

Fall, 2018  
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## **EXAMINATION #2**

*Instructions:* On your opscan form, mark your ID NUMBER, fyour NAME, and the number of the seat (e.g. G2) where you are actually sitting. Since a wrong answer has the same impact on your score as no answer, you should answer every question. Please also turn in this question sheet, after writing your NAME and SEAT NUMBER below. If you have any questions, ask now, not after the exam is over! There are 40 questions and 3 bonus questions. Each question is worth 2.5 points.

**Name:**

**Seat that you are actually occupying:**

**1. Whether it is appropriate to use the supply and demand model to study a particular market depends on:**

- (A) The quality of the data available for that market.
- (B) Whether the model makes reasonably accurate predictions in that market.
- (C) Whether the market satisfies all of the assumptions of a competitive market.
- (D) Whether the participants in that market understand the supply and demand model.

**2. What is most likely to cause the demand for chicken to shift to the right?**

- (A) A decrease in the price of beef.
- (B) An increase in the price of beef.
- (C) A decrease in the price of chicken food.
- (D) An increase in the price of chicken food.
- (E) The closing of many old chicken farms.
- (AB) The opening of many new chicken farms.

**3. In a competitive market, if demand rises and supply falls, simultaneously, then we expect the equilibrium:**

- (A) Price to fall.
- (B) Price to rise.
- (C) Quantity to fall.
- (D) Quantity to rise.

**4. If the demand for french fries rises, and the price of potatoes (an ingredient) falls, then we expect the equilibrium:**

- (A) Price to fall.
- (B) Price to rise.
- (C) Quantity to fall.
- (D) Quantity to rise.

**5. In January, chip manufacturers produced and sold 40 zillion memory chips, at a market price of \$5 per chip. In February, they produced and sold 50 zillion, at a market price of \$6. This implies that, between January and February:**

- (A) The supply of memory chips increased.
- (B) The supply of memory chips decreased.
- (C) The demand for memory chips increased.
- (D) The demand for memory chips decreased.

**6. The term "sunk costs" refers to:**

- (A) Costs that exceed revenues.
- (B) Costs that occur only in the long run.
- (C) Gold in submerged Spanish galleons.
- (D) Expenditures that cannot be recovered.
- (E) The current market value of resources used up in production.

**7. Wilbur Wildkitten is trying to decide whether he should get a job after high school or enter UA on a football scholarship with hopes of eventually entering the NFL. When he calculates the opportunity cost of pursuing a football career, he \_\_\_\_\_ consider the time that he invested developing his football skills in high school, and he \_\_\_\_\_ consider the four years of salary that he loses by playing for UA instead of working.**

- (A) should; should.
- (B) should; should not.
- (C) should not; should.
- (D) should not; should not.

**8. In a competitive market, with free entry, the long run:**

- (A) Market supply curve is vertical.
- (B) Market supply curve is horizontal.
- (C) Market demand curve is vertical.
- (D) Market demand curve is horizontal.

**9. What is required for free entry (mark all that apply)?**

- (A) Every seller is small relative to the market.
- (B) Sellers and potential entrants have the same long run costs.
- (C) Sellers and potential entrants have the same long run access to markets.
- (D) None of these conditions is required.

**10. If the firms in a market report profits in excess of normal profits, and this continues for a long time, then this indicates:**

- (A) The presence of excess demand.
- (B) The presence of a barrier to entry.
- (C) The presence of a few large sellers.
- (D) Cooperation among the firms in the market.

**11. Which firm has enjoyed the advantage of patent-based barriers to entry?**

- (A) Intel
- (B) Alcoa
- (C) Merck
- (D) Boeing
- (E) Starbucks

**12. A bottling company paid \$50,000 for a new machine to be installed on a new assembly line. If the firm does not build the assembly line, then it has no other use for the machine. It can return the machine to the manufacturer, but the manufacturer will pay only \$10,000 for the returned machine. In this situation, the opportunity cost of the machine is:**

- (A) \$0.
- (B) \$10,000.
- (C) \$40,000.
- (D) \$50,000.

**13. If a business activity would generate a negative economic profit, then this means that:**

- (A) The activity generates a negative cash flow.
- (B) More money can be made by investing the same resources elsewhere.
- (C) The opportunity cost of the resources used exceeds the acquisition cost.
- (D) The acquisition cost of the resources used exceeds the opportunity cost.

**14. Many corporations earn (approximately) zero economic profits, but they claim to earn substantial positive profits in their reports to shareholders. In most cases, these reported profits:**

- (A) Are fraudulent.
- (B) Are the result of barriers to entry.
- (C) Compensate shareholders for the opportunity cost of their investment.
- (D) Have been artificially inflated by the “expensing” of current R&D expenditures.

**15. If there is excess supply in a market, then normally we expect:**

- (A) The price to fall to bring the market into equilibrium.
- (B) The price to rise to bring the market into equilibrium.
- (C) The demand curve to shift left and the supply curve to shift right, to bring the market into equilibrium.
- (D) The demand curve to shift right and the supply curve to shift left, to bring the market into equilibrium.

**16. In the very long run, in a competitive industry with free entry, which statements are true? (Mark all that apply.)**

- (A) Firms earn zero economic profits.
- (B) Firms earn zero accounting profits.
- (C) Firms produce the quantity that minimizes their long run average costs.
- (D) None of (A)-(C) need be true.

**17. Which statement is an example of normative economics?**

- (A) The U.S. government deficit will rise to 5% of GDP within five years.
- (B) The dollar value of trade between the U.S. and Mexico will decrease next year.
- (C) The Federal Reserve should continue to raise interest rates until growth slows.
- (D) If the price of oil declines, then daily gasoline consumption will rise within thirty days.
- (E) If different parties control the House and Senate, then the S&P 500 will rise 3% in the month following the election.

**18. When market interest rates change, what changes for a typical corporate bond? (Mark all that apply.)**

- (A) The maturity date.
- (B) The price of the bond.
- (C) The principal that a corporation returns when the bond matures.
- (D) The interest payments that a corporation pays on the bond before maturity.
- (E) None of these things change.

**19. For a \$10,000 one-year Treasury bill, which statement is true about market price, between the date at which it is issued and the date it matures? The price:**

- (A) equals \$10,000.
- (B) remains at or above \$10,000.
- (C) remains at or below \$10,000.
- (D) can fluctuate above or below \$10,000.

**20. Since 1950 the Salvator Mundi has had three owners who bought it and then sold it a few years later. Based on the information in the article, which of these owners earned the highest annualized rate of return?**

- (A) The family in Louisiana.
- (B) The two art dealers who bought it from the family.
- (C) The collector who bought it from the two art dealers.

**21. If the auction price of a one-year \$1,000 Treasury bill is \$870, then the yield is closest to:**

- |          |           |
|----------|-----------|
| (A) 6%.  | (AB) 11%. |
| (B) 7%.  | (AC) 12%. |
| (C) 8%.  | (AD) 13%. |
| (D) 9%.  | (AE) 14%. |
| (E) 10%. | (BC) 15%. |

**22. By definition, what characteristics must a bond generally satisfy? It must (select all that apply):**

- (A) have a Rating.
- (B) have a date of Maturity.
- (C) make Interest payments.
- (D) have a Principal amount.
- (E) specify in advance the dates and amounts of any interest payments.

**23. If the yield on a one-year \$1,000 Treasury bill is 1.5% at the time of the auction, then the market price of the T-bill is closest to:**

- |            |             |
|------------|-------------|
| (A) \$950. | (AB) \$975. |
| (B) \$955. | (AC) \$980. |
| (C) \$960. | (AD) \$985. |
| (D) \$965. | (AE) \$990. |
| (E) \$970. | (BC) \$995. |

**24. If a consumer invests \$1,000 for 28 years at an annual yield of 4%, then the amount that she has at the end of this period is closest to:**

- |             |               |
|-------------|---------------|
| (A) \$2,100 | (AB) \$2,600  |
| (B) \$2,200 | (AC) \$2,700  |
| (C) \$2,300 | (AD) \$2,800  |
| (D) \$2,400 | (AE) \$2,900  |
| (E) \$2,500 | (BC) \$3,000. |

*For the next three questions, consider a 2-year \$1,000 corporate bond that pays \$20 interest every quarter, until it finally matures (after two years) and pays \$1,020.*

**25. One and a half years has passed, and the bond has just made an interest payment. So two payments are left. If at that point the annualized yield on the bond is 6%, then the bond's market price is closest to:**

- (A) \$960.                      (E) \$1,000.
- (B) \$970.                      (AB) \$1,010.
- (C) \$980.                      (AC) \$1,020.
- (D) \$990.                      (AD) \$1,030.

**26. One hour earlier, when the bond had three payments left, the bond's market price was closest to:**

- (A) \$960.                      (E) \$1,000.
- (B) \$970.                      (AB) \$1,010.
- (C) \$980.                      (AC) \$1,020.
- (D) \$990.                      (AD) \$1,030. But was numbered (AE) on actual exam.

**27. Assume that two months before maturity, the bond's annualized yield is 5%. Then the bond's market price is closest to:**

- (A) \$930.                      (AB) \$980.
- (B) \$940.                      (AC) \$990.
- (C) \$950.                      (AD) \$1,000.
- (D) \$960.                      (AE) \$1,010.
- (E) \$970.                      (BC) \$1,020.

**28. An inverted yield curve generally indicates that the market expects interest rates to \_\_\_\_\_ and \_\_\_\_\_ economic growth.**

- (A) Fall; weak.
- (B) Fall; strong.
- (C) Rise; weak.
- (D) Rise; strong.

**29. Which of the following situations are associated with high liquidity in a market? (Mark all that apply.)**

- (A) Low commissions.
- (B) Low trading volume.
- (C) Predictable transaction prices.
- (D) None of these are associated with liquidity.

**30. Recently, bond yields have been generally:**

- (A) Rising.
- (B) Falling
- (C) Unchanged; there is no clear trend up or down.

**31. A high corporate bond rating generally indicates:**

- (A) The corporation is large.
- (B) The yields on its bonds are high.
- (C) The corporation is unlikely to default.
- (D) The price of the bond is relatively stable.
- (E) All of the above.

**32. If the bonds of corporation A pay a higher interest rate than the bonds of corporation B, consistently over several years, the safest conclusion is that:**

- (A) Corporation A is larger.
- (B) Corporation B is larger.
- (C) Corporation A is more likely to go bankrupt.
- (D) Corporation B is more likely to go bankrupt.
- (E) The financial markets are not in equilibrium.

**33. Bonds issued by the U.S. Treasury have relatively low yields because (mark all that apply):**

- (A) The market for Treasury bonds is very liquid.
- (B) The U.S. Treasury is judged unlikely to default.
- (C) The interest payments are not subject to federal income taxes.
- (D) The Congress has passed laws requiring low yields, to reduce the cost of government borrowing.

**34. Which of the following kinds of bond currently has the highest yield?**

- (A) 5 year Treasury.
- (B) 5 year Corporate.
- (C) 5 year Municipal.
- (D) 20 year Treasury.
- (E) 20 year Corporate.
- (AB) 20 year Municipal.

**35. The current yield on those bonds (the ones on the list that offer the highest yield) is closest to:**

- (A) 4%
- (B) 4.5%
- (C) 5%
- (D) 5.5%
- (E) 6%.

**36. The best bond rating is:**

- (A) A
- (B) A+
- (C) AA
- (D) AAA
- (E) AAAA

**37. Bonds issued by states and cities usually have lower yields than U.S. Treasury bonds because \_\_\_\_\_.**

- (A) They are less liquid.
- (B) States and cities are more likely to default.
- (C) The interest payments are not subject to federal income taxes.
- (D) Yields are capped by laws that reduce the cost of government borrowing.

**38. If bond yields remain fairly constant over time, then we expect the market price of a bond to \_\_\_\_\_ over the life of the bond.**

- (A) Fall.
- (B) Rise.
- (C) Remain largely unchanged.

**39. One source of risk in buying a longer term bond is that \_\_\_\_\_ could lead to an unexpected loss if \_\_\_\_\_.**

- (A) early redemption; yields fall.
- (B) early redemption; yields rise.
- (C) holding the bond until maturity; yields fall.
- (D) holding the bond until maturity; yields rise.

**40. If bond yields fall, then bond prices \_\_\_\_\_ and stock prices usually \_\_\_\_\_.**

- (A) Fall; fall.
- (B) Fall; rise.
- (C) Rise; fall.
- (D) Rise; rise.

## **BONUS QUESTIONS**

**41. The total value of one-year Treasury bills sold in each of the Treasury's recent monthly auctions is closest to \_\_\_\_\_ billion:**

- (A) \$5                      (AB) \$50
- (B) \$10                    (AC) \$75
- (C) \$15                    (AD) \$100
- (D) \$20                    (AE) \$150
- (E) \$25                    (BC) \$200

**42. Salvator Mundi is a portrayal of:**

- (A) Jesus.
- (B) A bowl of fruit.
- (C) A bowl of pasta.
- (D) Heaven and hell.
- (E) An Italian aristocrat.
- (AB) A scene from Greek mythology.

**43. When the Salvator Mundi was sold in 2017, the commission earned by Christie's, the auction house was closest to:**

- (A) \$5 million.
- (B) \$10 million.
- (C) \$20 million.
- (D) \$50 million.
- (E) \$100 million.