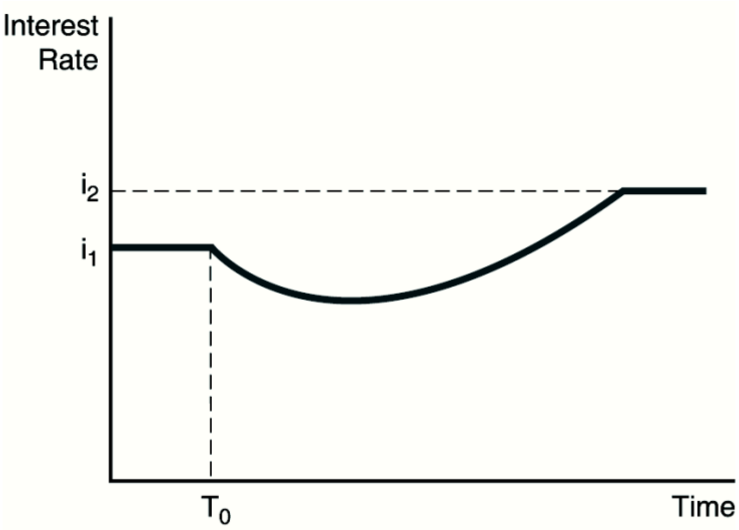
A) liquidity effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
B) liquidity effect is larger than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
C) liquidity effect is larger than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.
D) liquidity effect is smaller than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.

Answer: C
Ques Status: Previous Edition

32) The figure above illustrates the effect of an increased rate of money supply growth at time period T0 . From the figure, one can conclude that the

A) Fisher effect is dominated by the liquidity effect and interest rates adjust slowly to changes in expected inflation.
B) liquidity effect is dominated by the Fisher effect and interest rates adjust slowly to changes in expected inflation.
C) liquidity effect is dominated by the Fisher effect and interest rates adjust quickly to changes in expected inflation.
D) Fisher effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.

Answer: A
Ques Status: Previous Edition



33) The figure above illustrates the effect of an increased rate of money supply growth at time period T0. From the figure, one can conclude that the

A) liquidity effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.
B) liquidity effect is larger 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 slowly to changes in expected inflation.
D) liquidity effect is smaller than the expected inflation effect and interest rates adjust slowly to changes in expected inflation.

Answer: D
Ques Status: Previous Edition

34) The figure above illustrates the effect of an increased rate of money supply growth at time period T0. From the figure, one can conclude that the

A) Fisher effect is dominated by the liquidity effect and interest rates adjust slowly to changes in expected inflation.
B) liquidity effect is dominated by the Fisher effect and interest rates adjust slowly to changes in expected inflation.
C) liquidity effect is dominated by the Fisher effect and interest rates adjust quickly to changes in expected inflation.
D) Fisher effect is smaller than the expected inflation effect and interest rates adjust quickly to changes in expected inflation.

Answer: A
Ques Status: Previous Edition

35) Interest rates increased continuously during the 1970s. The most likely explanation is

A) banking failures that reduced the money supply.
B) a rise in the level of income.
C) the repeated bouts of recession and expansion.
D) increasing expected rates of inflation.

Answer: D
Ques Status: Previous Edition

36) Using the liquidity preference framework, what will happen to interest rates if the Fed increases the money supply?

Answer: The Fed's actions shift the money supply curve to the right. The new equilibrium interest rate will be lower than it was previously.

Ques Status: Previous Edition

37) Using the liquidity preference framework, show what happens to interest rates during a business cycle recession.

Answer: During a business cycle recession, income will fall. This causes the money demand curve to shift to the left. The resulting equilibrium will be at a lower interest rate.

Ques Status: Revised

5.6 Web Appendix 1: Models of Asset Pricing

1) The riskiness of an asset is measured by

A) the magnitude of its return.
B) the absolute value of any change in the asset's price.
C) the standard deviation of its return.
D) risk is impossible to measure.

Answer: C

Ques Status: Previous Edition

2) Holding many risky assets and thus reducing the overall risk an investor faces is called

A) diversification.
B) foolishness.
C) risk acceptance.
D) capitalization.

Answer: A

Ques Status: New

3) The ________ the returns on two securities move together, the ________ benefit there is from diversification.

A) less; more
B) less; less
C) more; more
D) more; greater

Answer: A

Ques Status: New

4) A higher ________ means that an asset's return is more sensitive to changes in the value of the market portfolio.

A) alpha
B) beta
C) CAPM
D) APT

Answer: B

Ques Status: Previous Edition

5) The riskiness of an asset that is unique to the particular asset is
A) systematic risk.
B) portfolio risk.
C) investment risk.
D) nonsystematic risk.

Answer: D
Ques Status: Previous Edition

6) The risk of a well-diversified portfolio depends only on the ________ risk of the assets in the portfolio.
A) systematic
B) nonsystematic
C) portfolio
D) investment

Answer: A
Ques Status: Previous Edition

7) Both the CAPM and APT suggest that an asset should be priced so that it has a higher expected return
A) when it has a greater systematic risk.
B) when it has a greater risk in isolation.
C) when it has a lower systematic risk.
D) when it has a lower systematic risk and a lower risk in isolation.

Answer: A
Ques Status: New

8) In contrast to the CAPM , the APT assumes that there can be several sources of ________ that cannot be eliminated through diversification.
A) nonsystematic risk
B) systematic risk
C) credit risk
D) arbitrary risk

Answer: B
Ques Status: Previous Edition

5.7 Web Appendix 2: Applying the Asset Market Approach to a Commodity Market: The Case of Gold

1) When stock prices become more volatile, the ________ curve for gold shifts right and gold prices ________, everything else held constant.
A) demand; increase
B) demand; decrease
C) supply; increase
D) supply; decrease

Answer: A
Ques Status: New

2) A return to the gold standard, that is, using gold for money will ________ the ________ for gold, ________ its price, everything else held constant.
A) increase; demand; increasing
B) decrease; demand; decreasing
C) increase; supply; increasing
D) decrease; supply; increasing

Answer: A
Ques Status: Previous Edition

3) When gold prices become more volatile, the ________ curve for gold shifts to the ________; ________ the price of gold.
A) supply; right; increasing
B) supply; left; increasing
C) demand; right; decreasing
D) demand; left; decreasing

Answer: D
Ques Status: Previous Edition

4) Discovery of new gold in Alaska will ________ the ________ of gold, ________ its price, everything else held constant.
A) increase; demand; increasing
B) decrease; demand; decreasing
C) decrease; supply; increasing
D) increase; supply; decreasing

Answer: D
Ques Status: Previous Edition

5) An increase in the expected inflation rate will ________ the ________ for gold, ________ its price, everything else held constant.
A) increase; demand; increasing
B) decrease; demand; decreasing
C) increase; supply; increasing
D) decrease; supply; increasing

Answer: A
Ques Status: Previous Edition

6) The price of gold should be ________ to the expected inflation rate.
A) positively related
B) negatively related
C) inversely related
D) unrelated

Answer: A
Ques Status: New

5.8 Web Appendix 3: Loanable Funds Framework

1) In the loanable funds framework, the ________ curve of bonds is equivalent to the ________ curve of loanable funds.
   A) demand; demand
   B) demand; supply
   C) supply; supply
   D) supply; equilibrium

   Answer: B
   Ques Status: Previous Edition

2) In the loanable funds framework, the ________ is measured on the vertical axis.
   A) price of bonds
   B) interest rate
   C) quantity of bonds
   D) quantity of loanable funds

   Answer: B
   Ques Status: Previous Edition