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

1) The primary purpose of deposit insurance is to
   A) protect bank shareholders against losses.
   B) protect bank employees from unemployment.
   C) prevent banking panics.
   D) improve the flow of information to investors.

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

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

4) A professional baseball player may be contractually restricted from skiing. The team owner includes this clause in the player's contract to protect against
   A) regulatory circumvention.  B) adverse selection.
   C) risk sharing.  D) moral hazard.

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

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

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

8) 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
9) Which of the following can be described as involving indirect finance?
   A) You buy shares in a mutual fund.
   B) A corporation buys a short-term security 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 loan to your neighbor.

10) The process where financial intermediaries create and sell low-risk assets and use the proceeds to purchase riskier assets is known as

11) The primary liabilities of a credit union are
    A) commercial loans.  B) bonds.  C) mortgages.  D) deposits.

12) 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.

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

14) 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.

15) Financial markets promote economic efficiency by
    A) creating inflation.  B) reducing investment.
    C) channeling funds from savers to investors.  D) channeling funds from investors to savers.

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

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

18) The yield to maturity is _______ than the _______ rate when the bond price is _______ its face value.
    A) greater; coupon; above
    B) less; perpetuity; below
    C) greater; perpetuity; above
    D) greater; coupon; below
19) An important function of secondary markets is to
   A) make it easier to sell financial instruments to raise funds.
   B) make it easier for governments to raise taxes.
   C) create a market for newly constructed houses.
   D) raise funds for corporations through the sale of securities.

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

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

22) 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) interest rate.  B) aggregate price level.
   C) exchange rate.  D) inflation rate.

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

24) 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) coupon bond.  B) discount bond.
   C) fixed-payment loan.  D) simple loan.

25) 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

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

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

28) 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.
29) 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) less; primary
   C) more; secondary   D) less; secondary

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

31) 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

32) When stock prices fall
   A) an individual’s wealth may decrease and their willingness to spend may decrease.
   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 is not affected nor is their willingness to spend.

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

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

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

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

37) When an investment bank _______ securities, it guarantees a price for a corporation’s securities and then sells them to the public.
   A) underwrites   B) overwrites   C) overtakes   D) undertakes

38) Banks are important to the study of money and the economy because they
   A) are the only important financial institution in the U.S. economy.
   B) channel funds from investors to savers.
   C) have been a source of rapid financial innovation.
   D) create inflation.
39) A problem with the yield on discount basis is that it _______ the yield to maturity, and this _______ increases, the _______ the maturity of the discount bond.

A) overstates; overstatement; shorter  
B) understates; understatement; longer  
C) overstates; overstatement; longer  
D) understates; understatement; shorter

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

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

41) Economists find no completely satisfactory way to measure money because

A) the “moneyness” or liquidity of an asset is a matter of degree.  
B) economists find disagreement interesting and refuse to agree for ideological reasons.  
C) money supply statistics are a state secret.  
D) the Federal Reserve does not employ or report different measures of the money supply.

42) For simple loans, the simple interest rate is _______ the yield to maturity.

A) not comparable to  
B) less than  
C) greater than  
D) equal to

43) Evidence from business cycle fluctuations in the United States indicates that

A) recessions have been preceded by dollar depreciation.  
B) a negative relationship between money growth and general economic activity exists.  
C) recessions have been preceded by declines in share prices on the stock exchange.  
D) recessions have been preceded by a decline in the growth rate of money.

44) 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

45) One likely explanation for the relatively high rates of inflation experienced in many Latin American countries is the

A) budget surpluses maintained in these countries.  
B) decline in the prices of basic commodities in these countries.  
C) relatively rapid growth in the money supply in these countries.  
D) relatively slow growth in the money supply in these countries.

46) 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.

47) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $1,200 next year?

A) 10 percent  
B) 25 percent  
C) -5 percent  
D) 5 percent
48) When money prices are used to facilitate comparisons of value, money is said to function as a
   A) payments-system ruler.           B) store of value.
   C) unit of account.                 D) medium of exchange.

49) 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) funny       D) electronic

50) 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 stays the same and M2 stays the same.
   D) M1 increases and M2 stays the same.
1) C  
2) B  
3) D  
4) D  
5) C  
6) C  
7) D  
8) A  
9) A  
10) B  
11) D  
12) D  
13) B  
14) A  
15) C  
16) B  
17) B  
18) D  
19) A  
20) C  
21) C  
22) A  
23) B  
24) B  
25) A  
26) B  
27) B  
28) D  
29) A  
30) A  
31) B  
32) A  
33) D  
34) B  
35) C  
36) B  
37) A  
38) C  
39) B  
40) B  
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42) D  
43) D  
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MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

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

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

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   A) country bonds. B) equity bonds.
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   C) discount bond.   D) coupon bond.

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   C) understates; understatement; shorter
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   B) The interest rate is 4 percent and the expected inflation rate is 1 percent.
   C) The interest rate is 25 percent and the expected inflation rate is 50 percent.
   D) The interest rate is 13 percent and the expected inflation rate is 15 percent.

43) Banks are important to the study of money and the economy because they
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   C) create inflation.
   D) are the only important financial institution in the U.S. economy.

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

50) For simple loans, the simple interest rate is ______ the yield to maturity.
    A) not comparable to
    B) greater than
    C) less than
    D) equal to
Answer Key
Testname: EXAM1_SPRING2008

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