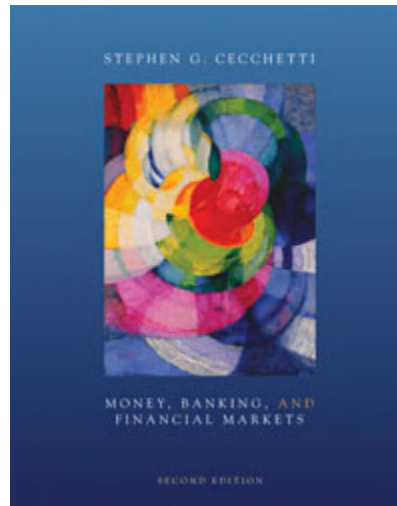


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## Money, Banking and Financial Markets, 2/e

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I see old paper's and assignments most of mcq's are given us from this book I want to share all data to my all fellow's.100% Correct

Answers

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## Quiz # 1

Q#1

Which item below is not one of the five parts of the Financial System?

- A) Money
- B) Central banks
- C) Financial Markets
- ✓D) Credit cards

**Reference Chapter:  
The Five Parts of the Financial System.**

Q#2

In the United States control of the money supply is given to:

- A) the President.
- B) Congress.
- C) the Secretary of the Treasury.
- ✓D) the Federal Reserve.

**Reference Chapter:  
The Five Parts of the Financial System.**

Q#3

Which of the following statements best describes financial markets?

A) Financial markets raise the cost and increase the speed of buying and selling financial instruments since people are earning fees for these transactions.

✓B) Financial markets increase the speed of buying and selling, and they also decrease the cost.

C) Financial markets are a good example of unregulated markets.

D) b and c

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#4**

The New York Stock Exchange is an example of:

- A) a financial instrument.
- B) a central bank.
- ✓ C) a financial market.
- D) All of the above.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#5**

Which of the following is NOT an accurate description of a trend associated with the U.S. financial system over the last few decades?

- A) It has become easier to withdraw funds from checking accounts.
- B) Financial innovations have made it easier for lower income households to participate in financial markets through the use of mutual funds.
- C) Banks have provided an expanding mix of services
- ✓ D) The Fed has become more secretive concerning its policy actions.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#6**

Which of the following is NOT likely to be a goal of a central bank?

- ✓ A) encouraging the use of paper currency instead of checking deposits
- B) maintaining a low inflation rate
- C) encouraging economic growth
- D) maintaining a stable financial system

**Reference Chapter:  
The Five Parts of the Financial System**

Q#7

The five core principles of Money and Banking include each of the following except:

- ✓ A) all people act rationally.
- B) time has value.
- C) information is the basis for decisions.
- D) risk requires compensation.

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

Q#8

The amount that a typical person would be willing to give up today (in the absence of anticipated deflation) to receive \$1,000 next year is:

- ✓ A) less than \$1,000.
- B) equal to \$1,000.
- C) greater than \$1,000.
- D) more or less than \$1,000, depending on the level of the interest rate.

**Reference Chapter:**

**The Five Core Principles of Money and Banking**

Q#9

When an individual obtains a student loan and makes all of the regular monthly payments, the sum of the payments made will exceed the initial amount of the loan. This is due *primarily* to the core principle that states that:

- A) most people do not pay back student loans.
- ✓ B) time has value.
- C) markets are sometimes inefficient at allocating resources.
- D) information is the basis for decisions.

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

**Q#10**

Banks usually offer lower rates of interest to people willing to keep their funds in the bank for a short time because:

- A) the banks really do not want these people as customers.
- B) banks really do not want a lot of people coming into the bank.
- ✓ C) bankers realize time has value and people need to be compensated if they are to keep their money in the bank longer.**
- D) All of the above.

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

**Q#11**

The statement "risk requires compensation" implies:

- A) people only accept risk when they absolutely have to.
- B) people will only accept risk when they are rewarded for doing so.
- C) people do not take risk.
- D) people will pay to avoid risk.
- ✓ E) b and d**

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

**Q#12**

The principle that "risk requires compensation" does NOT explain why:

- A) junk bonds provide a higher average return than do high-grade corporate bonds.
- B) college students pay high interest rates on credit cards than do adults with established credit histories.
- ✓ C) the interest rate is higher on 5-year CDs than on 1-year CDs.**
- D) individuals with poor credit ratings must pay higher interest rates on car loans.

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

**Q#13**

The core principles of money and banking would imply that if more students didn't pay back their student loans:

- A) student loans may become more difficult to obtain.
- B) the interest rate on student loans would increase.
- C) fewer people may attend college.
- ✓ D) All of the above.

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

**Q#14**

Monetary policy is best described as:

- A) attempts to keep inflation constant.
- B) determining the denominations and supply of a country's currency.
- C) one of the most important functions of Congress.
- ✓ D) attempts to keep inflation low and stable and growth high and stable.

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

**Q#15**

When an individual is faced with a choice between receiving a random income that on average equals \$40,000 per year or a certain income of \$40,000 per year, most individuals prefer the certain income to the one that varies because:

- A) information is the basis for decisions.
- ✓ B) stability improves welfare.
- C) markets determine prices and allocate resources.
- D) time has value.

**Reference Chapter:  
The Five Core Principles of Money and Banking**

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**Quiz # 2**

**Q#1**

A bank is an example of:

- A) a financial instrument.
- B) a financial market.
- ✓ C) a financial institution
- D) None of the above is correct.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#2**

Financial instruments are:

- A) used to transfer resources from savers to investors.
- B) used to transfer risk.
- C) sold in financial markets.
- ✓ D) All of the above are correct.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#3**

**Money:**

- A) consists solely of currency.
- B) consists solely of gold and silver coins.
- ✓ C) is used to purchase goods and services and to store wealth.
- D) is only rarely used to pay for transactions today.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#4**

Which of the following correctly describes trends associated with financial instruments in the U.S.?

A) Transactions have become relatively more costly over time due to rising brokerage fees.

**✓ B) Mutual funds now allow less wealthy households to purchase a share of a diversified collection of financial assets at a relatively low cost.**

C) The variety of types of financial instruments that are sold in financial markets has been reduced substantially over time.

D) The use of electronic networks to trade financial instruments has declined during the past 5 years in response to fears over the reliability and security of these networks.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#5**

The central bank for the U.S. today is:

A) the U.S. Treasury.

**✓ B) the Federal Reserve.**

C) the First Bank of the U.S.

D) the Second Bank of the U.S.

**Reference Chapter:  
The Five Parts of the Financial System.**

**Q#6**

Mutual funds pool the funds of savers and use them to buy:

A) shares in mutual savings banks only.

**✓ B) a variety of financial instruments.**

C) shares in the Federal Reserve system.

D) None of the above is correct.

**Reference Chapter:  
The Five Parts of the Financial System.**



Q#7

The variety of financial services offered by banks has \_\_\_\_\_ over the past 50 years.

A) expanded

B) contracted

C) remained the same

D) expanded and contracted periodically, but with a general downward trend in the range of services provided

**Reference Chapter:**

**The Five Parts of the Financial System.**

Q#8

After graduation from college, students observe that the total amount of their student loan payments is substantially greater than the amount that was borrowed. This occurs because:

A) the government forces students to pay excessively high interest rates compared to the interest rates that students pay on loans from credit card companies.

B) lenders must be compensated for giving up the use of funds since time has value.

C) default rates on student loans are much higher than on credit card loans.

D) All of the above are correct.

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

Q#9

Long-term government bonds offer higher interest rates than short-term government bonds, in part, because:

A) individuals must be compensated if they are to give up the use of their funds for longer periods.

B) the government wishes to discourage people from buying short-term bonds.

C) the higher interest rates on long-term bonds are really a marketing gimmick and are actually equivalent to the interest that would be received if people held a sequence of short-term bonds over the longer time period.

D) None of the above is correct.

**Reference Chapter:**

**The Five Core Principles of Money and Banking.**

**Q#10**

Individuals with poor credit scores are charged higher interest rates because:

- A) time has value.
- ✓ B) risk requires compensation.
- C) stability improves welfare.
- D) None of the above is correct.

**Reference Chapter:**  
**The Five Core Principles of Money and Banking.**

**Q#11**

Insurance companies receive more in premium payments in a typical year than they pay out in claims because:

- A) those that are buying the insurance are not aware they're overpaying for these services.
- ✓ B) individuals and firms are willing to pay a premium to transfer risk to the insurance company.
- C) insurance companies don't generally manage their portfolios of financial assets very well.
- D) None of the above is correct.

**Reference Chapter:**  
**The Five Core Principles of Money and Banking.**

**Q#12**

In well-developed financial markets, the value of stocks or bonds offered by a given company is determined by:

- A) government regulators.
- B) the Securities and Exchange Commission.
- ✓ C) the interaction of buyers and sellers in stock and bond markets.
- D) the pricing authorities of the Federal Reserve Board of Governors.

**Reference Chapter:**  
**The Five Core Principles of Money and Banking.**

**Q#13**

Since stability improves welfare, the Federal Reserve is charged with the task of:

- A) guaranteeing that a job exists for every worker.
- B) deterring technological change that may cause some workers to be replaced by machines.
- C) keeping the price of each and every good constant over time.
- ✓D) maintaining low and stable inflation and high and stable economic growth.**

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

**Q#14**

Because "risk requires compensation:"

- A) automotive insurance premiums are higher for new drivers than for more experienced drivers.
- B) junk bonds offer higher interest rates than bonds issued by companies with higher credit ratings.
- C) college students pay higher rates for credit cards than do individuals with an established (and positive) credit history.
- ✓D) All of the above are correct.**

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

**Q#15**

The core principles of money and banking imply that:

- A) most people would prefer a variable income that averages to \$70,000 per year to a certain income of \$70,000 per year.
- B) junk bonds will offer lower interest rates than other corporate bonds.
- ✓C) individuals benefit when the Fed is able to reduce cyclical fluctuations in output and prices.**
- D) most stock and bond prices are determined primarily by government pricing authorities.

**Reference Chapter:**

## The Five Core Principles of Money and Banking.

### True and False

Q#1

Transaction costs in financial markets have increased over time due to decreased competition in financial markets.

A) True

✓ B) False

Reference Chapter:

The Five Parts of the Financial System.

Q#2

The U.S. Treasury is charged with the task of adjusting the money supply to achieve low and stable inflation and high and stable economic growth.

A) True

✓ B) False

Reference Chapter:

The Five Parts of the Financial System.

Q#3

An increase in the perceived risk associated with corporate bonds will cause the interest rate on corporate bonds to increase.

✓ A) True

B) False

Reference Chapter:

The Five Core Principles of Money and Banking.

Q#4

Individuals will devote more resources to acquiring information when the expected benefits from acquiring the information are higher.

✓ A) True

B) False

Reference Chapter:

The Five Core Principles of Money and Banking.

**Q#5**

The rate of economic growth tends to be higher in countries that experience high and unstable inflation rates.

A) True

✓ B) False

**Reference Chapter:  
The Five Core Principles of Money and Banking.**

### Quiz # 3

**Q#1**

Which of the following would be considered a characteristic of money?

✓ A) It is a store of value.

B) It pays a higher return than most assets.

C) It is in fixed supply.

D) It is legal tender everywhere in the world.

**Reference Chapter:  
Money and How We Use It.**

**Q#2**

A society without any money:

A) would likely find people specializing more than they do now.

B) would find people doing everything for themselves.

✓ C) would have to rely strictly on barter.

D) would be more productive since people would be more self-sufficient.

**Reference Chapter:  
Money and How We Use It.**

**Q#3**

Which best describes money as a means of payment?

A) The use of money makes it more difficult to achieve a double coincidence of wants.

B) A double coincidence of wants with money never occurs.

**✓ C) The use of money makes it easier to achieve a double coincidence of wants.**

D) It is impossible to obtain a double coincidence of wants without using money.

**Reference Chapter:  
Money and How We Use It.**

**Q#4**

How many relative prices would there be in a barter economy with 10 goods?

A) 20

**✓ B) 45**

C) 90

D) 100

**Reference Chapter:  
Money and How We Use It.**

**Q#5**

While money is an asset not all assets are money because:

**✓ A) an asset can be money only if it serves as a means of payment.**

B) only money can store value over time.

C) only money maintains its value as a store of wealth during times of inflation.

D) an item can serve as money only if it is legal tender.

**Reference Chapter:  
Money and How We Use It.**

**Q#6**

In comparing money to a share of Microsoft stock held by an individual we can say:

A) the stock is an asset but money is not.

**✓ B) both are stores of value.**

- C) money is an asset but the stock is a liability of the individual.
- D) the stock is a store of value but the money isn't.

**Reference Chapter:  
Money and How we Use It.**

**Q#7**

Individuals who store their wealth in stamps rather than money will find:

- A) they will suffer larger real losses during periods of high inflation.
- B) they have far more liquidity than most savers.
- C) will incur higher transaction costs when they ultimately make purchases.
- D) All of the above.

**Reference Chapter:  
Money and How We Use It.**

**Q#8**

Money serves as a unit of account when it is used to:

- A) quote prices and record debts.
- B) store an individual's wealth over time.
- C) protect wealth from declining in value as a result of inflation.
- D) None of the above is correct.

**Reference Chapter:  
Money and How We Use It.**

**Q#9**

Which of the following could be used as commodity money?

- A) \$20 dollar bills
- B) gold coins
- C) checking deposits
- D) All of the above.

**Reference Chapter:**

**The Payments System.**

**Q#10**

Which of the following is a form of fiat money?

- A) gold coins
- B) checking deposits
- C) U.S. currency
- D) All of the above.

**Reference Chapter:  
The Payments System.**

**Q#11**

Checks are:

- A) a means of payment.
- B) money.
- C) not a promise of any kind.
- D) not acceptable by the U.S. government for payment of taxes.

**Reference Chapter:  
The Payments System.**

**Q#12**

An decrease in the number of credit cards issued:

- A) has the same impact on the economy as the Federal Reserve supplying less money.
- B) reduces the money supply since credit cards act like money.
- C) would probably lower the amount in M2 but would probably not affect M1.
- D) None of the above.

**Reference Chapter:  
The Payments System.**



**Q#13**

Tom uses a credit card to purchase a new pair of jeans. Tom is:

- A) using money to buy his jeans since credit cards are money.
- B) using a form of money included in M2.
- C) is using an electronic payment form of money that is in the category of checking deposits.
- ✓ D) creating a liability that is ultimately paid with money.**

**Reference Chapter:  
The Payments System.**

**Q#14**

A monetary aggregate can best be defined as:

- A) the amount of money the Federal Reserve is targeting for the economy.
- ✓ B) the amount of money measured at a particular point in time.**
- C) the average amount of money available to the economy over a year.
- D) the amount of U.S. currency the Bureau of Printing and Engraving has produced.

**Reference Chapter:  
Measuring Money.**

**Q#15**

The monetary aggregate M1 does *not* include:

- A) currency in the hands of the public.
- B) traveler's checks that have been issued.
- ✓ C) currency in the vaults of commercial banks.**
- D) demand deposits at commercial banks.

**Reference Chapter:  
Measuring Money.**

**Q#16**

The monetary aggregate M2 includes each of the following EXCEPT:

- A) small denomination time deposits.
- B) retail money market mutual fund shares.
- ✓ C) U.S. Treasury bills.
- D) M1.

**Reference Chapter:  
Measuring Money.**

**Q#17**

Since the early 1980s, M2 has:

- ✓ A) become a less useful measure of the relationship between the money supply and inflation.
- B) become the only money supply measure the Federal Reserve pays attention to in conducting monetary policy.
- C) become less useful than M1 due to new substitutes for standard checking accounts.
- D) generally been the slowest growing of all of the money aggregates.

**Reference Chapter:  
Measuring Money.**

**Q#18**

The Consumer Price Index (CPI):

- ✓ A) tends to overstate inflation due to substitution bias.
- B) tends to understate actual inflation.
- C) is more accurate than the GDP deflator.
- D) is based on basket of goods that changes monthly with consumer expenditures.

**Reference Chapter:  
Measuring Money.**

**Q#19**

Economists study the link between money and inflation because:

A) research shows that there is some inverse correlation between the supply of money and inflation.

B) economists believe that inflation in the 3-5% range is healthy for an economy.

C) as prices increase money becomes more valuable.

**✓ D) research shows that there is a direct correlation between the supply of money and inflation.**

**Reference Chapter:  
Measuring Money.**

**Q#20**

Which of the following statements is correct?

A) If you can buy the same goods this year as you bought last year with less money, the money supply decreased.

**✓ B) If it requires more money to purchase the same goods today that were purchased one year ago, then there must have been inflation.**

C) If it requires less money to purchase the same goods today as one year ago, then the money supply must have increased.

D) If it requires the same amount of money to purchase the same goods today that were purchased one year ago, then there must have been inflation.

**Reference Chapter:  
Measuring Money.**

## **Quiz # 4**

**Q#1**

An item is considered to be money only if it:

**✓ A) is generally accepted as a means of payment for goods and services.**

B) is used to store wealth over time.

C) is sometimes accepted in exchange for other goods or services.

D) None of the above is correct.

**Reference Chapter:**

**Money and How We Use It.**

**Q#2**

Which is the best example of the use of money as a store of value?

- A) A student cashes his paycheck and spends all of it on groceries.
- B) An individual uses money to buy stocks.
- C) A firm constructs its current balance sheet, expressing all credits and debits in dollars.
- ✓ D) A criminal holds \$10,000 in a wall safe to have in case he needs to leave the country quickly.**

**Reference Chapter:  
Money and How We Use It.**

**Q#3**

As compared to a barter economy, a monetary economy has:

- A) lower information requirements.
- B) lower transaction costs.
- ✓ C) Both of the above are correct.**
- D) None of the above is correct.

**Reference Chapter:  
Money and How We Use It.**

**Q#4**

Which of the following is the best example of money serving as a unit of account?

- A) A student uses money to pay for textbooks.
- B) A high school student deposits funds from a summer job into a savings account that will help be used to pay college tuition.
- ✓ C) A storeowner records all receipts and expenditures in dollars.**
- D) None of the above is correct.

**Reference Chapter:  
Money and How We Use It.**

**Q#5**

Which of the following is the most liquid asset?

- A) a home with a swimming pool
- B) a valuable art collection
- C) an extensive collection of Barbie dolls
- ✓ D) savings account balances

**Reference Chapter:  
Money and How We Use It.**

**Q#6**

Wealth may be held in the form of:

- A) money.
- B) stocks.
- C) bonds.
- ✓ D) All of the above are correct.

**Reference Chapter:  
Money and How We Use It.**

**Q#7**

Fiat money:

- A) is earned only by Italian autoworkers.
- B) has an intrinsic value as a commodity equal to its value as currency.
- ✓ C) is defined to be money by government decree.
- D) is always convertible into commodity money through the central bank of an economy.

**Reference Chapter:  
The Payments System.**

**Q#8**

The first form of money adopted by most societies has been a form of:

- ✓ A) commodity money.

- B) fiat money.
- C) legal tender.
- D) checking account.

**Reference Chapter:  
The Payments System.**

**Q#9**

Which of the following has *not* served at some time as a form of commodity money?

- A) gold
- B) paper currency issued by the U.S. government
- C) salt
- D) copper

**Reference Chapter:  
The Payments System**

**Q#10**

Over the last few years, the share of payments paid by paper checks has:

- A) increased due to a decline in the use of currency.
- B) increased due to the government's decision to consider checks to be a form of legal tender.
- C) decreased because they are no longer considered to be a form of legal tender.
- D) decreased as a result of an increased used of electronic transfers.

**Reference Chapter:  
The Payments System**

**Q#11**

When an individual uses a credit card to pay for an item purchased from an online vendor:

- A) the credit card itself is considered to be a form of money.

**✓ B) a loan is initiated and the company issuing the credit card provides an electronic transfer of money to the seller of the item.**

C) no monetary payment to the vendor occurs until the credit card statement is paid by the customer.

D) None of the above is correct.

**Reference Chapter:  
The Payments System**

**Q#12**

An ACH transaction involves:

**✓ A) an electronic transfer of funds from one account to another.**

B) a payment involving funds that are not considered to be money.

C) a payment made from a stored-value card.

D) All of the above are correct.

**Reference Chapter:  
The Payments System**

**Q#13**

It is expected that the use of money as a store of value in industrialized economies will:

A) continue to become more important over time due to the risk associated with other assets.

B) remain unchanged.

**✓ C) continue to decline as interest-bearing assets become more liquid.**

D) None of the above is correct.

**Reference Chapter:  
The Future of Money**

**Q#14**

Which of the monetary aggregates contains only assets that can be directly used to buy goods and services?

**✓ A) M1**

B) M2

C) currency only

D) checks only

**Reference Chapter:  
Measuring Money**

**Q#15**

Which of the following is not included in M1?

A) coins

B) travelers' checks

✓ C) savings deposits

D) currency

**Reference Chapter:  
Measuring Money**

**Q#16**

Suppose that the public shifts funds from checking accounts to savings accounts. Other things equal, this is expected to cause M1 to:

A) increase.

✓ B) decrease

C) remain unchanged.

D) change in an unpredictable manner.

**Reference Chapter:  
Measuring Money**

**Q#17**

Suppose that the public shifts funds from checking accounts to savings accounts. Other things equal, this is expected to cause M2 to:

A) increase.

B) decrease

✓ C) remain unchanged.



D) change in an unpredictable manner.

**Reference Chapter:  
Measuring Money**

**Q#18**

Time deposits are:

- A) included in M1, but not M2.
- ✓ B) included in M2, but not M1.
- C) included in both M1 and M2.
- D) included in neither M1 nor M2.

**Reference Chapter:  
Measuring Money**

**Q#19**

The change in the relationship between the growth rate in M2 and subsequent inflation since 1990 may be due to:

- A) a measure of the money supply that does not take into account changes in the way in which payments are made.
- B) the relatively low rates of money growth and inflation that have occurred during this period.
- ✓ C) Both of the above are correct.
- D) None of the above is correct.

**Reference Chapter:  
Measuring Money**

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## True and False

**Q#1**

As the inflation rate rises, money is more likely to be used as a store of value.

- A) True
- ✓ B) False

**Reference Chapter:  
Money and How We Use It.**

**Q#2**

Commodity money is an item that has a value as money equal to its intrinsic value as a commodity.

**A) True**

**B) False**

**Reference Chapter:  
The Payments System.**

**Q#3**

Both debit cards and ACH transactions result in electronic fund transfers.

**A) True**

**B) False**

**Reference Chapter:  
The Payments System.**

**Q#4**

Since the 1980s, monetary economists have shifted their focus from M2 to M1 as the best predictor of inflation.

**A) True**

**B) False**

**Reference Chapter:  
Measuring Money.**

**Q#5**

Beginning in the 1980s, M2 increased in size relative to M1 as a result of the availability of more liquid interest-bearing assets.

**A) True**

**B) False**

**Reference Chapter:  
Measuring Money.**

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## Quiz # 5

**Q#1**

The U.S. Government finances its budget deficits:

- A) using indirect finance.
- B) by using a financial intermediary.
- ✓ C) using direct finance.
- D) by printing money.

**Reference Chapter:  
Financial Instruments.**

**Q#2**

The loans made between borrowers and lenders:

- A) are liabilities to the lenders and assets to the borrowers since the borrower obtains the funds.
- ✓ B) are assets to the lenders and liabilities of the borrowers since the promises are made to the lenders.
- C) are not part of either's assets or liabilities until the loans are repaid.
- D) None of the above.

**Reference Chapter:  
Financial Instruments.**

**Q#3**

Which of the following is NOT a financial instrument?

- A) A share of General Motors stock
- ✓ B) A tuition bill
- C) A U.S. Treasury Bond
- D) A home insurance policy

**Reference Chapter:  
Financial Instruments.**

**Q#4**

Tom purchases automobile insurance; the insurance contract is:

- A) a form of money.

- ✓ B) a financial instrument.
- C) a transfer of risk from the insurance company to Tom.
- D) None of the above.

**Reference Chapter:  
Financial Instruments.**

**Q#5**

Which of the following statements is *incorrect*?

- A) When a risk is easy to predict, financial instruments are created to transfer these risks.
- ✓ B) Financial instruments are created to transfer risks that are relatively difficult to predict.
- C) Financial instruments do not require certainty of an event to be able to transfer risk.
- D) Financial instruments do not eliminate the risk from uncertainty, they transfer it.

**Reference Chapter:  
Financial Instruments.**

**Q#6**

The shares of McDonald Corporation stock are an example of:

- ✓ A) a standardized financial instrument.
- B) a standardized financial liability instrument.
- C) a non-standardized financial instrument since their prices can differ over time.
- D) a means of payment.

**Reference Chapter:  
Financial Instruments.**

**Q#7**

A derivative instrument:

- ✓ A) gets its value and payoff from the performance of the underlying instrument.

- B) is a high risk financial instrument used by highly risk-averse savers.
- C) comes into existence after the underlying instrument is in default.
- D) should be purchased prior to purchasing the underlying security.

**Reference Chapter:  
Financial Instruments.**

Q#8

Options provide:

A) an obligation to buy or sell a fixed quantity of an underlying instrument at a particular price.

**✓ B) a right, but not an obligation, to sell a fixed quantity of an underlying instrument at a particular price.**

C) neither a right nor an obligation to buy a fixed quantity of an underlying instrument at a particular price.

D) None of the above is correct.

**Reference Chapter:  
Financial Instruments**

Q#9

Considering the value of a financial instrument, the longer the time until the promised payment is made:

**✓ A) the less valuable is the promise to make it since time is valuable.**

B) the greater the risk, therefore the promise has greater value.

C) the more valuable is the promise to make it.

D) None of the above.

**Reference Chapter:  
Financial Instruments.**

Q#10

Asymmetric information in financial markets is a potential problem usually resulting from:

A) too much information being provided to market participants by third-party information providers.

B) lenders having more information than borrowers, allowing lenders to exploit naïve borrowers.

**✓ C) borrowers having more information than lenders, and having no incentive to disclose adverse information.**

D) excessive speculation in derivative markets.

**Reference Chapter:  
Financial Markets.**

**Q#11**

Economic research shows that:

A) there is a strong inverse correlation between financial market development and economic growth.

B) the correlation between financial development and economic growth is strong, but it frequently changes sign; sometimes it is positive and sometimes it is negative.

**✓ C) there is a relatively strong positive correlation between financial market development and economic growth.**

D) there isn't any correlation between financial market development and economic growth.

**Reference Chapter:  
Financial Markets.**

**Q#12**

Financial markets enable the transfer of risk by:

A) not allowing risk-averse investors access to U.S. Treasury bond markets.

B) making sure that higher default risk is offset by greater liquidity.

**✓ C) allowing individuals and firms less willing to bear risk to transfer risk to other individuals and firms more willing to bear risk.**

D) enabling even unsophisticated investors to purchase highly complex financial instruments.

**Reference Chapter:  
Financial Markets.**

**Q#13**

Brokerage fees charged by a stockbroker are an example of:

- A) monopoly profits.
- B) an insurance premium.
- ✓ C) transaction costs.**
- D) None of the above is correct.

**Reference Chapter:  
Financial Markets**

**Q#14**

Which of the following is not a characteristic of a well-run financial market?

- A) The market is designed to keep transaction costs low.
- B) The information the market pools and communicates is accurate and widely available.
- ✓ C) Prices only adjust slowly to be sure that the information they reflect is verified.**
- D) Investors need protection and proper safeguards.

**Reference Chapter:  
Financial Markets.**

**Q#15**

A financial intermediary:

- A) is an agency that guarantees a loan.
- B) is involved in direct finance.
- ✓ C) is used in indirect finance.**
- D) None of the above.

**Reference Chapter:  
Financial Institutions**

**Q#16**

John obtains a home improvement loan from New Town Bank:

- A) the loan is John's asset and the bank's liability.
- B) the loan is John's asset, but the liability belongs to the bank's depositors.
- ✓ C) **the loan is John's liability and an asset for New Town Bank.**
- D) the loan is John's liability and a liability of the bank until Tom pays it off.

**Reference Chapter:  
Financial Institutions.**

**Q#17**

The process of financial intermediation:

- A) creates a net cost to an economy but is unavoidable.
- B) is used primarily in underdeveloped countries.
- C) is always used when a borrower needs to obtain funds.
- ✓ D) **increases the economy's ability to produce.**

**Reference Chapter:  
Financial Institutions.**

**Q#18**

Which of the following statements is *incorrect*?

- A) Banks are financial intermediaries.
- B) A savings and loan is a financial intermediary.
- ✓ C) **All financial intermediaries are insurance companies.**
- D) Financial intermediaries increase the efficiency of the economy.

**Reference Chapter:  
Financial Institutions.**

**Q#19**

Small savers would use financial intermediaries rather than lend directly to borrowers because:



A) this allows savers to receive a higher interest rate than they could if they engaged in direct finance.

**✓ B) this allows savers to give up the use of their funds for a short time period.**

C) borrowers prefer short-term loans while savers prefer to make long-term loans.

D) funds placed in financial intermediaries are less liquid than but offer a higher return than assets used in direct finance.

**Reference Chapter:  
Financial Institutions.**

**Q#20**

Which of the following statements about financial institutions is *incorrect*?

A) Insurance companies accept premiums from policy holders, invest in securities and real estate, and provide insurance payments under specific conditions.

B) Finance companies raise funds using direct finance and make loans to individuals and firms.

**✓ C) Government-sponsored enterprises are small businesses located in economically depressed areas that receive government funding to help them compete with large firms located in more prosperous areas.**

D) Depository institutions accept deposits and make loans.

**Reference Chapter:  
Financial Institutions.**

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## Quiz # 6

**Q#1**

Which of the following is the best example of indirect finance?

**✓ A) An insurance company buys stocks and bonds using funds collected from insurance premiums.**

B) The U.S. Treasury sells bonds to the public.

C) A company provides its executives with stock options.

D) A company issues new stock.

**Reference Chapter:  
Financial Instruments.**

**Q#2**

Financial instruments:

- A) may be used to transfer risk.
- B) provide for the transfer of something of value to another party at a future date.
- C) **Both of the above are correct.**
- D) None of the above is correct.

**Reference Chapter:  
Financial Instruments.**

**Q#3**

Which of the following is an accurate description of a financial instrument?

- A) A financial instrument involves a legal commitment to transfer something of value at a specified future date.
- B) A financial instrument describes the conditions under which a future transfer occurs.
- C) A financial instrument imposes legal obligations on the party that makes a promise to provide a transfer of something of value.
- D) **All of the above are correct.**

**Reference Chapter:  
Financial Instruments.**

**Q#4**

Financial instruments are primarily used by the holder as a:

- A) means of payment.
- B) **store of value.**
- C) unit of account.
- D) None of the above is correct.

**Reference Chapter:  
Financial Instruments.**

**Q#5**

The use of standardized financial instruments and standardized reporting requirements:

- A) lowers information costs.
- B) reduces the problem of asymmetric information.
- ✓ C) Both of the above are correct.**
- D) None of the above is correct.

**Reference Chapter:  
Financial Instruments.**

**Q#6**

Derivative instruments are financial instruments that have a value that is derived:

- A) using the rules of differential calculus.
- ✓ B) from the behavior of an underlying instrument.**
- C) solely in primary markets, not secondary markets.
- D) None of the above is correct.

**Reference Chapter:  
Financial Instruments.**

**Q#7**

A financial instrument has a higher market value when:

- A) the future payoff is smaller.
- ✓ B) the probability of a future payment is greater.**
- C) the payment occurs further in the future.
- D) All of the above are correct.

**Reference Chapter:  
Financial Instruments.**

**Q#8**

An increase in the size of the promised future payment on a security, holding other things constant, will cause the price of the security to:

- A) rise.**
- B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Reference Chapter:  
Financial Instruments.**

**Q#9**

The price of a financial instrument will be higher when:

- A) the promised payment is received later.
- B) the promised payment is received sooner.**
- C) the probability of receiving the payment is reduced.
- D) None of the above is correct.

**Reference Chapter:  
Financial Instruments.**

**Q#10**

Which of the following financial instruments is primarily used to transfer risk?

- A) bonds
- B) home mortgages
- C) futures contracts**
- D) stocks

**Reference Chapter:  
Financial Instruments.**

**Q#11**

Which of the following is a correct statement about financial markets?

- A) They offer both savers and borrowers liquidity.

- B) They provide for the transfer of risk.
- C) They pool and communicate information.
- ✓ D) All of the above are correct.

**Reference Chapter:  
Financial Markets.**

**Q#12**

Newly issued securities are sold in:

- ✓ A) primary markets.
- B) secondary markets.
- C) centralized exchanges only.
- D) None of the above is correct.

**Reference Chapter:  
Financial Markets.**

**Q#13**

The New York Stock exchange is a(n):

- A) primary market.
- ✓ B) secondary market.
- C) over-the-counter market.
- D) None of the above is correct.

**Reference Chapter:  
Financial Markets.**

**Q#14**

An over-the-counter market is:

- A) a form of centralized exchange.
- ✓ B) a network of dealers connected electronically.
- C) an illegal secondary market for stocks used primarily by those attempting to evade taxes.

D) a primary market for stocks.

**Reference Chapter:  
Financial Markets.**

**Q#15**

What is the distinction between debt and equity markets?

A) Debt markets are those that are used only by individuals and firms that are on the verge of bankruptcy while equity markets provide more equitable borrowing terms to those borrowers that have sound credit ratings.

B) Debt markets are used primarily by those that are buying financial instruments using borrowed funds, while equity markets allow people to buy financial assets using only their own funds.

**✓ C) Debt markets are the market for mortgages, loans, and bonds while equity markets are the markets for stocks.**

D) None of the above is correct.

**Reference Chapter:  
Financial Markets.**

**Q#16**

Financial securities with a maturity of less than a year from their original issue date are sold in the:

**✓ A) money market.**

B) bond market.

C) equity market.

D) None of the above is correct.

**Reference Chapter:  
Financial Markets.**

**Q#17**

Depository institutions exist because they:

A) increase the transaction costs associated with borrowing and lending.

**✓ B) allow savers to give up the use of their funds for short periods and time and borrowers to borrow for long periods of time.**

C) always offer higher interest rates to savers than would be received under direct finance.

D) always provide lower interest rates on loans to borrowers than would be received under direct finance.

**Reference Chapter:  
Financial Institutions.**

Q#18

The existence of depository institutions provides savers with:

- ✓ A) more liquidity than they would have if they engaged in direct finance.
- B) less liquidity than they would have if they engaged in direct finance.
- C) the same liquidity that they would have if they engaged in direct finance.
- D) a higher return than they could receive under direct finance.

**Reference Chapter:  
Financial Institutions.**

Q#19

Which of the following is not a depository institution?

- A) commercial banks
- B) credit unions
- C) savings banks
- ✓ D) insurance companies

**Reference Chapter:  
Financial Institutions.**

## True and False

Q#1

Derivatives are used to transfer risk.

- ✓ A) True

B) False

**Reference Chapter:  
Financial Instruments.**

**Q#2**

The price of a financial instrument rises when a specified payment is made further in the future.

A) True

✓ B) False

**Reference Chapter:  
Financial Instruments.**

**Q#3**

Previously owned stocks and bonds are sold in primary markets.

A) True

✓ B) False

**Reference Chapter:  
Financial Markets.**

**Q#4**

Treasury bills are sold in bond markets.

A) True

✓ B) False

**Reference Chapter:  
Financial Markets.**

**Q#5**

Financial institutions make it possible to match the desired time horizons for both borrowers and lenders.

✓ A) True

B) False

**Reference Chapter:  
Financial Markets.**



## Quiz # 7

**Q#1**

The future value in 1 year of \$300 deposited today at a 6% annual interest rate is:

- A) \$282.00
- B) \$318.00
- C) \$306.00
- D) None of the above.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#2**

Which of the following expresses 6.5%?

- A) 0.0065
- B) 6.50
- C) 0.650
- D) 0.0650

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#3**

Which of the following best expresses the proceeds a lender receives from a one-year simple loan when it is paid back?

- A)  $PV(1 + i)$
- B)  $FV/i$
- C)  $PV + i$
- D)  $PV/i$

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#4**

Suppose that Joe receives a one-year simple loan from Bank A for \$9,000.00. At the end of the year Joe repays \$9,720.00 to Bank A. The interest *rate* on Joe's loan was:

- A) \$800.
- B) 7.2%.
- ✓ C) 8.0%.
- D) None of the above is correct.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#5**

Which of the following best expresses the payment a lender receives for lending his or her money for four years?

- ✓ A)  $PV(1+i)^4$
- B)  $PV/(1+i)^4$
- C)  $4PV$
- D) None of the above.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#6**

An individual is promised a \$1,000 payment one year from today. If she faces an interest rate of 5%, how much would she would be willing to accept today in exchange for this future payment?

- A) \$1005.00
- B) \$1050.00
- C) \$950.00
- ✓ D) \$952.38

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#7**

Mary deposits funds into a CD at her bank. The CD has an annual interest of 4.0%. If Mary leaves the funds in the CD for entire two years she will have \$1,081.60. What amount is Mary depositing?

- A) \$960.60
- B) \$900.00
- C) \$1,005.00
- ✓ D) **\$1,000.00**

**Reference Chapter:****Valuing Monetary Payments Now and in the Future.****Q#8**

The future value of \$100 left in a savings account earning 4.5% for two and a half years is best expressed by:

- A)  $\$100(1.045)^{3/2}$
- B)  $\$100(0.45)^{2.5}$
- ✓ C)  **$\$100(1.045)^{2.5}$**
- D)  $\$100 \times 2.5 \times (1.045)$

**Reference Chapter:****Valuing Monetary Payments Now and in the Future.****Q#9**

The rule of 72 says that at a 6% interest rate an initial balance of \$500 should become \$1,000 in about:

- A) 7 years.
- B) 8 years.
- ✓ C) **12 years.**
- D) 6.94 years.

**Reference Chapter:****Valuing Monetary Payments Now and in the Future.**

**Q#10**

The longer the time (n) until the payment:

- A) the lower the present value.**
- B) the higher the present value because time is valuable.**
- C) the lower must be the interest rate.**
- D) None of the above.**

**Reference Chapter:  
Valuing Monetary Payments Now and in the Future.**

**Q#11**

A change in the interest rate has:

**A a larger impact on the present value of a payment to be made far into the future than one to be made sooner.**

**B will not have a difference on the present value of two equal payments to be made at different times.**

**C) a smaller impact on the present value of a payment to be made far into the future than one to be made sooner.**

**D) None of the above.**

**Reference Chapter:  
Valuing Monetary Payments Now and in the Future.**

**Q#12**

An investment has grown from \$100.00 to \$160.00 or 60% over four years. What annual increase results in a 60% increase over four years?

- A) 7.50%**
- B) 12.47%**
- C) 15.00%**
- D) 13.24%**

**Reference Chapter:  
Valuing Monetary Payments Now and in the Future.**

**Q#13**

People with a high discount rate will require:

- A) a higher interest rate to entice them to save.**
- B) investment options with longer maturities.
- C) a lower interest rate to entice them to save.
- D) a and b

**Reference Chapter:  
Valuing Monetary Payments Now and in the Future.**

**Q#14**

If the internal rate of return from an investment is less than the opportunity cost of funds:

- A) the firm should make the investment.
- B) the firm should not make the investment.**
- C) the firm should only make the investment using retained earnings.
- D) None of the above.

**Reference Chapter:  
Applying Present Value.**

**Q#15**

A mortgage, where the monthly payments are not the same for the duration of the loan, is an example of:

- A) a variable payment loan.**
- B) an installment loan.
- C) a fixed payment loan.
- D) an equity security.

**Reference Chapter:  
Applying Present Value.**

**Q#16**

An investment carrying a current cost of \$130,000 is going to generate \$70,000 of revenue in each of the next three years. To calculate the internal rate of return we need to:

A) calculate the present value of each of the \$70,000 payments and multiply these and set this equal to \$130,000.

B) take the present value of \$210,000 for three years from now and set this equal to \$130,000.

**✓ C) set the sum of the present value of \$70,000 for each of the next three years equal to \$130,000.**

D) subtract \$130,000 from \$210,000 and set this difference equal to the interest rate.

**Reference Chapter:  
Applying Present Value.**

Q#17

The price of a bond is determined by:

A) taking the present value of the bond's final payment and subtracting the coupon payments.

B) taking the present value of the coupon payments and adding this to the face value.

C) taking the present value of the bond's final payment.

**✓ D) taking the sum of the present values of the future payments..**

**Reference Chapter:  
Applying Present Value.**

Q#18

If a bond has a face value of \$1,000 and the bondholder receives coupon payments of \$35.00 semi-annually, the bond's coupon rate is:

A) 3.5%

**✓ B) 7.0%**

C) 7.5%

D) Cannot be determined from the information provided.

**Reference Chapter:  
Applying Present Value.**

Q#19

Which formula below best expresses the nominal interest rate, (i)?

- A)  $i = r - \Pi^e$
- B)  $r = i + \Pi^e$
- ✓ C)  $i = r + \Pi^e$
- D)  $\Pi^e = i + r$

**Reference Chapter:**  
**Real and Nominal Interest Rates.**

Q#20

From the Fisher equation we see that an increase of 3% in the expected inflation rate will cause the nominal interest rate to increase by:

- A) more than 3%.
- B) less than 3%.
- ✓ C) 3%.
- D) 6%.

**Reference Chapter:**  
**Real and Nominal Interest Rates.**

## Quiz # 8

Q#1

The present value of a future payment is, *ceteris paribus*, higher when the:

- A) size of the future payment is smaller.
- B) interest rate rises.
- ✓ C) payment is received sooner.
- D) All of the above are correct.

**Reference Chapter:**  
**Valuing Monetary Payments Now and in the Future.**

Q#2

Expressed as a decimal value, 7.5% is represented as:

- A) 0.75
- ✓ B) 0.075
- C) 0.0075
- D) None of the above is correct.

**Reference Chapter:**

**Response: Valuing Monetary Payments Now and in the Future.**

Q#3

Suppose that an initial balance of \$200 is placed in an interest-bearing account for 5 years when the interest rate equals  $i$ . Which of the following represents the value of this balance at the close of this time period?

- A)  $\$200 + 5i$
- B)  $\$200(1+5i)$
- ✓ C)  $\$200(1+i)^5$
- D)  $\$200 / (1+i)^5$

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

Q#4

Suppose that \$1,000 is deposited in an interest-bearing account for 3 years when the annual interest rate is 5%. At the end of this three-year period, the value of the balance will equal:

- A) \$863.84.
- B) \$1,000.00.
- C) \$1,050.00.
- ✓ D) \$1,157.62.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**



**Q#5**

Using the rule of 72, if \$1,000 is deposited in an account that provides 3% annual interest, approximately how long will it take for the balance in this account to increase to \$2,000?

- A) 2 years
- B) 6 years
- C) 12 years
- ✓ D) 24 years

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#6**

Suppose that a balance of \$X is deposited in an account for 18 months. If the annual interest rate is  $i$ , which of the following represents the value of this balance at the end of the 18-month period?

- A)  $\$X(1+i)^{18}$
- ✓ B)  $\$X(1+i)^{1.5}$
- C)  $c)\$X(1+18i)$
- D) None of the above is correct.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#7**

If the annual interest rate is 6%, the corresponding monthly interest rate is:

- A) 0.50%.
- ✓ B) 0.487%.
- C) 0.72%.
- D) 0.072%.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#8**

Suppose that the interest rate is initially 5.25%. If the interest rate rises by 3 basis points, the new interest rate is:

- A) 8.25%.
- B) 5.55%.
- C) 5.28%.
- D) None of the above is correct.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#9**

When the interest rate is 5%, the present value of \$1,000 received two years from now equals:

- A) \$1000.
- B) \$1010.
- C) \$952.38.
- D) \$907.03.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#10**

The present value of a future payment is:

- A) the same as the future value.
- B) the amount that has to be given up today to receive the future value at the specified future date.
- C) always greater than the future value.
- D) All of the above are correct.

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#11**

When the interest rate rises, the price of discount bonds will:

- ✓ A) fall.
- B) rise.
- C) remain unchanged.
- D) This cannot be determined without additional information.

**Reference Chapter:  
Applying Present Value.**

Q#12

The internal rate of return on an asset is:

- A) always less than the market interest rate.
- B) the price of the asset at which the net benefit from holding the asset is zero
- ✓ C) the interest rate at which the present value of the q payment stream associated with the asset equals the asset price.
- D) All of the above are correct.

**Reference Chapter:  
Applying Present Value.**

Q#13

An individual should undertake an investment if:

- A) the internal rate of return is less than the market interest rate.
- ✓ B) the internal rate of return is greater than the market interest rate.
- C) the present value of the revenue stream generated by the investment is less than the present value of the cost of the investment.
- D) None of the above is correct.

**Reference Chapter:  
Applying Present Value.**

Q#14

When the interest rate falls, holders of coupon bonds will experience a(n):

- ✓ A) increase in the value of the bonds that they are already holding.

- B) decrease in the value of the bonds that they are already holding.
- C) unchanged value for the bonds that they are already holding.
- D) unpredictable effect on the value of the bonds that they hold.

**Reference Chapter:  
Applying Present Value.**

**Q#15**

Suppose that a discount bond provides a payment of \$10,000 in 2 years. If the interest rate is 7%, the current price of this bond will be:

- A) \$10,140.00.
- B) \$10,700.00.
- C) \$8734.39.
- D) \$8600.00.

**Reference Chapter:  
Applying Present Value.**

**Q#16**

The real interest rate is approximately equal to:

- A) nominal interest rate / price index.
- B) nominal interest rate x price index.
- C) nominal interest rate + the expected inflation rate.
- D) nominal interest rate – the expected inflation rate.

**Reference Chapter:  
Real and Nominal Interest Rates.**

**Q#17**

Which of the following statements is incorrect?

- A) The real interest rate can be negative.
- B) Higher nominal interest rates are usually associated with higher inflation rates.

✓ C) Higher real interest rates are usually associated with higher inflation rates.

D) It is easier to compute the *ex post* real interest rate than the *ex ante* real interest rate.

**Feedback:**

**LOD: 2**

**Real and Nominal Interest Rates.**

## True and False

**Q#1**

If the interest rate is greater than zero, the present value of a future payment of \$10,000 will always be greater than \$10,000.

A) True

✓ B) False

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#2**

An increase in the interest rate causes the present value of any given future payment to decline.

✓ A) True

B) False

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

**Q#3**

If a balance in an interest-bearing account grows by 5% per year, after 5 years, the balance will be 25% larger.

A) True

✓ B) False

**Reference Chapter:**

**Valuing Monetary Payments Now and in the Future.**

Q#4

An increase in the interest rate causes the price of discount bonds to rise.

- A) True
- ✓ B) False

**Reference Chapter:  
Applying Present Value.**

Q#5

Creditors benefit from an unexpected increase in the inflation rate.

- ✓ A) True
- B) False

**Reference Chapter:  
Real and Nominal Interest Rates.**

## Quiz # 9

Q#1

Which of the following is a correct statement concerning risk?

- A) Risk can always be avoided at no cost.
- ✓ B) Risk is a measure of uncertainty.
- C) Risk is not measured relative to a benchmark.
- D) Risk rarely involves a future payoff.

**Reference Chapter:  
Defining Risk.**

Q#2

All other factors held constant:

A) an investment with less risk should sell for a lower price and offer a lower return.

✓ B) an investment with more risk should sell for a lower price and offer a higher return.

C) an investment with less risk should sell for a lower price and offer a higher return.

D) an investment with more risk should offer a lower return and sell for a higher price.

**Reference Chapter:  
Defining Risk.**

**Q#3**

The sum of the probabilities for all possible outcomes must equal one because:

A) each possible outcome is more likely to occur than to not occur.

B) all possible outcomes are equally likely to occur.

✓ C) one of the possible outcomes must occur.

D) There is no way of determining the likelihood of one of the events occurring, so we normalize this likelihood by arbitrarily setting the sum of the probabilities to 1.

**Reference Chapter:  
Measuring Risk.**

**Q#4**

If a fair die is rolled, the probability of coming up with a one is:

A)  $1/12$  or 8.3 percent.

B) zero.

✓ C)  $1/6$  or 16.7 percent.

D) None of the above.

**Reference Chapter:  
Measuring Risk.**

**Q#5**

If there is a 50% probability that an investment will return \$2,000 and a 50% probability that this investment will return \$1,400, the expected value of this investment is:

A) \$3,400

B) \$2,000

- ✓ C) \$1,700
- D) \$1,400

**Reference Chapter:  
Measuring Risk.**

Q#6

An investor puts \$1,000 into an investment that will return \$1,300 one-half of the time and \$800 the remainder of the time. The expected *return* for this investor is:

- A) \$1,000
- B) 30%
- C) -20%
- ✓ D) 5%

**Reference Chapter:  
Measuring Risk.**

Q#7

The variance is somewhat less useful than the standard deviation because:

- A) the standard deviation is easier to calculate.
- B) variance is a measure of risk, while the standard deviation is a measure of the rate of return.
- ✓ C) the standard deviation is calculated in the same units as the payoffs and the variance isn't.
- D) None of the above.

**Reference Chapter:  
Measuring Risk.**

Q#8

Given a choice between two investments with the same expected payoff:

- A) most people will select the one with the highest variance.
- B) most people will opt for the one with the higher standard deviation.
- C) most people will be indifferent since the expected payoffs are the same.



**✓D) most people will choose the one with the lower standard deviation.**

**Reference Chapter:  
Measuring Risk.**

**Q#9**

A risk-averse investor:

A) will always take a risk, while a risk-neutral investor will not.

**✓B) needs more compensation for the same risk than would a risk-neutral investor.**

C) will always accept the same risk as a risk-neutral investor if the expected returns are equal.

D) None of the above.

**Reference Chapter:  
Risk Aversion, the Risk Premium, and the Risk-Return Tradeoff.**

**Q#10**

A risk-averse investor will:

A) always prefer an investment with a lower expected return.

**✓B) always prefer an investment with a certain return to one with the same expected return but any amount of uncertainty.**

C) always require a certain return.

D) always focus exclusively on the expected return.

**Reference Chapter:  
Risk Aversion, the Risk Premium, and the Risk-Return Tradeoff.**

**Q#11**

The risk premium for an investment:

**✓A) increases with risk.**

B) is a fixed amount added to the risk-free return, regardless of the amount of risk.

C) is negative for U.S. Treasury Securities.

D) is negative for risk-averse investors.

**Reference Chapter:**  
**Risk Aversion, the Risk Premium, and the Risk-Return Tradeoff.**

**Q#12**

When many industries perform poorly due to a recession, this is an example of:

- A) idiosyncratic risk
- ✓ B) **systematic risk.**
- C) risk premium.
- D) unique risk.

**Reference Chapter:**  
**Sources of Risk: Idiosyncratic and Systematic Risk.**

**Q#13**

Idiosyncratic risks are risks that are:

- A) associated with using an idiosyncratic management style.
- B) economy-wide risks.
- ✓ C) **unique to particular individuals or companies.**
- D) None of the above is correct.

**Reference Chapter:**  
**Sources of Risk: Idiosyncratic and Systematic Risk.**

**Q#14**

Diversification is the principle of:

- ✓ A) **holding more than one risk at a time.**
- B) reducing the risks we carry to just two.
- C) creating risk to increase returns.

D) eliminating all investments from our portfolio that have idiosyncratic risk.

**Reference Chapter:**  
**Reducing Risk through Diversification.**

Q#15

If ABC Inc. and XYZ Inc. have returns that are perfectly negatively correlated:

✓ A) adding XYZ Inc. to a portfolio that consists of only ABC Inc. will reduce risk.

B) adding ABC Inc. to a portfolio that includes only XYZ Inc. will increase risk.

C) adding XYZ Inc. to a portfolio that consists of only ABC Inc. will neither increase nor decrease the risk of the portfolio.

D) adding XYZ Inc. to a portfolio that consists of only ABC Inc. will neither increase nor decrease idiosyncratic risk but will lower systematic risk.

**Reference Chapter:  
Reducing Risk through Diversification.**

Q#16

Spreading involves:

A) finding assets whose returns are perfectly negatively correlated.

B) building a portfolio of assets whose returns move together.

C) investing in bonds and avoiding stocks during bad times.

✓ D) adding assets to a portfolio that move independently.

**Reference Chapter:  
Reducing Risk Through Diversification**

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## Quiz # 10

Q#1

Risk:

✓ A) is a measure of uncertainty.

B) is a measure of the expected value of the payoff of an investment.

C) does not vary across alternative investments.

D) None of the above is correct.

**Reference Chapter:  
Defining Risk.**

Q#2

Risk:

- A) involves uncertain future outcomes.
- B) is measured relative to a benchmark.
- C) involves future payoffs.
- ✓ D) All of the above are correct.

**Reference Chapter:  
Defining Risk.**

Q#3

Consider a security that has a 50% probability of paying \$800 and a 50% probability of paying \$1,400 next year. The expected value of next year's payoff equals:

- A) \$800.
- B) \$1,000.
- ✓ C) \$1,100.
- D) \$1,200.

**Reference Chapter:  
Measuring Risk.**

Q#4

Consider a security that has a 50% probability of paying \$800 and a 50% probability of paying \$1,400 next year. If the current price of this security is \$1,000, the expected rate of return on this security equals:

- A) -20%.
- ✓ B) 10%.
- C) 20%.
- D) 40%.

**Reference Chapter:  
Measuring Risk.**

Q#5

Which of the following is an accurate statement concerning the use of variance and standard deviation for a variable measured in dollars?

- A) The standard deviation of the variable is measured in units of squared dollars and this is inappropriate because dollars are rectangular, not square.
- B) Both variance and standard deviation are measured in terms of dollars.
- ✓ C) Standard deviation is measured in dollars, but the variance is measured in squared dollars.
- D) None of the above.

**Reference Chapter:  
Measuring Risk.**

Q#6

If two risky securities provide a payoff with the same expected value in 1 year, risk is higher for the security for which the:

- A) variance is higher.
- B) standard deviation is higher.
- ✓ C) Both of the above are correct.
- D) None of the above is correct.

**Reference Chapter:  
Measuring Risk.**

Q#7

Suppose that the variance in returns for an investment is 100. The standard deviation is:

- ✓ A) 10.
- B) 100.
- C) 1,000.
- D) 10,000.

**Reference Chapter:  
Measuring Risk.**

Q#8

The probability of an event occurring:

**✓A) is a measure of the relative frequency of the event's occurrence over repeated samples.**

- B) may be negative.
- C) may be greater than one.
- D) All of the above are correct.

**Reference Chapter:  
Measuring Risk.**

Q#9

The sum of the probabilities for all possible outcomes of an investment:

- A) will always be less than 1.
- B) will always be greater than 1.
- ✓C) equals 1.**
- D) may be greater than, less than, or equal to 1, depending on the actual probabilities of the individual outcomes.

**Reference Chapter:  
Measuring Risk.**

Q#10

Suppose that an investment has a 50% probability of a payoff of \$1,030 and a 50% probability of a payoff of \$990. Which of the following represents the variance of the payoff?

- A) 20 dollars
- B) 40 dollars
- C) 200 dollars<sup>2</sup>
- ✓D) 400 dollars<sup>2</sup>**

**Reference Chapter:  
Measuring Risk.**

Q#11

Suppose that an investment has a 50% probability of a payoff of \$1,030 and a 50% probability of a payoff of \$990. Which of the following represents the standard deviation of the payoff?

- A) 20 dollars
- B) 40 dollars
- C) 200 dollars<sup>2</sup>
- D) 400 dollars<sup>2</sup>

**Reference Chapter:  
Measuring Risk.**

Q#12

Suppose that two investments have an expected payoff of \$1,200, but one has a standard deviation of 30 while the other has a standard deviation of 40. A risk-averse individual will prefer the investment that:

- A) has a standard deviation of 40 because more is preferred to less.
- B) has a standard deviation of 30 because this investment is less risky.
- C) has a standard deviation of 40 because this investment is less risky.
- D) None of the above is correct.

**Reference Chapter:  
Measuring Risk.**

Q#13

Value-at-risk measures:

- A) the expected value of the return from an investment.
- B) the maximum expected gain associated with an investment.
- C) the worst possible loss that may occur over a specific time horizon, at a given probability.
- D) None of the above is correct.

**Reference Chapter:  
Measuring Risk.**

**Q#14**

Given two investments with the same expected payoff in a given time horizon, a risk-neutral individual will:

- A) always prefer an alternative with the lower variance in returns.
- B) always prefer an alternative with the higher variance in returns.
- ✓ C) be indifferent.
- D) care only about the standard deviation of the payoff, not the variance.

**Reference Chapter:**

**Risk Aversion, the Risk Premium, and the Risk-Return Trade-off.**

**Q#15**

An individual is risk-averse if he or she:

- ✓ A) prefers a certain return to a risky return with the same expected payoff.
- B) prefers a risky return to a certain return with the same expected payoff.
- C) is indifferent between a certain return and a risky return with the same expected payoff.
- D) always prefers a return with a greater variance, no matter what the expected payoff.

**Reference Chapter:**

**Risk Aversion, the Risk Premium, and the Risk-Return Trade-off.**

**Q#16**

If the expected value of the potential payoff is the same for two investments, the risk premium is higher for an investment that has a \_\_\_\_\_ in payoffs.

- A) lower variance
- B) lower standard deviation
- ✓ C) larger standard deviation
- D) Both a and b are correct.

**Reference Chapter:**

**Risk Aversion, the Risk Premium, and the Risk-Return Trade-off.**



Q#17

Risks that are unique to specific people, assets, or firms, are called:

- A) systematic risks.
- ✓ B) idiosyncratic risks.
- C) sycophantic risks.
- D) idiopathic risks.

**Reference Chapter:**

**Sources of Risk: Idiosyncratic and Systematic Risk**

Q#18

Systematic risk is a form of risk that is:

- A) unique to specific people, assets, or firms.
- ✓ B) economy-wide.
- C) sycophantic.
- D) None of the above is correct.

**Reference Chapter:**

**Sources of Risk: Idiosyncratic and Systematic Risk**

Q#19

Hedging reduces risk by:

- A) combining assets with high standard deviations of payoffs with those with low standard deviations of payoffs.
- B) engaging in diversification by buying a mix of assets that have uncorrelated returns.
- ✓ C) acquiring assets with offsetting risks.
- D) increasing the variance in the payoff associated with a portfolio of investments.

**Reference Chapter:**

**Sources of Risk: Idiosyncratic and Systematic Risk**

Q#20

Risk spreading involves:

- A) increasing the variance in outcomes.
- ✓ B) reducing the variance in the returns on a portfolio through diversification.
- C) trying to shift the blame for mistakes to others.
- D) None of the above is correct.

**Reference Chapter:**

**Sources of Risk: Idiosyncratic and Systematic Risk**

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## True an False

Q#1

A certain outcome has a probability equal to 1.

- ✓ A) True
- B) False

**Reference Chapter:**

**Measuring Risk.**

Q#2

Comparing two investments with the same expected value, the investment with the largest variance in payoffs is less risky.

- A) True
- ✓ B) False

**Reference Chapter:**

**Measuring Risk.**

Q#3

Suppose that a set of investments is ranked from highest to lowest according to the variance in payoffs. If the same set of investments is ranked from highest to lowest by the standard deviation, the same ranking would result.

- ✓ A) True
- B) False

**Reference Chapter:  
Measuring Risk.**

**Q#4**

Risk-averse individuals always prefer a risky investment to a certain investment with the same expected payoff.

- A) True
- ✓ B) False

**Reference Chapter:  
Risk Aversion, the Risk Premium, and the Risk-Return Trade-off.**

**Q#5**

It is generally easier to reduce idiosyncratic risk than systematic risk by risk spreading.

- ✓ A) True
- B) False

**Reference Chapter:  
Sources of Risk: Idiosyncratic and Systematic Risk**

**Quiz # 11**

**Q#1**

A zero coupon bond:

- A) does not pay any coupon payments because the issuer is in default.
- B) pays coupons only once a year instead of the usual twice a year payments received on other bonds.
- ✓ C) promises a single future payment.
- D) provides coupon payments only if the bond price is below face value.

**Reference Chapter:  
Response: Bond Prices.**

**Q#2**

Which of the following best expresses the formula for determining the price of a U.S. Treasury bill per \$100 of face value with a maturity  $n$  years in the future?

- A)  $\$100(1 + i)$
- ✓ B)  $\$100/(1 + i)^n$
- C)  $\$100/n(1 + i)$
- D)  $1 + \$100/(1 + i)^n$

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#3**

If the annual interest rate is 4% (.04); the price of a one-year Treasury bill with a face value of \$1,000 would be:

- A) \$940.00.
- B) \$952.38.
- ✓ C) \$961.54.
- D) \$960.10.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#4**

If the annual interest rate is 6% (.06) the price of a three-month Treasury bill with a face value of \$1000 would be:

- A) \$987.90.
- B) \$950.00.
- ✓ C) \$985.54.
- D) \$943.40.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#5**

The relationship between the price and the interest rate for a zero-coupon bond is *best* described as:

- A) volatile.
- B) stable.
- C) non-existent
- ✓ D) inverse.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#6**

The value of a fixed-payment mortgage loan is:

- A) greater than the sum of the present value of all future mortgage payments.
- B) less than the sum of the present value of all future mortgage payments.
- C) equal to the sum of the present value of all future mortgage payments.
- D) equal to  $FP \times N$ , where  $FP$  = the value of the mortgage payments and  $N$  is the number of remaining mortgage payments.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#7**

The price of a coupon bond can best be described as the:

- A) present value of the face value.
- B) future value of the coupon payments and the face value.
- C) present value of the coupon payments.
- D) present value of the coupon payments plus the present value of the face value.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#8**

Suppose that the interest rate increases from 3% to 6%. In response to this increase in the interest rate, the price of a consol would:

- A) rise by 3%.
- B) fall by 3%.
- C) double.
- D) fall to  $\frac{1}{2}$  of its original value.

**Reference Chapter:**  
**Response: Bond Prices.**

**Q#9**

When the price of a bond is above the bond's face value, the yield to maturity:

- A) will be above the coupon rate.
- B) is below the coupon rate.

- C) will equal zero.
- D) will equal the coupon rate.

**Reference Chapter:**  
**Response: Bond Yields.**

**Q#10**

If the price of a coupon bond equals the bond's face value, then the yield to maturity:

- A) exceeds the coupon rate.
- B) will be less than the coupon rate.
- ✓ C) **equals the coupon rate.**
- D) may be greater than, less than, or equal to the coupon rate.

More information is required to determine the relative magnitudes of the yield to maturity and the coupon rate.

**Reference Chapter:**  
**Response: Bond Yields**

**Q#11**

The coupon rate of bond:

- A) is another term for the current yield.
- B) is another term for the yield to maturity.
- ✓ C) **could not be calculated for a zero-coupon bond.**
- D) None of the above is correct.

**Reference Chapter:**  
**Response: Bond Yields.**

**Q#12**

A \$1,000 face value bond purchased for \$950.00, with an annual coupon of \$60, and 20 years to maturity has a:

- A) coupon rate equal to 6.32%.
- B) current yield equal to 6.00%.
- ✓ C) **current yield equal to 6.45%.**
- D) yield to maturity and current yield equal to 6.32%.

**Reference Chapter:**  
**Response: Bond Yields.**

**Q#13**

When the current yield and the coupon rate are equal:

- ✓ A) **the bond is purchased at a price that equals the face value.**
- B) the bond is purchased at a discount.
- C) the bond is a zero coupon bond.
- D) the bond is purchased at a price that exceeds face value.

**Reference Chapter:**

**Response: Bond Yields.**

**Q#14**

The current yield will overstate the yield to maturity on a coupon bond when the bond is selling:

- A) below its face value.
- B) **above its face value.**
- C) at its face value.
- D) in the open market.

**Reference Chapter:**

**Response: Bond Yields**

**Q#15**

The bond dealer's spread is:

- A) the bid price plus the asking price.
- B) the difference between the current yield and the yield to maturity.
- C) **the asking price less the bid price.**
- D) usually negative; the dealer makes a profit holding the bonds.

**Reference Chapter:**

**Response: Bond Yields.**

**Q#16**

Which of the following best expresses the equation for a one-year holding period return?

- A) current yield - coupon rate
- B) yield to maturity + current yield
- C) coupon rate + capital gain
- D) **current yield + capital gain**

**Reference Chapter:**

**Response: Bond Yields.**

**Q#17**

Bond prices and bond yields are:

- A) **inversely related.**
- B) directly related.
- C) unrelated to each other.
- D) both fixed once the bond is issued.

**Reference Chapter:**

**Response: Bond Yields.**

**Q#18**

Suppose that a long-term coupon bond with a coupon rate of 5% is purchased today at a price of \$1,000 and resold a year later for a price of \$1,020. The holding period return for this bond is equal to:

- A) 2%.
- B) 3%.
- C) 5%.
- ✓ D) 7%.

**Reference Chapter:**  
**Response: Bond Yields**

**Q#19**

If the quantity of bonds supplied exceeds the quantity of bonds demanded, then it is expected that:

- A) bond prices would fall and yields would fall.
- ✓ B) **bond prices would fall and yields would rise.**
- C) bond prices would rise but yields will remain constant.
- D) bond prices and yields would increase.

**Reference Chapter:**  
**Response: The Bond Market and the Determination of Interest Rates.**

**Q#20**

When expected inflation increases for any given nominal interest rate:

- ✓ A) **the real cost of repayment for bond issuers decreases.**
- B) the real return for bondholders increases.
- C) the real cost of repayment for bond issuers increases.
- D) the bond demand curve shifts right.

**Reference Chapter:**  
**Response: The Bond Market and the Determination of Interest Rates.**

## Quiz # 12

**Q#1**

Consider a 2-year risk-free zero coupon bond with a face value of \$1,000. If the market interest rate is 5%. The current price of this bond will be:

- A) \$1,102.50.
- B) \$1,050.00.
- C) \$952.38.
- ✓ D) **\$907.03.**

**Reference Chapter:**  
**Bond Prices.**

**Q#2**

Suppose that a risk-free 6-month zero coupon bond has a face value of \$1,000. If the market interest rate is 4%, the current price of this bond will be:

- A) \$1,000.00.



- B) \$960.10.  
 C) **\$980.58.**  
 D) \$1,020.00.

**Reference Chapter:  
Bond Prices.**

**Q#3**

Suppose that a 2-year risk-free coupon bond has a face value of \$1,000 and an annual coupon payment of \$50 when the market interest rate is 7%. The current price of this bond will be:

- A) \$1,000.00.  
 B) **\$963.84.**  
 C) \$1,142.34.  
 D) \$1,014.00.

**Reference Chapter:  
Bond Prices.**

**Q#4**

Economic theory predicts that, as the market interest rate rises, bond prices:

- A) also rise.  
 B) **fall.**  
 C) remain unchanged.  
 D) change in a manner that cannot be predicted, even when

everything else is held constant.

**Reference Chapter:  
Bond Prices.**

**Q#5**

A decrease in the market interest rate will cause the value of a bank's portfolio of fixed-payment loans to:

- A) **rise.**  
 B) fall.  
 C) remain unchanged.  
 D) change in a manner that cannot be predicted, even when

everything else is held constant.

**Reference Chapter:  
Bond Prices.**

**Q#6**

A risk-free consol provides an annual payment of \$50. If the market interest rate is 5%, the price of this consol will be:

- A) \$55.  
 B) \$500.  
 C) **\$1,000.**

D) \$1,050.

**Reference Chapter:  
Bond Prices.**

Q#7

The yield to maturity of a coupon bond will exceed the current yield if the current price of the bond:

- A) exceeds the face value.
- B) **is less than the face value.**
- C) equals the face value.
- D) is greater than the price that you originally paid for the

bond.

**Reference Chapter:  
Bond Yields.**

Q#8

The current yield will equal the coupon rate and the yield to maturity if the bond price:

- A) rises over time.
- B) exceeds the face value of the bond.
- C) is less than the face value of the bond.
- D) **equals the face value of the bond.**

**Reference Chapter:  
Bond Yields.**

Q#9

A coupon bond with a face value of \$1,000 and a coupon rate of 5% sells for \$1,024. What is the current yield on this bond?

- A) **4.88%**
- B) 5.00%
- C) 9.88%
- D) None of the above is correct.

**Reference Chapter:  
Bond Yields.**

Q#10

A one-year zero coupon bond with a face value of \$1,000 sells for \$960 today. The yield to maturity on this bond equals:

- A) 4.00%.
- B) 40.0%.
- C) **4.17%.**
- D) 1,004%.

**Reference Chapter:  
Bond Yields.**

Q#11

Bond holders receive capital losses when:

- A) bond prices increase.
- B) interest rates decline.
- ✓ C) **interest rates rise.**
- D) inflation declines.

Reference Chapter:

**Bond Yields.**

Q#12

The one-year holding period return on a bond equals the:

- A) coupon rate + capital gain.
- ✓ B) **current yield + capital gain.**
- C) coupon rate – capital gain.
- D) current yield – capital gain.

Reference Chapter:

**Bond Yields.**

Q#13

Suppose that a long-term coupon bond with a coupon rate of 5% is purchased at its face value of \$1,000 and resold a year later for a price of \$950. The holding period return for this bond is equal to:

- ✓ A) **0%.**
- B) 2%.
- C) 3%.
- D) 5%.

Reference Chapter:

**Bond Yields**

Q#14

The supply of bonds increases when:

- A) government borrowing rises.
- B) the economy grows more rapidly.
- C) expected inflation rises.
- ✓ D) **All of the above are correct.**

Reference Chapter:

**The Bond Market and the Determination of Interest Rates**

Q#15

An increase in wealth is expected to cause the equilibrium price of bonds to:

- ✓ A) **rise.**
- B) fall.
- C) remain unchanged.

- D) change in an unpredictable manner.

**Reference Chapter:  
The Bond Market and the Determination of Interest Rates**

**Q#16**

An increase in the liquidity of bonds relative to other assets is expected to cause the equilibrium price of bonds to:

- ✓ A) rise.  
B) fall.  
C) remain unchanged.  
D) change in an unpredictable manner.

**Reference Chapter:  
The Bond Market and the Determination of Interest Rates**

**Q#17**

An increase in the expected inflation rate is expected to cause the demand for bonds to:

- ✓ A) rise.  
B) fall.  
C) remain unchanged.  
D) change in an unpredictable manner.

**Reference Chapter:  
The Bond Market and the Determination of Interest Rates**

**Q#18**

An increase in the risk of bonds relative to other assets is expected to cause the equilibrium price of bonds to:

- ✓ A) rise.  
B) fall.  
C) remain unchanged.  
D) change in an unpredictable manner.

**Reference Chapter:  
The Bond Market and the Determination of Interest Rates**

**Q#19**

An increase in the risk of bonds relative to other assets is expected to cause the equilibrium interest rate on bonds to:

- ✓ A) rise.  
B) fall.  
C) remain unchanged.  
D) change in an unpredictable manner.

**Q#20**

Interest-rate risk is larger for:

- A) short-term bonds.

- ✓ B) long-term bonds.
- C) government bonds.
- D) None of the above is correct.

**Reference Chapter:**  
**The Bond Market and the Determination of Interest Rates**

## True and False

**Q#1**

The price of a Treasury bill is the present value of a single future payment.

- ✓ A) True
- B) False

**Reference Chapter:**  
**Bond Prices.**

**Q#2**

The yield to maturity of a bond is always equal to the bond's coupon rate.

- ✓ A) True
- B) False

**Reference Chapter:**  
**Bond Yields.**

**Q#3**

A change in government borrowing would affect the demand for bonds.

- ✓ A) True
- B) False

**Reference Chapter:**  
**The Bond Market and the Determination of Interest Rates.**

**Q#4**

Bonds are risky because the bond's issuer may fail to make the promised payment.

- ✓ A) True
- B) False

**Reference Chapter:**  
**Why Bonds are Risky.**

**Q#5**

In thinking about U.S. Treasury bonds we can ignore inflation risk.

- ✓ A) True
- B) False

**Reference Chapter:**

Why Bonds are Risky.

**Quiz # 13**

Q#1

The bond rating of a security refers to the:

- A) size of the coupon payment relative to the face value.
- B) return a holder is likely to receive.
- ✓ C) likelihood the lender/borrower will be repaid by the borrower/issuer.
- D) number of years until the bond matures.

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

Q#2

The lowest rating for an investment grade bond assigned by Moody's is:

- A) BBB.
- B) ABB.
- ✓ C) **Baa.**
- D) Aaa.

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

Q#3

Which of the following would probably be rated below an A rating from Standard & Poor's?

- A) A 30-year bond issued by the U.S. Treasury
- ✓ B) **A bond issued by a new vegetarian fast-food chain that is having trouble meeting payments on bonds, but is not in default.**
- C) 90-day T-Bills from the U.S. Treasury
- D) A bond issued by Microsoft

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

Q#4

Fallen angels are:

- A) junk bonds issued by newly created firms that attempt to enter established oligopoly markets.
- ✓ B) **junk bonds that were investment-grade bonds until the issuer began to experience financial difficulties.**

C) bonds issued by companies that specialize in mergers and acquisitions.

D) bonds issued by companies that initially produced wholesome, family-friendly commodities, but now specialize in producing products that appeal to human vices.

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#5**

Commercial paper is a:

- A) secured loan issued by firms and government.
- B) short-term unsecured loan that is offered by nearly all corporations.
- C) daily or weekly newspaper that focuses on business news.
- D) **short-term unsecured loan issued by only the most creditworthy corporations and the government.**

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#6**

The *risk spread* is:

- A) the difference between a bond's purchase price and selling price.
- B) positive for all U.S. Treasury bonds.
- C) **the difference between the bond's yield and the yield on a U.S. Treasury bond of the same maturity.**
- D) assigned by a bond rating agency.

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#7**

The default premium:

- A) is positive for a U.S. Treasury bond.
- B) must always be less than 0 (zero).
- C) **is also known as the risk spread.**
- D) is assigned by a bond rating agency.

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#8**

As the risk associated with a bond rises, the price of the bond will \_\_\_\_\_ and the yield will \_\_\_\_\_.

- A) rise; rise
- B) rise; fall

- ✓ C) **fall; rise**
- D) fall; fall

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#9**

Both economic theory and empirical evidence indicate that:

- A) the interest rates on a variety of bonds will move together.
- B) U.S. Treasury bond yields always change by more than other bonds.
- ✓ C) c). lower rated bonds will have higher yields.
- D) **a and c**

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#10**

The interest on municipal bonds:

- ✓ A) **is not taxed by the federal government.**
- B) is taxed by both the state and the federal government.
- C) is not taxed by the state, but is subject to federal tax.
- D) None of the above is correct.

**Reference Chapter:  
Differences in Tax Status and Municipal Bonds.**

**Q#11**

Municipal bonds are:

- A) issued only by states.
- ✓ B) **issued by states and cities and their interest is exempt from U.S. government taxation.**
- C) issued by states and cities, but their interest is taxable only at the federal level.
- D) issued by the U.S. Treasury, but the proceeds can only be used by cities.

**Reference Chapter:  
Differences in Tax Status and Municipal Bonds.**

**Q#12**

An investor earning 8% from a tax-exempt bond, who is in a 25% tax bracket, holding risk constant:

- ✓ A) **would be indifferent to a taxable bond with a 10.67% yield.**
- B) would be indifferent to a taxable bond with a 6.0% yield.
- C) would be indifferent to a taxable bond with a 6.25% yield.
- D) None of the above is correct.



**Reference Chapter:  
Differences in Tax Status and Municipal Bonds.**

**Q#13**

Which of the following is *not* a true statement concerning the term structure of interest rates?

- A) Interest rates of bonds with different maturities generally move together.
- B) **Yields on short-term bonds are less volatile than yields on long-term bonds.**
- C) Long-term yields tend to be higher than short-term yields.
- D) All of the above are true statements.

**Reference Chapter:  
The Term Structure of Interest Rates**

**Q#14**

The expectations hypothesis does *not* suggest that the:

- A) **yield curve should usually be downward sloping.**
- B) slope of the yield curve depends on the expectations for future short-term rates.
- C) slope of the yield curve is positive if people expect higher future short-term interest rates..
- D) slope of the yield curve is negative if people expect short-term interest rates to fall in the future.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#15**

When the yield curve is downward sloping:

- A) people could be expecting a tightening in monetary policy
- B) short-term yields are lower than long-term yields.
- C) this is impossible, since the yield curve always slopes upward.
- D) **people are expecting an economic slowdown.**

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#16**

The expectations hypothesis cannot explain why:

- A) **yield curves are generally upward sloping.**
- B) yield curves are generally downward sloping.
- C) interest rates tend to move together for bonds of different maturities.
- D) None of the above is correct.

Q#17

Considering the liquidity premium theory, if investors expect short-term interest rates to decrease then the:

- A) yield curve must have a positive slope.
- B) yield curve must be inverted.
- ✓ C) **yield curve could be flat.**
- D) slope of the yield curve should actually increase.

**Reference Chapter:  
The Term Structure of Interest Rates.**

Q#18

In the fall of 1998 we saw an increase in the risk spread:

- A) because the risk spread always increases as we approach the end of the year.
- B) there was an extraordinarily large amount of corporate fraud being reported in 1998.
- ✓ C) **the Russian government defaulted on some of its bonds.**
- D) there was a significant increase in U.S. income tax rates.

**Reference Chapter:  
The Information Content of Interest Rates.**

Q#19

Inflation risk increases as the maturity of a bond increases because:

- A) the inflation rate always increases over time.
- ✓ B) **it is more difficult to forecast inflation over longer periods of time.**
- C) we always have inflation.
- D) investors are more focused on nominal returns than real returns.

**Reference Chapter:  
The Information Content of Interest Rates.**

Q#20

The slope of the yield curve seems to predict the performance of the economy with usually a:

- A) 3-month lag.
- B) two-year lag.
- C) lag of a few weeks.
- ✓ D) **one-year lag.**

**Reference Chapter:  
The Information Content of Interest Rates.**

## Quiz # 14

Q#1

Bonds that are rated Baa or better by Moody's (or rated as BBB or better by Standard & Poor's) are referred to as:

- ✓ A) **investment grade.**
- B) speculative grade.
- C) highly speculative.
- D) junk bonds.

**Reference Chapter:**

**Ratings and the Risk Structure of Interest Rates.**

Q#2

Bonds that were initially released as investment grade, but were later reclassified as junk bonds are known as:

- A) transitional junk bonds.
- B) investment-grade junk bonds.
- ✓ C) **fallen angels.**
- D) defaulted bonds.

**Reference Chapter:**

**Ratings and the Risk Structure of Interest Rates.**

Q#3

Commercial paper is:

- ✓ A) **a short-term loan issued on a discount basis.**
- B) a long-term loan issued on a discount basis.
- C) essentially equivalent to a long-term coupon bond.
- D) another name for a short-term coupon bond.

**Reference Chapter:**

**Ratings and the Risk Structure of Interest Rates.**

Q#4

The default-risk premium on a bond equals the:

- A) expected return on the bond.
- ✓ B) **difference between the expected return on the bond and the U.S. Treasury yield.**
- C) sum of the expected return on the bond and the risk-free return.
- D) U.S. Treasury yield.

**Reference Chapter:**

**Ratings and the Risk Structure of Interest Rates.**

Q#5

Economic theory and empirical evidence indicate that:

- A) longer-term bonds are riskier than short-term bonds and interest rates are generally higher on longer-term bonds.
- B) interest rates on all categories of bonds are likely to move together over time.
- C) the interest rate is higher on bonds that are riskier.
- ✓ D) **All of the above are correct.**

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

**Q#6**

If the interest-rate on a taxable bond is 8%, and the income tax rate for a typical bondholder is 25%, then a tax-free bond with the same risk and maturity will offer a yield of:

- A) 12.5%.
- B) 10.5%.
- C) 10%.
- ✓ D) **6%.**

**Reference Chapter:  
Differences .in Tax Status and Municipal Bonds.**

**Q#7**

For a typical bondholder, municipal bonds offer a pre-tax yield that is \_\_\_\_\_ that of federal government bonds, and an after-tax yield that is \_\_\_\_\_ that of federal government bonds.

- A) lower than; lower than
- B) higher than; higher than
- ✓ C) **lower than; higher than**
- D) greater than; equal to

**Reference Chapter:  
Differences .in Tax Status and Municipal Bonds.**

**Q#8**

Yield curves are generally:

- A) horizontal.
- B) vertical.
- ✓ C) **upward sloping.**
- D) downward sloping.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#9**

Which of the following statements concerning the term structure of interest rates is *false*?

- ✓ A) **Long-term bonds generally provide lower interest rates than do short-term bonds.**

- B) Interest rates tend to move together over time for bonds of different maturities.
- C) Yields on short-term bonds are more volatile than yields on long-term bonds.
- D) All of the above are correct statements.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#10**

Under the expectations hypothesis, if people expect interest rates to be stable over time, yield curves would be:

- A) upward sloping.
- B) downward sloping.
- ✓ C) **horizontal.**
- D) vertical.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#11**

Under the expectations hypothesis, a downward sloping yield curve indicates that people believe that short-term interest rates will:

- A) rise over time.
- ✓ B) **fall over time.**
- C) remain constant.
- D) change in an unpredictable manner over time.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#12**

Suppose that the current interest rate on 1-year bonds is 5% and the expected interest rates on 1-year bonds next year and the following year are 7% and 9%, respectively. Under the expectations hypothesis, the interest rate on a 3-year bond today will equal:

- A) 5%.
- ✓ B) **7%.**
- C) 9%.
- D) 21%.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#13**

The expectations hypothesis explains why:

- ✓ A) **interest rates move together for bonds of different maturities.**
- B) yield curves are generally upward sloping.

- C) yield curves are generally downward sloping.
- D) None of the above is correct.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#14**

The liquidity premium theory modifies the expectations hypothesis by taking into account the:

- A) **higher inflation risk and interest-rate risk associated with longer-term bonds**
- B) effect of expectations of future interest rates on current short-term interest rates.
- C) higher inflation rate that always occurs in the long run.
- D) None of the above is correct.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#15**

Suppose the current and expected future interest rate is 4% for each of the next two years. Under the liquidity premium theory of the term structure, the interest rate on a 3-year bond will be:

- A) 4%.
- B) **greater than 4%.**
- C) less than 4%
- D) 12%.

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#16**

According to the liquidity premium theory of the term structure, the risk premium \_\_\_\_\_ as the maturity of the bond rises.

- A) **rises**
- B) falls
- C) remains constant
- D) changes in an unpredictable manner

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#17**

According to the liquidity premium theory of the term structure, a horizontal yield curve indicates that short-term interest rates are expected to \_\_\_\_\_ over time.

- A) rise
- B) **fall**
- C) remain constant

- D) change in an unpredictable manner

**Reference Chapter:  
The Term Structure of Interest Rates.**

**Q#18**

When an economic downturn occurs, the risk spread generally:

- A) narrows.
- B) **widens.**
- C) does not change.
- D) sometimes widens and sometimes narrows, with roughly

equal probability.

**Reference Chapter:  
The Information Content of Interest Rates.**

**Q#19**

Based on past experience, when an inverted yield curve is observed, a recession is:

- A) not likely to occur within the next 5 years.
- B) likely to begin within a week or two.
- C) likely to begin within 2-3 months.
- D) **likely to begin in about a year.**

**Reference Chapter:  
The Information Content of Interest Rates.**

**Q#20**

An inverted yield curve often occurs when:

- A) **the Fed is trying to reduce inflationary pressures, resulting in high short-term interest rates.**
- B) the Fed is trying to stimulate the economy, resulting in low long-term interest rates.
- C) most bond traders people expect interest rates to rise in the future.
- D) None of the above is correct.

**Reference Chapter:  
The Information Content of Interest Rates.**

**True and False**

**Q#1**

Investment grade bonds consist of only those bonds with Triple A ratings.

- A) True
- B) **False**

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

Q#2

The higher a bond's rating the higher its default risk.

- ✓ A) True  
B) False

**Reference Chapter:  
Ratings and the Risk Structure of Interest Rates.**

In the United States the interest income from bonds issued by one government is not taxed by another government, although the issuing government may tax it.

- ✓ A) True  
B) False

**Reference Chapter:  
Differences in Tax Status and Municipal Bonds.**

Q#3

A bond's inflation risk increases with its time to maturity.

- ✓ A) True  
B) False

**Reference Chapter:  
The Term Structure of Interest Rates.**

Q#4

An inverted yield curve is a predictor of a general economic slowdown.

- ✓ A) True  
B) False

**Reference Chapter:  
The Information Content of Interest Rates**

**Quiz # 15**

Q#1

A share of common stock represents:

- A) a claim from a lender to a borrower.  
B) a share in the company's assets.  
C) an unlimited liability to the owner of the stock.  
✓ D) a share of ownership of the company.

**Reference Chapter:  
The Essential Characteristics of Common Stocks.**



Q#2

The fact that common stockholders are *residual claimants* means the:

- A) stockholders receive their dividends before any other residuals are paid.
- ✓ B) stockholders receive the remains after everyone else is paid.
- C) stockholders are paid any past due dividends before other claims are paid.
- D) common stockholders are responsible for all corporate debts.

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#3

The concept of limited liability says a stockholder of a corporation:

- A) is liable for the corporation's liabilities, but nothing more.
- B) cannot receive dividends that exceed his/her investment.
- C) cannot own more than five percent of any public corporation.
- ✓ D) cannot lose more than his/her investment.

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#4

Which of the following statements is correct concerning the ownership of corporate stock?

- A) Common stockholders are able to vote in annual meetings.
- B) Owners of common stock have limited liability.
- C) Corporations are owned by their stockholders
- ✓ D) All of the above are correct.

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#5

An index number is a valuable tool because:

- A) the number by itself provides all of the useful information needed.
- ✓ B) the index provides a meaningful measurement scale to calculate percentage changes.

C) the index is more stable than the data it reflects.

D) it does not require any calculations to compute percentage changes.

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#6**

The Dow Jones Industrial Average is an example of:

A) a weighted average in which the output of each firm is used for the weights..

B) a value-weighted index.

C) a price-weighted index.

D) a secondary market.

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#7**

If the Dow Jones Industrial Average increases to 15,250 from 14,800, the percentage change in the index is:

- A) 0.304%
- B) **3.04%**
- C) 0.00304%
- D) 2.95%

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#8**

The value of a stock decreases by 25% from its original price of \$80. What percentage increase is required for the stock price to return to \$80?

- A) 20%
- B) 25%
- C) **33.33%**
- D) 50%

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#9**

You start with a \$1000 portfolio; it loses 40% over the next year, the following year it gains 50% in value. At the end of two years your portfolio is worth:

- ✓ A) \$900.
- B) \$600.
- C) \$1000.
- D) \$1100.

Q#10

The most broadly based stock index in use is the:

- A) Dow Jones Industrial Average.
- ✓ B) Nasdaq Composite Index.
- ✓ C) **Wilshire 5000.**
- D) Standard and Poor's 500 Index.

**Reference Chapter:**

**Measuring the Level of the Stock Market**

Q#11

The dividend-discount model of stock valuation:

A) takes the annual dividend, adds it to the expected future selling price and divides by the number of years to get the current price.

B) takes the net present value of expected dividends and add it to the future sale price of the stock.

C) takes the net present value of the expected future price of the stock and add the annual dividend.

- ✓ D) **is an application of the net present value formula.**

**Reference Chapter:**

**Valuing Stocks.**

Q#12

If we ignore risk, the dividend-discount model says the market price of a stock is simply:

- ✓ A)  $D_{\text{today}}(1+g) / (i-g)$ .
- B)  $D_{\text{today}} / (i+g)$ .
- C)  $D_{\text{today}}(i+g) / i$ .
- D)  $D_{\text{today}} (i+g)$ .

**Reference Chapter:**

**Valuing Stocks.**

Q#13

The dividend-discount model indicates that the current market price of a stock will rise if:

- ✓ A) **the interest rate rises.**
- B) the growth rate of dividends rises.

- C) the current dividend is higher.
- D) All of the above are correct.

**Reference Chapter:  
Valuing Stocks.**

**Q#14**

The dividend-discount model will always predict an increase in the price of a stock if the interest rate \_\_\_\_\_ and the expected rate of dividend growth \_\_\_\_\_.

- A) rises; rises
- B) falls; falls
- C) rises; falls
- ✓ D) **falls; rises**

**Reference Chapter:  
Valuing Stocks.**

**Q#15**

If the risk premium declines for a stock, the current price of the stock is expected to:

- ✓ A) **rise.**
- B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Reference Chapter:  
Valuing Stocks.**

**Q#16**

The theory of efficient markets:

- ✓ A) **allows for higher than average returns if the investor takes higher than average risk.**
- B) says that insider-information makes markets less efficient.
- C) rules out high returns due to chance.
- D) assumes people have *equal* luck.

**Reference Chapter:  
Valuing Stocks.**

**Q#17**

Consider a game which involves the rolling of a fair pair of dice. The winner is the individual who calls the outcome correctly, the loser obviously called the wrong outcome. The theory of efficient markets would say:

- A) part of the key information is to know the outcomes of the previous tosses.
- B) part of the key information is to know the skill of the person you are playing against.

✓ C) the key information is to know the probabilities of the outcome and the expected payoff.

D) All of the above.

**Reference Chapter:  
Valuing Stocks.**

**Q#18**

Professor Jeremy Siegel, of the University of Pennsylvania, did research that suggests that:

- A) investors should only own stocks for short periods of time to maximize returns.
- B) over the long run, bonds are less risky than stocks.
- ✓ C) over the long run, bonds frequently outperform stocks.
- D) **over the long run, stocks are less risky than bonds.**

**Reference Chapter:  
Investing In Stocks for the Long Run.**

**Q#19**

Stock market *bubbles* can lead to:

- A) an inefficient allocation of resources.
- B) stock market crashes.
- ✓ C) patterns of volatile returns from the stock market.
- D) **All of the above.**

**Reference Chapter:  
The Stock Market's Role in the Economy.**

**Q#20**

When stock prices reflect fundamental values:

- A) all investors will experience capital gains.
- B) all companies will have an easier task of obtaining financing for investment projects.
- ✓ C) **the allocation of resources will be more efficient.**
- D) the overall level of the stock market should move higher continuously.

**Reference Chapter:  
The Stock Market's Role in the Economy**

**QUIZ # 16**

Q#1

Shares of common stock:

- A) are shares of the ownership of the company that issued the stock.**
- B) are debt instruments that must be repaid if the company declares bankruptcy.**
- C) entitle the stockholder to a share of the profits of the corporation, but also require the owner to cover a share of any losses by the firm.**
- D) None of the above is correct.**

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#2

Stockholders are said to be residual claimants because:

- A) they receive a share of the residuals from any movies or books written about the firm.**
- B) they receive what revenue is left over after all other claims have been satisfied in the event of a bankruptcy.**
- C) they are able to go to the firm at any time and ask that their share of the firm's physical capital be turned over to them in return for their stock certificates.**
- D) None of the above is correct.**

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#3

As a result of limited liability, the maximum amount that a shareholder can lose when a firm becomes bankrupt is his or her:

- A) share of the total debt of the company.**
- B) entire personal wealth.**
- C) financial investment in that company's stock.**
- D) None of the above is correct.**

**Reference Chapter:**

**The Essential Characteristics of Common Stocks.**

Q#4

Which of the following statements *incorrectly* describes the role of common stockholders in a corporation?

- A) Stockholders can replace current management.
- B) Stockholders are the owners of the corporation.
- ✓ C) **Stockholders have unlimited liability.**
- D) Stockholders are residual claimants.

**Reference Chapter:  
The Essential Characteristics of Common Stocks.**

Q#5

An index number:

- A) may be used to compute the percentage change in a variable.
- B) may be used to measure changes in the quantity of output or in the price level
- ✓ C) **Both of the above are correct.**
- D) None of the above is correct.

**Reference Chapter:  
Measuring the Level of the Stock Market**

Q#6

Which of the following is an example of a price-weighted average?

- ✓ A) **the Dow Jones Industrial Average**
- B) the Standard & Poor's 500 average
- C) the Nasdaq composite index
- D) All of the above are correct.

**Reference Chapter:  
Measuring the Level of the Stock Market**

Q#7

If the Dow Jones Industrial Average increases from 14,200 to 14,645, the percentage change in this index is:

- A) 0.31%.
- ✓ B) **3.13%.**
- C) 31.3%.
- D) 3.04%.

**Reference Chapter:  
Measuring the Level of the Stock Market**

Q#8

The value of a stock decreases by 20% from its original price of \$50. What percentage increase is required for the stock price to return to \$50?

- ✓ A) **25%**
- B) 33.33%
- C) 50%
- D) 20%

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#9**

Suppose that you initially had a portfolio of stocks worth \$1,000. This portfolio loses 50% over the next year, but gains 50% over the following year. At the end of two years your portfolio is worth:

- A) \$500.
- B) **\$750.**
- C) \$1,000.
- D) \$1,250.

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#10**

Which of the following is the *most* comprehensive measure of the performance of the overall stock market?

- A) the Dow Jones Industrial Average
- B) Standard and Poor's 500 index
- C) **the Wilshire 5000**
- D) the Birmingham 6000

**Reference Chapter:  
Measuring the Level of the Stock Market.**

**Q#11**

Economic theory suggests that the price of a stock equals:

- A) **the present value of the expected payment stream associated with the stock.**
- B) a purely random value that is unrelated to fundamental value.
- C) a value that is best predicted by careful analysis of trends in stock prices and in the psychology of the market.
- D) None of the above is correct.

**Reference Chapter:  
Valuing Stocks.**

**Q#12**

The dividend-discount model suggests that an increase in the expected rate of dividend growth will cause the market price of a stock to:

- A) **rise.**
- B) fall.



- C) remain unchanged.
- D) change in an unpredictable manner.

**Reference Chapter:  
Valuing Stocks.**

**Q#13**

The dividend-discount model suggests that an increase in the interest rate will cause the market price of a stock to:

- A) rise.
- B) **fall.**
- C) remain unchanged.
- D) change in an unpredictable manner.

**Reference Chapter:  
Valuing Stocks.**

**Q#14**

An increase in the risk premium associated with stocks will cause the current price of stocks to:

- A) rise.
- B) **fall.**
- C) remain unchanged.
- D) change in an unpredictable manner.

**Reference Chapter:  
Valuing Stocks.**

**Q#15**

The theory of efficient markets suggests that the current price of a stock is:

- A) **based upon all available information.**
- B) typically an overestimate of the fundamental value of the stock.
- C) typically an underestimate of the fundamental value of the stock.
- D) None of the above is correct.

**Reference Chapter:  
Valuing Stocks.**

**Q#16**

According to the theory of efficient markets, day-to-day changes in stock prices:

- A) **cannot be predicted in advance.**
- B) are best predicted by past trends and cycles in stock prices.
- C) can be forecast by the best mutual fund managers.
- D) None of the above is correct.

**Reference Chapter:  
Valuing Stocks.**

**Q#17**

The theory of efficient markets suggests that the best predictor of the future value of a stock is:

- ✓ A) **today's stock price.**
- B) provided by financial analysts.
- C) provided by financial newspapers.
- D) None of the above is correct.

**Reference Chapter:  
Valuing Stocks.**

**Q#18**

Jeremy Siegel's research suggests that:

- A) stocks are a better short-term investment than bonds.
- B) stocks are less risky than bonds in both the short-term and the long-term.
- ✓ C) **stocks have been a relatively safe long-term investment, but can be risky as a short-term investment.**
- D) bonds have provided higher returns than stock in both the short term and the long term.

**Reference Chapter:  
Valuing Stocks.**

**Q#19**

Stock market bubbles result in economic inefficiency because they:

- A) result in excessive investment spending in the industries in which the bubble is occurring.
- B) result in larger variations in household wealth over time.
- ✓ C) **Both of the above are correct.**
- D) None of the above is correct.

**Reference Chapter:  
The Stock Market's Role in the Economy**

**Q#20**

Resources are allocated most efficiently when stock prices:

- A) are rising rapidly for firms in some industries during a stock market bubble.
- B) are declining after a stock market bubble bursts.
- ✓ C) **reflect fundamental values.**

- D) None of the above is correct.

**Reference Chapter:  
Valuing Stocks.**

## **Quiz # 17**

**Q#1**

Derivatives are financial instruments that:

A) present low levels of risk and are used by people who otherwise couldn't purchase the financial assets.

**✓ B) when used correctly, can actually lower risk.**

C) should only be used by people seeking high returns from high risk.

D) a and b

**Feedback:**

**LOD: 1**

**The Basics: Defining Derivatives.**

**Q#2**

The value of a derivative contract is ultimately determined by:

**✓ A) the value of the underlying asset.**

B) SEC regulation.

C) the Federal Reserve

D) the risk-free rate of return.

**Feedback:**

**LOD: 1**

**The Basics: Defining Derivatives.**

**Q#3**

The *short* position in a futures contract represents the party that will:

A) accept the risk.

B) ultimately suffer the loss.

**✓ C) deliver a commodity or financial instrument to the buyer at a future date.**

D) benefit from increases in price of the underlying asset.

**Feedback:**

**LOD: 1**

**Forwards and Futures.**

**Q#4**

We have a futures contract for the purchase of 100 bushels of wheat at \$2.30 per bushel. If the market price of wheat increases to \$3.00 per bushel:

**✓ A) the seller (short position) needs to transfer \$70 to the buyer (long position).**

B) nothing happens since with a futures contract all payments are made at the settlement date.

C) nothing happens since market to market adjustments only take place when the market price falls below the contract price.

D) None of the above.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#5**

A farmer who must purchase his inputs now but will sell his corn at a market price at a future date:

A) faces a market risk that cannot be offset.

B) is a good example of what the chapter refers to as a speculator.

**✓ C) would hedge by taking the short position in a corn futures contract.**

D) would hedge by taking the long position in a corn futures contract.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#6**

A person with a long position receives an increase in his or her margin account when the price of the commodity:

- A) rises.
- ✓ B) falls.
- C) remains unchanged.
- D) rises or falls.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#7**

Speculators differ from hedgers in the sense that:

- A) speculators do not like risk.
- ✓ B) hedgers seek to transfer risk.
- C) speculators are hedgers, there isn't any difference.
- D) All above given

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#8**

Tom sells a futures contract for U.S. Treasury bonds and on the settlement date the interest rate on U.S. Treasury bonds is lower than Tom expected. Tom will have:

- ✓ A) gained money on his short position.
- B) lost money on his long position.
- C) gained money on his long position.
- D) lost money on his short position.

**Feedback:**

**LOD: 3**

**Forwards and Futures.**

Q#9

An arbitrageur is someone who:

- A) always takes the long position in a futures contract.
- ✓ B) **simultaneously buys and sells financial instruments to benefit from temporary price differences.**
- C) seeks the high returns that come from the high risk inherent in futures markets.
- D) always takes the short position in a futures contract.

Feedback:

LOD: 2

Forwards and Futures.

Q#10

The price of a futures contract will converge to the price of the underlying asset as the future contract approaches its settlement date:

- A) under no circumstances.
- B) due to federal law
- C) only in very rare circumstances.
- ✓ D) **as a result of arbitrage.**

Feedback:

LOD: 2

Forwards and Futures.

Q#11

There's a call option written for 100 shares of GM stock for \$75.00 a share, prior to the third Friday of November 2008: The option *writer*:

- ✓ A) **has the requirement to sell 100 shares of GM for \$75 a share on or before the third Friday of November 2008 if the option holder wants to exercise the option.**
- B) has the option to sell 100 shares of GM for \$75 a share on or before the third Friday of November 2008.
- C) can cancel the option before the third Friday of November 2008.

D) None of the above.

**Feedback:**

**LOD: 2**

**Options.**

**Q#12**

If a put option is described as being *at the money*, this indicates that the:

A) market price of the stock is above the strike price.

B) market price of the stock is below the strike price.

✓ C) market price of the stock equals the strike price.

D) option has been exercised.

**Feedback:**

**LOD: 1**

**Options.**

**Q#13**

If a call option is described as being *in the money*, this indicates that the:

✓ A) market price of the stock is above the strike price.

B) market price of the stock is below the strike price.

C) market price of the stock equals the strike price.

D) option has been exercised.

**Feedback:**

**LOD: 2**

**Options.**

**Q#14**

The two parts that make up an option's price are:

A) its extrinsic value and the time value of the option.

✓ B) its intrinsic value and the time value of the option.

C) the commission and the time value of the option.

D) the price of the underlying asset and the time value of the option.

**Feedback:**

**LOD: 1**

**Options.**

**Q#15**

Assume we have a stock currently worth \$100. We also assume the interest rate is *zero*, and we can buy options for this stock with a strike price of \$100. If the stock can rise or fall by \$10 with equal probability over the option period, and the option cannot be exercised until the expiration date, what is the time value of the option?

- A) \$10
- B) \$0
- C) \$5
- D) \$100

**Feedback:**

**LOD: 3**

**Options.**

**Q#16**

At expiration, the value of an option is:

- A) zero.
- B) greater than the intrinsic value.
- C) equal to the intrinsic value.
- D) less than the intrinsic value.

**Feedback:**

**LOD: 2**

**Options.**

**Q#17**

The *option holder* is:

- A) the buyer of an option.
- B) another name for the clearinghouse used in futures contracts.
- C) the seller of an option.



D) the person who initiates the option.

**Feedback:**

**LOD: 1**

**Options.**

**Q#18**

An individual buying a commodity or financial instrument in the future can reduce risk by buying a \_\_\_\_\_ option.

✓ A) call

B) put

C) clearinghouse

D) sweep

**Feedback:**

**LOD: 2**

**Options.**

**Q#19**

An increase in the market price of the underlying asset will cause the price of a put option to:

A) rise.

✓ B) fall.

C) remain unchanged.

D) change in an unpredictable manner.

**Feedback:**

**LOD: 2**

**Options.**

**Q#20**

A decrease in the volatility of the price of the underlying asset will cause the price of a put option to:

A) rise.

✓ B) fall.

- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#21**

The *primary* risk(s) in swaps is:

- A) one of the parties will default.**
- B) interest rates will not change.
- C) they are highly liquid and the market price will change.
- D) All of the above.

**Feedback:**  
**LOD: 2**  
**Swaps.**

## **Quiz # 18**

**Q#1**

The acquisition of derivatives, as a part of an individual's portfolio:

- A) will always lower the risk associated with the portfolio.
- B) will always increase the risk associated with the portfolio.**
- C) may reduce the risk associated with the portfolio.
- D) has no effect on the risk associated with the portfolio.

**Feedback:**  
**LOD: 1**  
**The Basics: Defining Derivatives.**

**Q#2**

The value of a derivative is based upon:

- A) the value of an underlying asset.**
- B) the general level of the Dow Jones Industrial Average.

- C) price controls established by commodity trading boards.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Basics: Defining Derivatives.**

**Q#3**

A person takes a *long* position in a futures contract when he or she agrees to \_\_\_\_\_ a commodity or a financial instrument at a specified future date.

- A) sell
- ✓ B) buy
- C) both buy and sell an equal amount of a commodity
- D) first sell then buy

**Feedback:**

**LOD: 1**

**Forwards and Futures.**

**Q#4**

Consider a futures contract for the purchase of 100 bushels of wheat at \$3.00 per bushel. If the market price of wheat increases to \$2.75 per bushel:

- A) the seller (short position) needs to transfer \$25 to the buyer (long position).
- ✓ B) he buyer (long position) needs to transfer \$25 to the seller (short position).
- C) the seller (long position) needs to transfer \$25 to the buyer (short position).
- D) the buyer (short position) needs to transfer \$25 to the seller (long position).

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

Q#5

Consider a utility company that produces electricity by burning natural gas. It may hedge against the risk of price changes in the natural gas market by:

- A) taking a short position in the market for natural gas.
- ✓ B) taking a long position in the market for natural gas.
- C) doing nothing since changes in natural gas prices impose no risk to this utility.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

Q#6

A person with a short position receives an increase in his or her margin account when the price of the commodity \_\_\_\_\_.

- ✓ A) rises
- B) falls
- C) remains unchanged
- D) changes in either direction

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

Q#7

Futures markets may be used for speculating or for hedging. The difference between these strategies is:

- A) that speculators attempt to reduce their risk while hedgers increase their risk in an attempt to receive higher returns.
- ✓ B) that hedgers attempt to reduce their risk while speculators increase their risk in an attempt to receive higher returns.
- C) nonexistent; both hedgers and speculators attempt to reduce their risk.
- D) nonexistent; both hedgers and speculators increase their risk in an attempt to receive higher returns.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#8**

Julie buys a futures contract for U.S. Treasury bonds and on the settlement date the interest rate on U.S. Treasury bonds is lower than she had expected. Julie will have:

- A) gained money on her short position.
- B) lost money on her long position.
- C) gained money on her long position.
- ✓ D) lost money on her short position.

**Feedback:**

**LOD: 3**

**Forwards and Futures.**

**Q#9**

Profitable speculation in futures markets will cause the price of a commodity to:

- ✓ A) become more stable over time.
- B) become less stable over time.
- C) increase in all time periods.
- D) decrease in all time periods.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#10**

As a result of arbitrage, the price of the futures contract at its settlement date will:

- A) exceed the price of the underlying asset.
- B) be less than the price of the underlying asset.
- ✓ C) equal the price of the underlying asset.
- D) have no relationship to the price of the underlying asset.

**Feedback:**

**LOD: 2**

**Forwards and Futures.**

**Q#11**

Joe writes a put option for 500 shares of Microsoft stock at \$90 prior to February 15, 2009. As a result of this transaction, Joe has:

A) the option to sell 500 shares of Microsoft stock at any time until February 15, 2009 if this benefits him.

B) the option to buy 500 shares of Microsoft stock at any time until February 15, 2009 if this benefits him.

**✓ C) the obligation to sell 500 shares of Microsoft stock at any time until February 15, 2009 if the option holder exercises this option.**

D) the obligation to buy 500 shares of Microsoft stock at any time until February 15, 2009 if the option holder exercises this option.

**Feedback:**

**LOD: 2**

**Options.**

**Q#12**

If a call option is described as being *at the money*, this indicates that the:

A) market price of the stock is above the strike price.

B) market price of the stock is below the strike price.

**✓ C) market price of the stock equals the strike price.**

D) option has been exercised.

**Feedback:**

**LOD: 1**

**Options.**

**Q#13**

If a put option is described as being *in the money*, this indicates that the:

A) market price of the stock is above the strike price.

**✓ B) market price of the stock is below the strike price.**

C) market price of the stock equals the strike price.

D) option has been exercised.

**Feedback:**

**LOD: 2**

**Options.**

**Q#14**

The part of the option price that reflects its value if it is immediately exercised is the option's \_\_\_\_\_ while the part that reflects the potential future benefit from holding the option is called the \_\_\_\_\_.

A) extrinsic value; intrinsic value

B) intrinsic value; external value

✓ C) **intrinsic value; time value of the option**

D) time value of the option; intrinsic value

**Feedback:**

**LOD: 1**

**Options.**

**Q#15**

Assume that we have a stock currently worth \$150. We also assume the interest rate is *zero*, and we can buy options for this stock with a strike price of \$150. If the stock can rise or fall by \$30 with equal probability over the option period, and the option cannot be exercised until the expiration date, what is the time value of the option?

A) \$30

B) \$0

✓ C) **\$15**

D) \$150

**Feedback:**

**LOD: 3**

**Options.**

**Q#16**

As an option approaches its maturity date, its price will converge to:

A) the time value of the option.

- ✓ B) its intrinsic value.
- C) the price of the underlying asset.
- D) the market interest rate.

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#17**

Which of the following may be used to reduce or transfer risk?

- A) futures contracts
- B) put options
- C) call options
- ✓ D) All of the above are correct.

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#18**

The *option writer* is:

- A) the buyer of an option.
- B) a clearinghouse for options contracts.
- ✓ C) the seller of an option.
- D) the broker that ensures that the option will be exercised.

**Feedback:**  
**LOD: 1**  
**Options.**

**Q#19**

An individual selling a commodity or financial instrument can reduce risk by buying a \_\_\_\_\_ option.

- A) call



- B) put
- C) clearinghouse
- D) sweep

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#20**

An increase in the market price of the underlying asset will cause the price of a call option to:

- A) rise.
- B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#21**

An increase in the volatility in the price of the underlying asset will cause the price of a put option to:

- A) rise.
- B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**  
**LOD: 2**  
**Options.**

**Q#22**

Financial institutions and the government may reduce interest-rate risk by:

- A) engaging in interest-rate swaps.

**B)** not altering the interest rates that they receive and/or pay when market interest rates change.

**C)** Either of the above strategies.

**D)** Neither of the above strategies.

**Feedback:**

**LOD: 2**

**Options.**

## **Quiz # 19**

**Q#1**

An American traveling to Europe will find it easier to make purchases now because:

**A)** most countries in Europe have adopted the U.S. dollar as their currency.

**✓ B)** many of the countries in Europe now use the same currency, the euro.

**C)** most of the countries of Europe have adopted the British pound as the standard currency.

**D)** None of the above.

**Feedback:**

**LOD: 1**

**Foreign Exchange Basics.**

**Q#2**

The nominal exchange rate:

**A)** is measured in goods.

**B)** is a synonymous term for the *swap* rate.

**C)** is always expressed as units of a foreign currency per U.S. \$.

**✓ D)** is the rate at which one can exchange the currency of one country for the currency of another country.

**Feedback:**

**LOD: 1**

**Foreign Exchange Basics.**

**Q#3**

If the Japanese yen depreciates against the U.S. dollar:

- A) Americans should find that Japanese goods are now more expensive.
- ✓ B) Japanese residents would find that Japanese goods have become relatively less expensive than American goods.**
- C) U.S. goods should have an easier time competing against Japanese goods in both countries.
- D) Japanese goods will become relative more expensive (compared to U.S. goods) in both the U.S. and Japan.

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#4**

Suppose that the value of Argentina's peso changes from \$0.33 to \$0.35 (in U.S. dollars). This implies that the U.S. dollar must have:

- A) appreciated relative to all other national currencies.
- ✓ B) depreciated from 3.03 pesos to 2.86 pesos.**
- C) appreciated from 2.86 pesos to 3.03 pesos.
- D) None of the above is correct.

**Feedback:**

**LOD: 3**

**Foreign Exchange Basics.**

**Q#5**

If the real exchange rate is greater than one, then:

- ✓ A) domestic goods are relatively more expensive than imported goods.**
- B) imported goods are relatively more expensive than domestic goods.
- C) purchasing power parity occurs.
- D) None of the above is correct.

**Feedback:**

**LOD: 2****Foreign Exchange Basics.****Q#6**

If the current exchange rate is 1€/1\$U.S. and bagels cost 1€ in France and 1\$ in the U.S. and the current exchange rate for bagels is 1.15 European bagel / 1 U.S. bagel and if the bagels are identical, then:

**✓ A) an American would be better off trading U.S. bagels for European bagels.**

**B) a person from France would be better off trading European bagels for U.S. bagels.**

**C) the theory of purchasing power parity is working.**

**D) a and c.**

**Feedback:****LOD: 2****Foreign Exchange Basics****Q#7**

If we let  $P$  = the domestic price of a basket of goods and  $P_f$  the foreign price of the same basket of goods, and  $e$  = the nominal exchange rate of foreign currency/\$U.S., the real exchange rate is best expressed as:

**A)  $e \cdot \frac{P}{P_f} < a$**

**B)  $\frac{P_f}{P} < a$**

**C)  $\frac{P_f}{P \cdot e} < a$**

**✓ D)  $\frac{P}{P_f \cdot e} < a$**

**Feedback:****LOD: 2****Foreign Exchange Basics.****Q#8**

If the U.S. dollar appreciates relative to the Canadian dollar:

A) imports from Canada will become more expensive in the U.S. and U.S. exports to Canada become relatively more expensive in terms of Canadian dollars.

B) imports from Canada will become more expensive in the U.S. and U.S. exports to Canada become relatively less expensive in terms Canadian dollars.

**✓ C) imports from Canada will become less expensive in the U.S. and U.S. exports to Canada become relatively more expensive in terms of Canadian dollars.**

D) imports from Canada will become less expensive in the U.S. and U.S. exports to Canada become relatively less expensive in terms of Canadian dollars.

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#9**

The *forward* exchange rate:

A) is the same as the spot rate.

B) is a synonymous term for the nominal exchange rate.

**✓ C) is the rate at which foreign exchange dealers are willing to commit to buying or selling a currency in the future.**

D) since it carries greater risk, is always above the spot rate.

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#10**

The law of one price:

A) is based on the law of diminishing marginal returns.

B) applies only to financial assets and not real assets.

**✓ C) can explain long-run exchange rates but not short-run exchange rates.**

D) is more of a mathematical concept, but it is not useful in explaining exchange rates.

**Feedback:**

**LOD: 1**

**Exchange Rates in the Long Run.**

**Q#11**

If the euro/\$ U.S. exchange rate is 1.05€/ \$ in New York but 1.1€/ \$ in London, we should see:

A) people selling dollars and buying euros in New York and then selling those euros and buying dollars in London.

**✓ B) people selling euros and buying dollars in New York and then buying euros by selling dollars in London.**

C) the price differential between the markets increase as people seek to take advantage of the situation.

D) the dollar should appreciate in New York relative to the euro.

**Feedback:**

**LOD: 3**

**Exchange Rates in the Long Run.**

**Q#12**

Differences in inflation rates between two countries can:

**✓ A) explain long-run changes in the exchange rate but not short-run changes.**

B) explain changes in the real exchange rate over the long run, but not changes in the nominal exchange rate.

C) explain well short-run changes in the exchange rate but not long-run changes.

D) None of the above.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#13**

Considering the theory of purchasing power parity, if inflation in the U.S. is 5% while prices in Mexico are stable, we should expect:

A) the dollar to appreciate 5% relative to the peso.

- B) the peso to appreciate 5% relative to the dollar.
- C) the nominal exchange rate to stay fixed.
- D) the real exchange rate of U.S. goods / Mexican goods to appreciate 5%.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#14**

When a currency is described as overvalued, this implies:

- A) it is overvalued relative to what the describer believes purchasing power parity to be.
- B) it is overvalued relative to the exchange rate set by the nation's central bank.
- C) the exchange rate is greater than one.
- D) the exchange rate is lower than one year previous.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#15**

A country with a current account deficit:

- A) has imported more than it has exported.
- B) has exported more than it has imported.
- C) also has a capital account surplus.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#16**

Short-run movements in nominal exchange rates are primarily due to:

- A) changing prices of goods and services in the countries involved.

- B) inflation differentials.
- ✓ C) changes in the real exchange rate.
- D) None of the above.

**Feedback:**

**LOD: 1**

**Exchange Rates in the Short Run.**

**Q#17**

If Americans lose their taste for Mexican-made goods, we should observe which of the following change(s) in the dollar-peso market?

- A) The supply curve of dollars shifts right.
- B) The demand curve for dollars shifts left.
- ✓ C) The supply curve of dollars shifts left.
- D) The demand curve for dollars shifts right.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run.**

**Q#18**

An *expected* depreciation of the dollar, everything else held constant, should cause the:

- A) supply of dollars to decrease.
- B) demand for dollars to increase.
- ✓ C) demand for dollars to decrease.
- D) dollar to appreciate *now* relative to other currencies.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run**

## Quiz # 20



**Q#1**

The countries in the European Monetary Union all use \_\_\_\_\_ as their official currency.

- A) the U.S. dollar
- B) separate national currencies
- ✓ C) the euro
- D) the British pound

**Feedback:**

**LOD: 1**

**Foreign Exchange Basics.**

**Q#2**

Suppose that the value of a pound rises from \$1.90 to \$2.00 over the course of a year. This indicates that the:

- ✓ A) nominal exchange rate has changed.
- B) real exchange rate has changed.
- C) nominal and real exchange rates have necessarily changed.
- D) dollar has appreciated relative to the pound.

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#3**

If the exchange value of \$1 rises from 27 to 29 Russian rubles, then the:

- ✓ A) Russian ruble has depreciated from \$0.0370 to \$0.0345.
- B) Russian ruble has appreciated from \$0.0345 to \$0.0370.
- C) value of the Russian ruble may have risen or fallen relative to the dollar. There is insufficient information to determine whether the value of the ruble has appreciated or depreciated with respect to the U.S. dollar.
- D) None of the above is correct.

**Feedback:**

**LOD: 3**

**Foreign Exchange Basics.**

**Q#4**

If the dollar appreciates relative to the pound, then the pound:

- A) must have depreciated relative to the dollar.**
- B) must have appreciated relative to the dollar.**
- C) may have either appreciated or depreciated relative to the dollar; this cannot be determined without additional information.**
- D) None of the above is correct.**

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#5**

If the real exchange rate is greater than 1:

- A) imports are more expensive than domestic goods.**
- B) imports are less expensive than domestic goods.**
- C) the law of one price holds.**
- D) domestic inflation must be high.**

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics.**

**Q#6**

Suppose that the current exchange rate between the U.S. dollar and the British pound is  $2\$U.S / 1\pounds$  and identical CDs cost 9 $\pounds$  in England and \$16 in the U.S. If there are no differences in shipping costs between domestic and imported CDs in the U.S., then:

- A) an American would be better off buying imported CDs from England.**
- B) an American would be better off buying domestic CDs instead of imported CDs.**
- C) purchasing power parity holds.**
- D) None of the above is correct.**

**Feedback:**

**LOD: 3**

**Foreign Exchange Basics**

**Q#7**

The current exchange rate for foreign exchange transactions to be conducted at a specific future date is called the:

- A) spot rate.
- ✓ B) forward rate.
- C) backward rate.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Foreign Exchange Basics**

**Q#8**

The real exchange rate equals:

- A) price of domestic goods / foreign price of imported goods.
- B) foreign price of imported goods / price of domestic goods.
- ✓ C) price of domestic goods / domestic price of imported goods.
- D) domestic price of imported goods / price of domestic goods.

**Feedback:**

**LOD: 2**

**Foreign Exchange Basics**

**Q#9**

The law of one price suggests that, in the long run, the real exchange rate:

- A) will exceed one.
- B) will be less than one.
- ✓ C) equals one.
- D) None of the above is correct.

**Q#10**

Purchasing power parity occurs if the real exchange rate:

- A) equals 1.**
- B) exceeds 1.
- C) is less than 1.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Exchange Rates in the Long Run**

**Q#11**

If the euro/\$ U.S. exchange rate is 1.20€/ \$ in New York but 1.15€/ \$ in London, we should see:

- A) people selling dollars and buying euros in New York and then selling those euros and buying dollars in London.**
- B) people selling euros and buying dollars in New York and then buying euros by selling dollars in London.
- C) the price differential between the markets increase as people seek to take advantage of the situation.
- D) the dollar appreciate in New York relative to the euro.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#12**

Differences in inflation rates between countries can explain:

- A) most short-run fluctuations in the exchange rate, but cannot explain long-run fluctuations.
- B) long-run fluctuations in the exchange rate.**
- C) both long-run and short-run exchange rate fluctuations equally well.
- D) none of the fluctuations that occur in the exchange rate.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#13**

Under purchasing power parity, an increase in the domestic inflation rate, relative to foreign inflation rates, will cause the domestic currency to:

- A) appreciate.
- B) depreciate.
- C) maintain the same exchange rate.
- D) change in a manner that cannot be predicted.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#14**

If the inflation rate in the U.S. consistently exceeds the Canadian inflation rate by 2%, we would expect the Canadian dollar to:

- A) appreciate by approximately 2% per year.
- B) depreciate by approximately 2% per year.
- C) maintain its current value since this exchange rate is fixed.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Long Run.**

**Q#15**

If the U.S. imports more than it exports, it must:

- A) have a trade surplus.
- B) have a trade deficit.
- C) Both of the above are possible.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run.**

**Q#16**

An increase in U.S. wealth, *ceteris paribus*, will cause the U.S. dollar to:

- A) appreciate.
- ✓ B) depreciate.
- C) maintain a constant value.
- D) depreciate at an accelerating rate over time.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run.**

**Q#17**

Interest-rate differentials across countries are a primary explanation of:

- ✓ A) short-run exchange rate fluctuations, but not long-run exchange rate fluctuations.
- B) long-run exchange rate fluctuations, but not short-run exchange rate fluctuations.
- C) both short-run and long-run exchange rate fluctuations.
- D) neither short-run nor long-run exchange rate fluctuations.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run.**

**Q#18**

The demand for dollars will rise when:

- ✓ A) U.S. interest rates rise.
- B) foreign interest rates rise.
- C) U.S. income rises.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Exchange Rates in the Short Run.**

## **Quiz # 21**

**Q#1**

Financial intermediation is:

- A) far less important than direct finance through stock and bond markets.
- B) much more important than direct finance through stock and bond markets.
- C) only more important than direct finance in the United States.
- D) b and c

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries**

**Q#2**

When the amount of direct and indirect financing are summed, the result is usually:

- A) approximately 75% of GDP.
- B) equal to one half of the amount in GDP.
- C) the amount in M2.
- D) greater than 100% of GDP.

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries.**

**Q#3**

Emerging market economies, compared to industrialized economies, have financial markets that:

- A) are the same in composition but differ in size.
- B) differ in composition but not in size.
- C) differ in composition and size.
- D) are similar in composition and size.

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries.**

**Q#4**

Which of the following is a role of a financial institution acting as a financial intermediary?

- ✓ **A) pooling the resources of small savers**
- B) formulating oversight regulations
- C) sending out free calendars at the holidays
- D) lobbying legislators

**Q#5**

Without the ability of financial intermediaries to pool the resources of small savers:

- A) borrowers needing large amounts of money would find it less costly to obtain the funds.
- B) the economy would likely grow faster.
- C) people would likely save more.
- ✓ **D) the risk associated with lending would increase.**

**Feedback:**

**LOD: 2**

**The Role of Financial Intermediaries.**

**Q#6**

The fact that a financial intermediary can use the same contract for many customers is an example of:

- A) economies of scope.
- B) the law of diminishing marginal returns.
- C) the law of increasing opportunity cost.
- ✓ **D) economies of scale.**



**Q#7**

A bank can usually offer a saver a higher return for the same risk because:

- A) the bank can usually purchase assets at a higher cost than any one saver.
- B) the bank can pool the resources of larger savers and purchase lower denominated assets.
- C) economies of scale can be applied by the bank in its purchase of assets.
- D) None of the above.

**Feedback:**

**LOD: 2**

**The Role of Financial Intermediaries.**

**Q#8**

If a bank has 4,000 depositors, each of whom deposits \$500 in the bank, and the bank makes 200 loans of \$10,000 each, then each depositor has contributed:

- A) \$100 to each loan.
- B) \$2.50 to each loan.
- C) \$5 to each loan.
- D) \$25 to each loan.

**Feedback:**

**LOD: 3**

**The Role of Financial Intermediaries.**

**Q#9**

If information in a financial market is asymmetric, this means that:

- A) borrowers and lenders have perfect information.
- B) borrowers would have more information than lenders.
- C) borrowers and lenders have the same information.
- D) lenders lack any information.

**Q#10**

Della's Donut Shop goes out of business due to decreasing sales resulting from the dramatic increase in people on low carbohydrate diets. The decrease in business also results in Della's defaulting on the loan it has with the bank. This is an example of:

- A) asymmetric information in financial markets.
- ✓ B) **lack of perfect information in financial markets.**
- C) moral hazard in financial markets.
- D) adverse selection.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#11**

Suppose that a bank issues credit cards with a 25% interest rate to all applicants. It finds that it has a higher default risk on these accounts than is experienced by banks that offer credit cards with lower interest rates to carefully selected customers. This is primarily an example of the:

- A) moral hazard problem.
- ✓ B) **adverse selection problem.**
- C) symmetric information problem.
- D) All of the above are correct.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#12**

In a financial market where information is symmetric:

- ✓ A) **the same information would be known by both parties in a transaction.**
- B) one party to a transaction knows information the other party does not.
- C) the ability to obtain information is available to only one party.
- D) All of the above.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#13**

One of the conclusions from Akerlof's paper, titled "The Market for Lemons," is that:

A) high-quality goods and low-quality goods will co-exist in the market, in equal proportion to the share of high-quality and low-quality goods held by individuals.

B) lacking the ability to distinguish high from low quality, the quality the market will end up offering will be the average quality.

C) high quality is always demanded by consumers over low quality, so low-quality goods will not be offered for sale.

**✓ D) since consumers lack the ability to distinguish high from low quality, low-quality goods may drive high-quality goods out of the market.**

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#14**

Requiring a large deductible on the part of an insurance contract is one way that insurers treat the problem of:

A) free-riding.

**✓ B) moral hazard.**

C) adverse selection.

D) the lemons market.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#15**

CEO compensation packages that include substantial benefits in the form of stock options are designed primarily to reduce the \_\_\_\_\_ problem associated with the separation of ownership and control.

A) symmetric information problem

- B) adverse selection problem
- ✓ C) moral hazard problem
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#16**

Deflation compounds information problems because:

- A) it increases a company's net worth.
- ✓ B) it reduces the dollar value of assets while the dollar value of liabilities stays constant.
- C) it tends to understate a company's assets and overstate its liabilities.
- D) it always harms lenders.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#17**

Often a bank will require a loan officer to make personal visits on customers with loans outstanding. This is encouraged because:

- A) the bank worries about competitors trying to steal its customers.
- B) the bank wants to make sure the business is still there.
- C) the bank likely has excess funds available and hopes to make another loan to the business.
- ✓ D) this is an effective monitoring technique and should reduce moral hazard.

**Feedback:**

**LOD: 2**

**Financial Intermediaries and Information Costs**

**Q#18**

Most investment spending by firms is financed internally as a result of:

- A) the problem of imperfect information in financial markets.**
- B) the symmetric information available to all parties under direct finance.**
- C) the higher interest rate that the firm faces when internal finance is used.**
- D) none of the above.**

**Feedback:**

**LOD: 2**

**Financial Intermediaries and Information Costs**

## Quiz # 22

**Q#1**

Which of the following statements is correct concerning the relative importance of direct and indirect finance in the U.S.?

- A) Financial intermediaries provide a larger share of total financing than is provided by stocks and bonds.**
- B) Stocks and bonds provide a larger share of total financing that is provided by financial intermediaries.**
- C) Bonds are the most important source of total financing.**
- D) Both b and c are correct.**

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries.**

**Q#2**

In industrialized economies, the sum of direct and indirect finance is typically:

- A) less than 5% of GDP.**
- B) roughly 10% of GDP.**
- C) about half of GDP.**
- D) over 100% of GDP.**

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries.**

**Q#3**

In less developed and emerging market economies, indirect finance is \_\_\_\_\_ than in industrialized economies.

- A) smaller (relative to GDP)**
- B) larger (relative to GDP)
- C) of roughly equal importance (relative to GDP)
- D) sometimes smaller and sometimes larger (relative to GDP)

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries**

**Q#4**

Compared to direct finance, the use of financial intermediaries:

- A) raises transaction and information costs.
- B) lowers transaction and information costs.**
- C) raises transaction costs but lowers information costs.
- D) lowers transaction costs but raises information costs.

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries**

**Q#5**

Which of the following advantages is *not* provided by financial intermediaries?

- A) pooling the savings from many small savers
- B) providing liquidity to savers
- C) offering higher interest rates on savings deposits than are available under direct finance**
- D) collecting and processing information

**Feedback:**

**LOD: 2**

**The Role of Financial Intermediaries**

**Q#6**

The use of financial intermediaries:

- A) increases the cost of engaging in financial transactions.
- ✓ B) reduces the cost of engaging in financial transactions.
- C) has no effect on the cost of engaging in any financial transaction.
- D) reduces economic efficiency by raising transaction costs.

**Feedback:**

**LOD: 1**

**The Role of Financial Intermediaries**

**Q#7**

One of the advantages of indirect finance over direct finance is that:

- A) direct finance always provides a more diversified portfolio of assets.
- ✓ B) indirect finance allows borrowers to borrow for long time periods while lenders may give up the use of their funds for short time periods.
- C) economies of scale are less likely to be realized with indirect finance.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Role of Financial Intermediaries**

**Q#8**

Large banks are often able to make loans at a lower cost per loan than occurs for smaller banks even when both large and small banks offer an equivalent mix of services. This is most likely an example of:

- A) economies of scope.
- ✓ B) economies of scale.
- C) the law of diminishing returns.
- D) the law of diminishing marginal utility.

**Feedback:**

**LOD: 2**

**The Role of Financial Intermediaries**

**Q#9**

If a bank has 2,000 depositors, each of whom deposits \$500 in the bank, and the bank makes 100 loans of \$10,000, then each depositor has contributed:

- A) \$5 to each loan.**
- B) \$50 to each loan
- C) \$100 to each loan.
- D) \$500 to each loan.

**Feedback:**

**LOD: 3**

**The Role of Financial Intermediaries.**

**Q#10**

Asymmetric information in financial markets:

- A) occurs because borrowers have more relevant information than do lenders.**
- B) may result in a moral hazard problem.
- C) may result in an adverse selection problem.
- D) All of the above are correct.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs**

**Q#11**

Which of the following is the *best* example of an adverse selection problem?

- A) A business owner hires some local youth to set fire to his unprofitable business so that he may collect on his insurance.
- B) Individuals that apply for high interest rate credit cards are more likely to default on their debt than a typical person in the population.**



C) Individual borrowers sometimes pay more interest than necessary because they have not shopped around for the best available interest rate.

D) None of the above is an example of the adverse selection problem.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs**

**Q#12**

Which of the following is the *best* example of a moral hazard problem?

**✓ A) A business owner hires some local youth to set fire to his unprofitable business so that he may collect on his insurance.**

B) Individuals that apply for high interest rate credit cards are more likely to default on their debt than a typical person in the population.

C) Individual borrowers sometimes pay more interest than necessary because they have not shopped around for the best available interest rate.

D) None of the above is an example of the adverse selection problem.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#13**

The work by Akerlof suggests that the "lemons problem" occurs in the market for loans because:

A) once someone receives a loan, he or she may choose to not pay it back.

**✓ B) individuals that are willing to borrow money, particularly at high interest rates, are relatively poor credit risks.**

C) some banks provide deceptive terms in their loan contracts, inducing more people to borrow money than is optimal.

D) bank loans always leave a sour taste in all parties' mouths.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#14**

The adverse selection problem associated with bank loans may be reduced by:

- ✓ **A) relying on information from credit reporting agencies.**
- B) charging a higher interest rate on loans.
- C) making loans available to more customers.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#15**

Restrictive covenants in loan agreements are introduced *primarily* to reduce the:

- ✓ **A) adverse selection problem.**
- B) moral hazard problem.
- C) diminishing returns problem.
- D) symmetric information problem.

**Feedback:**

**LOD: 2**

**Information Asymmetries and Information Costs.**

**Q#16**

Banks monitor firms receiving commercial loans to reduce the:

- A) adverse selection problem.
- ✓ **B) moral hazard problem.**
- C) diminishing returns problem.
- D) economies of scale problem.

**Feedback:**

**LOD: 2**

**Financial Intermediaries and Information Costs.**

**Q#17**

The use of stock options as a substantial component of CEO compensation became more common in the 1990s in an attempt to:

- A) reduce the adverse selection problem in hiring CEOs.
- ✓ B) reduce the moral hazard problem by aligning the interests of CEOs with those of stockholders.
- C) benefit the CEO at the expense of the firm's profitability.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Financial Intermediaries and Information Costs**

## Quiz # 23

**Q#1**

Which of the following correctly states the relationship regarding banks' balance sheets?

- A) total bank liabilities = total bank capital + total bank assets
- ✓ B) total bank assets = total bank liabilities + total bank capital
- C) total bank assets = total bank liabilities - total bank capital
- D) total bank assets = total bank capital - total bank liabilities

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#2**

Considering the balance sheet for all commercial banks in the U.S., ratio of debt to equity of banks is:

- A) about 20 to one.
- B) about 7 to one.
- C) about 2 to one.
- ✓ D) about 10 to one.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#3**

A bank's *reserves* do not include:

- A) U.S. Treasury bills.**
- B) currency in the bank.
- C) the bank's deposits at the Federal Reserve.
- D) currency in ATM machines.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#4**

Bank's hold marketable securities as part of their assets. For U.S. banks, these marketable securities do not include:

- A) common stocks.**
- B) the bonds of the U.S. Treasury.
- C) U.S. Treasury Bills.
- D) All of the above.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#5**

For U.S. commercial banks:

- A) loans make up nearly one-third of total assets.
- B) loans make-up one-half of total assets.
- C) loans make up nearly two-thirds of total assets.**
- D) loans make up over three-quarters of liabilities.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#6**

The federal funds market is the:

**✓ A) inter-bank market where excess reserves from one bank can be loaned to another bank.**

B) lending to banks by the U.S. Treasury when banks face liquidity emergencies.

C) term used for bank borrowing from the Federal Reserve System.

D) borrowing by American banks from foreign lenders.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#7**

Which of the following is a bank liability?

A) reserves

B) U.S. Treasury bonds

C) mortgage loans

**✓ D) checkable deposits**

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#8**

The liabilities of a bank represent the its:

A) uses of funds.

**✓ B) sources of funds.**

C) abuses of funds.

D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#9**

A bank's uses of funds corresponds to the part of its balance sheet called:

- A) assets.
- B) liabilities.
- C) bank capital.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#10**

Repurchase agreements are usually used by banks that:

- A) have a need for long-term equity financing.
- B) have negative net worth.
- C) need cash for a very short period of time.
- D) cannot obtain financing from any other source.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#11**

If a bank sells off all of its assets and pays all of its liabilities the amount remaining would be the bank's:

- A) net profit.
- B) net worth.
- C) reserves.
- D) excess reserves.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#12**

If a bank has \$270 million in assets and a net worth of \$30 million, its debt to equity ratio is:

- A) 9 to 1.
- B) 7 to 1.
- C) 8.75 to 1.
- ✓ D) 8 to 1.

**Feedback:**

**LOD: 3**

**The Balance Sheet of Commercial Banks.**

**Q#13**

A bank's return on equity (ROE) is calculated by:

- A) dividing the banks liabilities by the bank's capital.
- ✓ B) dividing the bank's net profit after taxes by the bank's capital.
- C) taking the bank's assets plus the net profit after taxes and dividing this sum by the bank's capital.
- D) dividing the bank's net profit after taxes by the sum of the bank's assets and its liabilities.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#14**

The difference between a bank's *reserves* and its required reserves is:

- A) equity.
- ✓ B) excess reserves.
- C) net interest income.
- D) nothing; they are the same thing.

**Feedback:**

**LOD: 2**

**Bank Risk: Where It Comes From and What to Do about It.**

**Q#15**

If a bank has deposits of \$400 million, reserves that total \$45 million and has a required reserve rate of 10 percent, then the bank:

- A) is short of required reserves.
- B) has excess reserves of \$10 million.
- C) has excess reserves of \$5 million.
- ✓ D) has a net profit of \$5 million.

**Feedback:**

**LOD: 3**

**Bank Risk: Where It Comes From and What to Do about It.**

**Q#16**

One way for a bank to deal with credit risk is to:

- ✓ A) add a mark-up to the cost of funds for a specific borrower based on the borrower's credit history.
- B) charge all borrowers from the same industry an average rate for that industry.
- C) avoid making loans to borrowers from a broad spectrum and to specialize geographically and in specific industries.
- D) limit the number of loans made in any year.

**Feedback:**

**LOD: 2**

**Bank Risk: Where It Comes From and What to Do about It.**

**Q#17**

The procedure that estimates the interest-rate sensitivity of a bank's assets and liabilities is called:

- A) managing credit risk.
- ✓ B) gap analysis.
- C) trading risk minimization.
- D) bank managerial finance.



**Feedback:**

**LOD: 2**

**Bank Risk: Where It Comes From and What to Do about It.**

**Q#18**

If a bank has more interest-rate sensitive liabilities than interest-rate sensitive assets, a 1% increase in the interest rate on interest-rate sensitive assets and interest-rate sensitive liabilities will cause its profits to:

- A) increase.
- ✓ B) decrease.
- C) remain unchanged.
- D) either increase or decrease depending upon the size of the interest-rate increase.

**Feedback:**

**LOD: 2**

**Bank Risk: Where It Comes From and What to Do about It.**

## Quiz # 24

**Q#1**

A bank's capital equals:

- A) total bank assets + total bank liabilities.
- B) total bank liabilities – total bank assets.
- ✓ C) total bank assets – total bank liabilities.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#2**

Bank capital accounts for approximately \_\_\_\_\_ of the liabilities of commercial banks.

- A) 1%

B) 10%

C) 50%

D) 100%

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#3**

The assets of a bank directly represents its:

A) sources of funds.

B) uses of funds.

C) net worth.

D) total profits.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#4**

The sources of a bank's funds is represented by its:

A) assets.

B) liabilities.

C) profits.

D) vault cash.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks**

**Q#5**

Vault cash is a(n):

A) asset of a bank.

- B) liability of a bank.
- C) measure of the capital of the bank.
- D) measure of the bank's profits.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks**

**Q#6**

A bank's reserves includes:

- A) checkable deposits.
- B) loans.
- C) government securities.
- ✓ D) deposits at the Fed.**

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#7**

The term "secondary reserves" is sometimes used to refer to a bank's:

- A) mortgage loans.
- B) capital.
- C) vault cash.
- ✓ D) holdings of government securities.**

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#8**

Which of the following is *not* held by commercial banks as a component of their assets?

- A) U.S. government bonds
- ✓ B) common stock**

- C) mortgage loans
- D) consumer loans

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#9**

A bank may meet its short-term borrowing needs by:

- ✓ **A) engaging in repurchase agreements.**
- B) buying government securities.
- C) issuing more mortgage loans.
- D) None of the above is correct.

**Q#10**

If a bank has \$400 million in assets and a net worth of \$50 million, its debt to equity ratio is:

- A) 10 to 1.
- ✓ **B) 7 to 1.**
- C) 8.75 to 1.
- D) 8 to 1.

**Feedback:**

**LOD: 3**

**The Balance Sheet of Commercial Banks.**

**Q#11**

Over the past 40 years, checking account balances, as a proportion of a bank's liabilities, have:

- A) declined as depositors have shifted their funds into interest-bearing assets.
- ✓ **B) increased since more of these accounts now pay interest.**
- C) not changed as a share of a bank's liabilities.

**D)** remained a trivial share of a bank's liabilities because most checking account balances are part of bank assets, not bank liabilities.

**Feedback:**

**LOD: 1**

**The Balance Sheet of Commercial Banks.**

**Q#12**

Banks with reserve shortfalls may:

**A)** borrow reserves from the Fed in the form of discount loans.

**B)** borrow money from other banks in the federal funds market.

**C)** sell securities to acquire additional reserves.



**D) All of the above are correct.**

**Q#13**

An increase in a bank's capital, holding its assets and net profits constant:

**✓ A) reduces the return on equity.**

**B)** increases the return on equity.

**C)** has no effect on the return on equity.

**D)** has an unpredictable effect on a bank's return on equity.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#14**

If a bank's interest-rate spread increases, its profits will:

**✓ A) increase.**

**B)** decrease.

**C)** remain unchanged.

**D)** change in an unpredictable manner.

**Feedback:**

**LOD: 2**

**The Balance Sheet of Commercial Banks.**

**Q#15**

Suppose that a bank has deposits of \$400 million and reserves that total \$45 million. If the bank has a required reserve rate of 10 percent, then this bank has:

- A) no excess reserves.
- ✓ B) excess reserves of \$5 million.
- C) excess reserves of \$10 million.
- D) a reserve shortfall of \$5 million.

**Feedback:**

**LOD: 3**

**Bank Risk: Where it Comes From and What to Do About It.**

**Q#16**

A bank may reduce its liquidity risk by:

- A) primarily issuing long-term mortgage loans.
- B) reducing its holdings of securities and increasing its loans.
- ✓ C) holding more excess reserves.
- D) offering more loan commitments.

**Feedback:**

**LOD: 2**

**Bank Risk: Where it Comes From and What to Do About It.**

**Q#17**

A bank may reduce its credit risk by:

- ✓ A) diversifying its loan portfolio.
- B) charging a high interest rate to all loan customers.
- C) only making consumer loans.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Bank Risk: Where it Comes From and What to Do About It.**

**Q#18**

A bank is subject to more interest-rate risk when:

**✓ A) it possesses a large gap (either positive or negative) between its interest-rate sensitive assets and interest-rate sensitive liabilities.**

**B) its holding of interest-rate sensitive assets matches its holding of interest-rate sensitive liabilities.**

**C) it holds a large (and equal) volume of both interest-rate sensitive assets and interest-rate sensitive liabilities.**

**D) None of the above is correct.**

**Feedback:**

**LOD: 2**

**Bank Risk: Where it Comes From and What to Do About It.**

**Q#19**

If a bank has more interest-rate sensitive assets than interest-rate sensitive liabilities, a 1% increase in the interest rate on interest-rate sensitive assets and interest-rate sensitive liabilities will cause its profits to:

**✓ A) increase.**

**B) decrease.**

**C) remain unchanged.**

**D) either increase or decrease depending upon the size of the interest-rate increase.**

**Feedback:**

**LOD: 2**

**Bank Risk**

## **Quiz # 25**

**Q#1**

The U.S. is unusual when compared to Canada or Japan in that the U.S.:

A) has banks that are privately owned, where banks in the other countries are public institutions.

B) has fewer banks than Japan but more than Canada.

✓ C) has more banks than either Japan or Canada.

D) has more banks than Japan but fewer than Canada.

**Feedback:**

**LOD: 1**

**Financial Industry Structure.**

**Q#2**

The *dual banking system* in the U.S. today refers to:

A) a bank's ability to issue checking and saving accounts.

✓ B) the ability of banks to be either federally or state chartered.

C) a bank's ability to own another financial institution.

D) the ability of a depository institution to be both a commercial bank and a savings and loan simultaneously.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#3**

A bank exerts some control over who will regulate it because:

A) banks spend a lot of money contributing to political campaigns.

B) the bank pays the salary of the regulator.

C) bank stockholders vote on which regulator will oversee their bank.

✓ D) banks can switch their charter from state to federal and vice versa.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#4**

Prior to the passage of the National Banking Act of 1863, paper currency was issued by:



- A) the Federal Reserve Board.
- B) the U.S. Treasury.
- C) the Comptroller of the Currency.
- ✓ D) state-chartered banks.**

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#5**

In the early years of the Great Depression, 1929 – 1933:

- ✓ A) more than a third of all U.S. banks failed.**
- B) two-thirds of U.S. banks failed.
- C) over three-fourths of all U.S. banks failed.
- D) a little less than one-quarter of U.S. banks failed.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#6**

Which of the following most accurately describes the state of banking in the U.S.?

- A) a large number of large banks and a small number of small banks
- ✓ B) a large number of small banks and a small number of large banks**
- C) a small number of large and small banks
- D) a large number of large and small banks

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#7**

The *actual* results of the McFadden Act included:

- A) increased efficiency of banking across the country.

B) a very competitive banking system.

✓ C) a reduction in competition in the banking industry.

D) the creation of an incentive system that encouraged banks to become larger by exploiting economies of scale.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#8**

Over the last twenty years in the U.S., the number of banks has:

✓ A) steadily decreased.

B) stayed about the same.

C) increased about 10 percent a year.

D) more than doubled.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#9**

The Bank Holding Act of 1956:

A) limited bank holding companies to operating only within their chartered state.

✓ B) significantly broadened the scope of what bank holding companies could do.

C) limited the scope of bank holding companies in terms of services offered.

D) a and b

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#10**

The Reigle-Neal Act has resulted in:

- A) higher interest rates paid to depositors.
- B) increased profitability for larger and more efficient banks.
- C) lower interest rates on loans issued by banks.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#11**

Eurodollars are:

- ✓ A) dollar-denominated deposits in foreign banks.
- B) euro-denominated deposits in U.S. banks.
- C) the official currency of the European Economic Union.
- D) dollars that are specially printed for use in the European Union countries to minimize counterfeiting.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#12**

In which of the following ways does term life insurance differs from whole life?

- A) Whole life has a variable premium over the life of the policy, increasing as the policyholder gets older; term life has a premium the policyholder pays once and the policy is in force until death.
- B) Term life has a savings component whole life is pure insurance.
- C) Term life is usually more expensive than whole life.
- ✓ D) Whole life is a combination of term life insurance and a savings account.

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

**Q#13**

An insurance company provides liability insurance to a bakery protecting the owner against claims from customers. One area of coverage is protection against food poisoning claims. The insurance company may periodically send an employee into the bakery to observe food preparation and food storage processes. The insurance company is trying to avoid:

- A) bad publicity.
- B) adverse selection.
- ✓ C) moral hazard.
- D) transaction costs.

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

**Q#14**

Health and life insurance companies generally require a physical exam before an insurance policy is issued. If serious health problems are found, insurance is not provided. Insurance companies do this as a way of dealing with the \_\_\_\_\_ problem.

- A) moral hazard
- ✓ B) adverse selection
- C) transaction cost
- D) inflation

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

**Q#15**

The reinsurance market is characterized as:

- A) a few buyers and many sellers.
- ✓ B) many buyers and a few sellers.
- C) a monopoly since reinsurance is provided by the government.
- D) many buyers and sellers.

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

**Q#16**

Pension funds resemble insurance companies in that they:

- A) pool the savings of many investors.
- B) spread risk.
- C) accept deposits.
- ✓ D) a and b**

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

**Q#17**

Finance companies perform which of the following functions?

- ✓ A) issue commercial paper and securities**
- B) take deposits
- C) issue certificates of deposit
- D) offer demand deposit accounts

**Feedback:**

**LOD: 1**

**Nondepository Institutions.**

**Q#18**

Fannie Mae, Ginnie Mae, and Freddie Mac are examples of:

- A) private regulatory bodies that supervise home mortgage lenders.
- B) government-sponsored agencies that were chartered to encourage small business loans.
- ✓ C) government-sponsored agencies chartered to encourage home lending.**

**D)** government-sponsored agencies that provide homeowner's insurance to people that cannot obtain it from private insurers.

**Feedback:**

**LOD: 2**

**Nondepository Institutions.**

## **Quiz # 26**

**Q#1**

The U.S. banking system is said to be a dual banking system because:

- A) banks may operate as either savings banks or commercial banks.
- B) each bank operates using both its physical banking facilities and ATMs.
- C) each bank provides other financial services in addition to banking.
- ✓ D) None of the above is correct.**

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#2**

Throughout much of the past century, it was often difficult for federal regulatory agencies to impose strong restrictions on banks because:

- A) the U.S. government has preferred to rely on markets rather than regulation to encourage banks to engage in sound banking practices.
- B) state banking authorities generally imposed more restrictive policies on banks.
- C) the U.S. Congress specifically exempted banks from federal regulation.
- ✓ D) banks could choose to pursue state charters if federal policies were more restrictive than state policies.**

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#3**

Which of the following is a correct description of the banking structure of the U.S. during the past 20 years?

A) The number of banks has been rising rapidly in the U.S., but it is still below the number of banks in Canada and Japan.

B) The number of banks in the U.S. has been stable, but there are more banks in the U.S. than in the U.S. and Japan.

**✓ C) The number of banks has been declining in the U.S., but there are still more banks in the U.S. than in Canada or Japan.**

D) The number of banks has been declining in the U.S. and there are fewer banks in the U.S. than in Canada or Japan.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#4**

The National Banking Act of 1863:

A) effectively eliminated paper currency issues by state chartered banks.

B) allowed the creation of nationally chartered banks.

C) created the dual banking system that is still in existence in the U.S.

**✓ D) All of the above are correct.**

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#5**

During the years 1929 to 1933:

A) the U.S. banking system became much more stable than it had been in earlier years.

B) the U.S. began the process of introducing a dual banking system.

**✓ C) about a third of U.S. banks failed.**

D) less than 10% of U.S. banks failed.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#6**

In 1935, most banks had:

- A) only one branch.**
- B) two or three branches.
- C) five to ten branches.
- D) dozens of branches.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#7**

The McFadden Act:

- A) allowed banks to branch across state lines.
- B) resulted in a reduction in the total number of banks in the U.S.
- C) subjected nationally chartered banks to the branching restrictions imposed on state chartered banks.**
- D) increased concentration in the banking industry.

**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#8**

Changes in the number of banks in the U.S. since the passage of the Reigle-Neal Interstate Banking and Branching Efficiency Act of 1994 suggest that, under the McFadden Act, banks were:

- A) not fully able to realize economies of scale.**
- B) too large.
- C) operating at an efficient scale.
- D) None of the above is correct.



**Feedback:**

**LOD: 1**

**Banking Industry Structure.**

**Q#9**

The Reigle-Neal Act has resulted in:

- A) lower total profits for commercial banks.
- B) higher interest rates on loans issued by banks.
- ✓ C) higher interest rates paid by banks on deposits.
- D) All of the above are correct.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#10**

Eurodollar deposits:

- A) are dollar-denominated deposits held by banks outside of the U.S.
- B) are not subject to U.S. banking regulations.
- C) provide higher interest-rates than deposits in domestic U.S. banks.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#11**

The interest rate at which banks lend eurodollars to each other is called the:

- A) discount rate.
- B) eurodollar lending rate.
- ✓ C) London Interbank Offered Rate.
- D) international funds rate.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#12**

Large financial holding companies may be more profitable than smaller banks as a result of:

- A) economies of scale.
- B) economies of scope.
- C) Both of the above are correct.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Banking Industry Structure.**

**Q#13**

Whole life insurance plans differ from term life insurance plans in that whole life plans:

- A) have a savings component as well as an insurance component.
- B) have only an insurance component and do not have a savings component.
- C) provide insurance throughout an individual's life while term life plans may only be granted to individuals between the ages of 18 and 50.
- D) None of the above is correct.

**Feedback:**

**LOD: 1'**

**Nondepository Institutions.**

**Q#14**

Physical exams are used to screen applicants for health and life insurance plans to.

- A) reduce the moral hazard problem associated with these forms of insurance.
- B) reduce the adverse selection problem associated with these forms of insurance.
- C) to reduce both the moral hazard and adverse selection problems associated with these forms of insurance.

D) None of the above is correct.

**Feedback:**

**LOD: 1'**

**Nondepository Institutions.**

**Q#15**

A moral hazard problem exists with health insurance contracts because:

A) most people that buy insurance are immoral.

B) the people that buy insurance are those that are most at risk of illness.

**✓ C) individuals that have insurance face a lower cost of medical services and respond by consuming more services.**

D) None of the above is correct.

**Feedback:**

**LOD: 1'**

**Nondepository Institutions.**

**Q#16**

Reinsurance firms:

A) insure risks for insurance companies that cannot get regular insurance coverage since they have had too many claims in the past.

**✓ B) are used so that insurance companies can issue large policies while maintaining a diversified mix of insurance policies.**

C) are no longer legal in the U.S.

D) are the companies that provide car insurance to new drivers.

**Feedback:**

**LOD: 1'**

**Nondepository Institutions.**

**Q#17**

Under a defined contribution pension plan, the risk of financial market fluctuations is borne by:

**✓ A) workers.**

B) employers.

C) the government.

D) All of the above.

**Feedback:**

**LOD: 1**

**Nondepository Institutions.**

**Q#18**

Investment banks:

A) provide stock underwriting services.

B) provide advice to firms concerning mergers and acquisitions.

C) attempt to buy newly issued stock and sell it at a higher price in the secondary market.

✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**Nondepository Institutions**

## **Quiz # 27**

**Q#1**

A bank faces a tradeoff that can impact its likelihood of failure in that:

A) banks that are operating in more competitive markets tend to be less efficient than banks that are monopolies in their local market.

✓ B) more profitable banks tend to be less liquid and more likely to fail.

C) the greater the regulation from government the more likely the bank will fail.

D) the larger the bank in asset size the more likely it will fail.

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#2**

What matters most during a bank run is:

**✓ A) the liquidity of the bank.**

**B) the solvency of the bank.**

**C) the number of depositors.**

**D) All of the above.**

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#3**

The federal government is concerned about the health of the banking system for many reasons; the most important of which may be that:

**A) banks are where government bonds are traded.**

**B) a significant number of people are employed in the banking industry.**

**✓ C) banks are of great importance in enabling the economy to operate efficiently.**

**D) many people earn the majority of their income from interest on bank deposits.**

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#4**

Contagion effects occur, in the absence of deposit insurance, because:

**A) when one bank becomes insolvent, most banks generally become insolvent.**

**B) U.S. banking regulations effectively guarantee that all banks will receive the same level of profits or losses.**

**✓ C) there is asymmetric information concerning the solvency of banks.**

**D) bank failures tend to occur more frequently during periods of rapid economic growth.**

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#5**

It is difficult for depositors to know the true health of banks because:

- A) regulations prohibit this information from being made public.
- ✓ B) most of the information on bank loans is private and based on sophisticated models.
- C) the financial statements of banks are too difficult for most people to understand.
- D) banking is competitive and financial records of banks are not divulged to prevent competitor banks from having an advantage.

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#6**

The government provides deposit insurance, which protects:

- A) large corporate deposit accounts, but only the amounts that exceed the \$100,000 deductible.
- B) the deposits of banks in their Federal Reserve accounts.
- ✓ C) depositors for up to \$100,000 should a bank fail.
- D) the deposits that people have, but only for federally chartered banks.

**Feedback:**

**LOD: 1**

**The Government Safety Net.**

**Q#7**

One of the unique problems that banks face is that:

- ✓ A) they hold illiquid assets to meet liquid liabilities.
- B) they hold liquid assets to meet illiquid liabilities.
- C) they hold liquid assets to meet liquid liabilities.

D) both banks' assets and liabilities are illiquid.

**Feedback:**

**LOD: 1**

**The Government Safety Net.**

**Q#8**

If the lender of *last resort function* of the government is to be effective in minimizing a crisis it must be:

- ✓ A) credible, with banks knowing they can get loans quickly.
- B) used on a limited basis.
- C) reserved only for those banks which are most deserving.
- D) very difficult for banks to obtain to minimize moral hazard.

**Feedback:**

**LOD: 2**

**The Government Safety Net.**

**Q#9**

With deposit insurance:

- A) depositors need to involve themselves with the risk taking by bank managers.
- B) the deposits of a bank customer are insured up to the amount on deposit.
- ✓ C) there is a creation of potential moral hazard by bank managers.
- D) All of the above are correct.

**Feedback:**

**LOD: 2**

**The Government Safety Net.**

**Q#10**

Under the *purchase and assumption method* of dealing with a failed bank, the FDIC:

- A) sells the failed bank to the Federal Reserve.
- ✓ B) finds another bank to take over the insolvent bank.

C) takes over the day-to-day management of the bank.

D) sells off the profitable loans of the failed bank in an open auction.

**Feedback:**

**LOD: 2**

**The Government Safety Net.**

**Q#11**

Which of the following statements is *incorrect*?

A) The higher the deposit insurance limit the higher the risk of moral hazard.

B) The lower the deposit insurance limit the lower the risk of moral hazard.

**✓ C) Deposit insurance limits do not impact moral hazard, they only impact adverse selection.**

D) Increasing the deposit insurance limits above \$100,000 would increase coverage for relatively few depositors.

**Feedback:**

**LOD: 2**

**The Government Safety Net.**

**Q#12**

The government's *too-big-to-fail* policy applies to:

A) a bank run in specific highly populated states which impacts a large percent of the total population.

B) banks that have branches in more than two states.

C) large corporate payroll accounts held by some banks where many people would lose their income.

**✓ D) large banks whose failure would certainly start a widespread panic in the financial system.**

**Feedback:**

**LOD: 1**

**The Government Safety Net.**

**Q#13**

The *too-big-to-fail* policy results in a moral hazard problem that:



A) is larger in small banks.

✓ B) is larger in large banks.

C) affects large and small banks equally.

D) is smaller than the moral hazard problem that would exist in the absence of this policy.

**Feedback:**

**LOD: 1**

**The Government Safety Net.**

**Q#14**

You have savings accounts at two separately FDIC insured banks. At one of the banks your account has a balance of \$70,000. At the other bank the account balance is \$65,000. If both banks fail you will receive:

A) \$100,000.

✓ B) \$135,000.

C) \$70,000.

D) \$67,500.

**Feedback:**

**LOD: 2**

**The Government Safety Net.**

**Q#15**

One reason that financial regulations restrict the assets that banks can own is to:

A) limit the growth rate of banks.

✓ B) combat the moral hazard that government safety nets provide.

C) prevent banks from being too profitable.

D) keep banks from spending lavishly on perks for executives.

**Feedback:**

**LOD: 1**

**Regulation and Supervision of the Financial System.**

**Q#16**

One reason a bank officer may be reluctant to write off a past-due loan is:

- A) it will decrease the bank's assets and capital.**
- B) it will increase the bank's liabilities.
- C) it will increase the bank's liabilities and assets, requiring more capital to be held.
- D) Bank officers are not reluctant to write-off past due loans.

**Feedback:**

**LOD: 2**

**Regulation and Supervision of the Financial System.**

**Q#17**

The CAMELS ratings are:

- A) made public monthly to the financial markets so people can judge the relative quality of banks.
- B) published once a quarter in banking journals issued by the Federal Reserve.
- C) not made public.**
- D) included in the annual report of publicly owned banks.

**Feedback:**

**LOD: 1**

**Regulation and Supervision of the Financial System**

## **Quiz # 28**

**Q#1**

Banks that are more liquid are generally:

- A) also more profitable than less liquid banks.
- B) as profitable as less liquid banks.
- C) less profitable than less liquid banks.**

D) more likely to fail.

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#2**

The main factor in whether a bank can survive a bank run during a bank panic is the bank's:

A) profitability.

**✓ B) liquidity.**

C) solvency.

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#3**

A bank is illiquid if:

A) it is insolvent.

**✓ B) it has insufficient liquid assets to cover deposit outflows.**

C) its bank capital is less than the required level.

D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#4**

Government officials have generally taken an active role in attempting to prevent widespread bank failures primarily because of concern over:

A) the loss of jobs by bank employees when banks fail.

**✓ B) contagion effects.**

C) the loss of profits by bank owners.

D) the increase in inflation that inevitably results from widespread bank failures.

**Feedback:**

**LOD: 2**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#5**

Which of the following has historically been a factor in causing a bank panic?

- A) an economic recession
- B) deflation
- C) declines in bank capital due to rising loan defaults
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Sources and Consequences of Runs, Panics, and Crises.**

**Q#6**

The government regulates and protects the banking system more heavily than most other industries because:

- A) small investors in the banking industry have imperfect information concerning the soundness of banks.
- B) mergers of large banks could result in a reduction in competition and harm both depositors and borrowers.
- C) banks are inherently unstable since poor decisions can result in a very rapid failure of a bank.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Government Safety Net**

**Q#7**

Banks face risks that differ from those faced by nondepository institutions in that banks primarily hold:

- A) liquid assets and liquid liabilities.
- B) illiquid assets and illiquid liabilities.
- C) liquid assets and illiquid liabilities.
- ✓D) illiquid assets and liquid liabilities.**

**Feedback:**

**LOD: 1**

**The Government Safety Net**

**Q#8**

The rationale for the "lender of last resort" function of central banks is to:

- A) provide low-income households with access to mortgage loans.
- B) increase bank lending to firms that are at risk of bankruptcy.
- ✓C) reduce the likelihood of the contagion effect.**
- D) encourage banks to hold more reserves.

**Feedback:**

**LOD: 1**

**The Government Safety Net**

**Q#9**

The FDIC provides insurance that covers:

- A) only deposits in savings banks.
- B) only deposits in commercial banks.
- C) deposits in nationally chartered banks, but not deposits in state-chartered banks.
- ✓D) deposits up to \$100,000 in checking and savings accounts at most U.S. banks.**

**Feedback:**

**LOD: 1**

**The Government Safety Net**

**Q#10**

The existence of deposit insurance:

A) reduces the moral hazard problem for bank managers.

**✓ B) increases the moral hazard problem for bank managers.**

C) has no effect on the moral hazard problem for bank managers.

D) increases the moral hazard problem for managers in small banks but reduces it for managers in large banks.

**Feedback:**

**LOD: 2**

**The Government Safety Net**

**Q#11**

If the FDIC uses the payoff method to resolve the insolvency of a bank:

**✓ A) a merger is arranged with another bank that is "paid off" by the FDIC to take over the failed bank.**

B) the bank continues operations under FDIC supervision.

C) bribes are paid to the appropriate Senators to allow the bank to continue operations.

D) depositors will lose any balances over \$100,000 on deposit at the bank.

**Feedback:**

**LOD: 2**

**The Government Safety Net**

**Q#12**

Under the too-big-too-fail policy, the nation's largest banks have:

A) more incentive to avoid making risky loans than do small banks.

**✓ B) more incentive to make risky loans than do small banks.**

C) an incentive to sell off some of their assets to become smaller.

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Government Safety Net**

**Q#13**

Bank regulations designed to reduce the risk of bank failure include:

- A) the use of risk-based capital requirements.
- B) restrictions on asset holdings.
- ✓ C) Both of the above are correct.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Regulation and Supervision of the Financial System**

**Q#14**

Regulatory competition:

- A) reduces the incentives for regulators to innovate.
- ✓ B) may result in banks choosing to be regulated by the agencies that impose the least stringent requirements on them.
- C) Both of the above are correct.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Regulation and Supervision of the Financial System**

**Q#15**

Increased competition among banks:

- ✓ A) raises the interest rate that depositors receive on their deposits.
- B) raises the interest rates that borrowers pay on their loans.
- C) tends to reduce the quality of the services that banks provide.
- D) encourages banks to take on less risk.

**Feedback:**

**LOD: 1**

**Regulation and Supervision of the Financial System**

## Quiz # 29

### Q#1

The central bank in the United States is:

- A) the Bank of America.
- B) the U.S. Treasury.
- ✓ C) the Federal Reserve.
- D) the Bank of The United States.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

### Q#2

Many governments give their central bank control over issuing currency because:

- A) the only way to distribute currency to banks is through the central bank.
- B) having large amounts of currency can lead to lower rates of inflation.
- C) central banks use the profits from issuing currency to finance their operations.
- ✓ D) printing currency can be profitable for a government, so government officials may have a strong incentive to print too much.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

### Q#3

Monetary policy in the United States is under the control of the:

- ✓ A) Federal Reserve.
- B) President.
- C) U. S. Treasury.
- D) U.S. Senate.



**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#4**

Central banks perform each of the following EXCEPT:

- A) issuing currency.
- B) serving as the government's bank.
- C) controlling the availability of money and credit.
- ✓ D) managing fiscal policy.

**Feedback:**

**LOD: 3**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#5**

A central bank typically:

- A) facilitates interbank payments.
- B) controls the money supply.
- C) has a monopoly in printing currency.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#6**

The specific goals of central banks include each of the following EXCEPT:

- A) high and stable real growth.
- B) low and stable inflation.
- ✓ C) high levels of imports.
- D) low and stable unemployment rates.

**Feedback:**

**LOD: 1**

**Stability: The Primary Objective of All Central Banks.**

**Q#7**

If prices are not stable:

- A) money performs better as a unit of account.
- ✓ B) money becomes less useful as a store of value.
- C) it may be an inconvenience, but resources are still allocated efficiently.
- D) None above given

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#8**

Low and stable inflation implies:

- A) that the rate of inflation *averaged* over many years is zero (0).
- B) low rates of economic growth.
- ✓ C) that the rate of inflation year after year is low.
- D) low rates of unemployment.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#9**

Everything else equal, if the growth rate of a country exceeds its sustainable rate, then the central bank:

- A) will keep interest rates low to keep the momentum.
- ✓ B) is likely to raise interest rates to slow the rate of growth.
- C) will now identify this new rate as the sustainable rate and try to maintain it.
- D) is likely to lower the interest rate thinking a slowdown is coming to offset this boom.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#10**

The Fed and other central banks often have a positive, rather than a zero, inflation rate target because:

- ✓ **A) a zero inflation rate target introduces a risk of deflation.**
- B) economic growth is higher when inflation is higher.
- C) politicians prefer having a higher inflation rate because this raises incomes and purchasing power for everyone.
- D) None of the above is correct.

**Q#11**

Successful monetary policy relies on:

- A) luck.
- B) the institutional environment.
- C) competent people in responsible positions.
- D) knowledgeable citizens who know how to react to the policy.
- ✓ E) b and c

**Feedback:**

**LOD: 2**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#12**

The idea that central banks should be independent of political pressure is an idea that:

- A) the Federal Reserve Act included in 1913.
- ✓ **B) is relatively new.**
- C) every central bank was founded upon.
- D) became quite popular in the early 1900s.

**Feedback:**

**LOD: 1**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#13**

The operational components required for truly independent central banks include:

**✓ A) monetary policies that cannot be reversed by anyone outside of the central bank.**

B) the ability to have policies reversed.

C) a budget controlled by Congress.

D) the chairperson of the bank being answerable only to the president.

**Feedback:**

**LOD: 2**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#14**

One argument for an independent central bank is:

A) without independence, competent people would not take a position in a central bank.

**✓ B) successful monetary policy requires a long time horizon; one that is usually well beyond the next election of most public officials.**

C) politicians have a long-run focus that is not well tuned to addressing economic problems.

D) central bankers have a short-run focus that usually corrects problems faster.

**Feedback:**

**LOD: 2**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#15**

The means for assuring *accountability* and *transparency*:

A) are the same for all successful central banks.

**✓ B) are different across the central banks of most countries.**

C) involve setting specific numerical targets so there is no confusion as to what the goal is.

D) All of the above.

**Feedback:**

**LOD: 1**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#16**

One reason given for more central bankers releasing their decisions publicly is:

A) to let the public debate the appropriateness of monetary policy decisions.

B) most people do not understand monetary policy, so it really doesn't do any harm to release the decisions publicly.

**✓ C) that for monetary policy to be stabilizing, speculation about central bankers decisions should be minimized.**

D) so that central banks across the world can coordinate their policies.

**Feedback:**

**LOD: 2**

**Meeting the Challenge: Creating a Successful Central Bank.**

**Q#17**

One thing that is true about economic policy in the U.S. is that:

**✓ A) monetary and fiscal policy often times conflict.**

B) fiscal and monetary policy never conflict.

C) monetary policy ultimately controls fiscal policy since the Fed controls the money supply.

D) fiscal policy ultimately controls monetary policy since Congress can control the Fed's budget.

**Feedback:**

**LOD: 1**

**Fitting Everything Together: Central Banks and Fiscal Policy**

## **Quiz # 30**

**Q#1**

A central bank typically:

- A) has a monopoly in issuing currency.
- B) use monetary policy in attempts to stabilize economic growth and/or inflation.
- C) serves as a "bankers' bank" that provides services to other banks.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#2**

The primary reason for the existence of central banks today is to:

- A) help finance wars.
- B) serve as a bank for the government, accepting deposits and providing the government with checkable deposits.
- ✓ C) control the money supply.
- D) stabilize the prices of specific commodities.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#3**

Monetary policy in the countries that are part of the European Monetary Union is controlled by the:

- ✓ A) European Central Bank.
- B) central banks of each of the member countries.
- C) Federal Reserve Board.

D) Bank of England.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#4**

Which of the following tasks is **NOT** performed by a central bank as part of its role as a "bankers' bank?"

- ✓
- A) providing loans to banks during periods of financial stress
  - B) managing the payments system
  - C) **controlling stock prices**
  - D) accepting deposits from banks

**Q#5**

Central banks can serve as a lender of last resort because:

- ✓ A) **they have the ability to create money.**
- B) they are the only financial institution that is legally allowed to make loans during a financial panic.
- C) the interest rates they charge are so high that banks are virtually never willing to borrow from the Fed.
- D) banks are more likely to borrow money from their depositors during a financial panic.

**Feedback:**

**LOD: 2**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#6**

Fedwire:

- A) is a financial news network developed by the Federal Reserve Board.
- ✓ B) **is used for interbank transfers.**
- C) was once heavily used by banks, but is rarely used today since there is little need for interbank transfers now that the internet exists.
- D) is used by the Fed solely to make loans to member banks.

**Feedback:**

**LOD: 1**

**The Basics: How Central Banks Originated and Their Role Today.**

**Q#7**

Historical evidence indicates that the U.S. financial system is:

- A) always very stable as long as the government does not imposed any regulations.
- ✓ B) prone to periods of instability that have imposed substantial costs on society.**
- C) somewhat unstable, but this does not matter much since the social cost of the instability is always low.
- D) as unstable today as it was in the late 1800s.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#8**

One of the main objectives of a central bank is to:

- A) reduce idiosyncratic risk in financial markets.
- ✓ B) reduce systematic risk in financial markets.**
- C) encourage a low and stable rate of economic growth.
- D) achieve a high and stable inflation rate.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#9**

Central banks generally place a great deal of emphasis on maintaining a low and stable inflation rate because:

- A) inflation lowers the information content of prices.
- B) economic growth tends to decline as inflation rates rise.
- C) inflation tends to be less predictable when inflation rates rise.
- ✓ D) All of the above are correct.**



**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#10**

Central banks usually establish a positive inflation rate target rather than a zero inflation rate target because:

A) economic growth is higher when the inflation rate rises.

**✓ B) a positive inflation rate makes it possible for firms to reduce real wages without reducing nominal wages, leading to more efficient labor markets.**

C) the Fed is a more profitable operation for the government when the inflation rate is positive.

D) a higher inflation rate results in a higher unemployment rate, and higher unemployment rates are preferred by policymakers.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#11**

Which of the following is *not* a primary objective of the Fed?

A) low and stable inflation

B) high and stable real growth

C) financial system stability

**✓ D) maintaining low interest rates**

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#12**

Exchange-rate stability is:

A) a more important goal for the Fed than it is for the central banks of smaller and more trade-oriented economies.

**✓ B) a less important goal for the Fed than it is for the central banks of smaller and more trade-oriented economies.**

C) equally important as a goal for the Fed as it is for the central banks of smaller and more trade-oriented economies.

D) a primary objective of the Fed.

**Feedback:**

**LOD: 2**

**Stability: The Primary Objective of All Central Banks.**

**Q#13**

Which of the following is *not* generally a characteristic of a successful central bank?

A) Central bank policy must be controlled by the same authorities.

B) Central bank decisions must be made in private and policy should not be publicly announced.

C) Decision making should be made by an individual, not a committee, to ensure consistency of goals.

**✓ D) The central bank should operate within a framework in which it has clear goals.**

**Feedback:**

**LOD: 1**

**Stability: Meeting the Challenge: Creating a Successful Central Bank**

**Q#14**

Central bank independence is:

A) not very common in industrialized countries today.

B) a practice that was widely adopted by central banks for industrialized countries in the late 1800s.

**✓ C) a relatively recent historical phenomenon.**

D) a policy that is practiced by the European Central Bank, but not the Fed.

**Feedback:**

**LOD: 2**

**Stability Meeting the Challenge: Creating a Successful Central Bank**

**Q#15**

Empirical evidence suggests that a higher level of central bank independence results in:

A) higher average inflation rates than occur in countries with less independent central banks.

✓ **B) lower average inflation rates than occur in countries with less independent central banks.**

C) the same average inflation rates that occur in countries with less independent central banks.

D) lower rates of economic growth than occurs in countries with less independent central banks.

**Q#16**

A source of conflict between monetary and fiscal policy decision makers is that:

A) fiscal policy decision makers place more emphasis on short-term objectives while monetary policy makers focus on long-term objectives.

B) it is easier, from a political standpoint, to pay for increased government spending by a monetary expansion than by raising taxes.

✓ **C) Both of the above are correct.**

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Fitting Everything Together: Central Banks and Fiscal Policy**

## **Quiz # 31**

**Q#1**

The three branches of the Federal Reserve System include each of the following EXCEPT the:

A) Board of Governors.

B) Federal Open Market Committee.

✓ **C) Comptroller of the Currency.**

D) twelve regional Reserve Banks.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#2**

The Federal Reserve was created in:

- A) 1939.
- B) 1919.
- C) 1929.
- D) 1913.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#3**

Currently the requirement of holding a non-interest earning reserve account at the Fed must be met by:

- A) only nationally chartered banks.
- B) only member banks.
- C) member banks and non-member banks over \$100 million in assets.
- D) all banks, member or not.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#4**

The Federal Reserve Districts are a product of:

- A) economic and political forces as well as population distribution.
- B) solely economic forces that existed at the time of the Federal Reserve Act.
- C) economic and political forces that existed at the time the Fed was formed.

- D) solely population distribution at the time of the Federal Reserve Act.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#5**

In its role as the *government's bank*, the Federal Reserve performs all of the following services EXCEPT:

- A) issue new currency.
- B) manage U.S. Treasury borrowings.
- C) maintain the U.S. Treasury's bank account.
- ✓ D) provide discount loans.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#6**

Open market operations are conducted at the \_\_\_\_\_ Fed.

- ✓ A) New York
- B) Richmond
- C) Chicago
- D) San Francisco

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#7**

Buying and selling U.S. Treasury Securities for the Fed's own portfolio is called:

- A) managing the Treasury account.
- B) discount buying.
- ✓ C) open market operations.
- D) reserve adjustment.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#8**

The largest Federal Reserve District geographically is serviced by:

- A) the Reserve Bank in New York.
- B) the Reserve Bank in Chicago.
- ✓ C) **the Reserve Bank in San Francisco.**
- D) None of the above, since the districts are divided fairly equally geographically.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#9**

Current law regarding the Fed's Board of Governors stipulates that:

- ✓ A) **no more than one governor can come from the same district.**
- B) no more than two governors can come from the same district.
- C) every district must have at least one governor on the board.
- D) no more than three governors can come from the same district.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#10**

The permanent voting members on the FOMC include the:

- ✓ A) **President of the New York Fed.**
- B) Secretary of the Treasury.
- C) President of the Federal Reserve Bank of Atlanta.
- D) Director of the FDIC.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#11**

The federal funds rate is the interest rate:

- A) the Fed charges banks who borrow from them.
- B) the U.S. Treasury charges banks that need emergency funds.

**✓ C) banks charge each other for overnight loans of their excess reserves at the Fed.**

D) the FDIC charges banks who need to borrow from them to meet depositor demands.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#12**

The FOMC controls the *real* interest rate:

**✓ A) if inflation is slow to adjust.**

B) if inflation changes quickly.

C) only if they adjust the federal funds rate by an amount greater than the change in the rate of inflation.

D) None of the above.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#13**

FOMC meetings would best be described as:

**✓ A) fairly formal sessions with not much give and take.**

B) an informal meeting with the Chairman as a passive observer.

C) informal meetings with significant give and take among participants.

**D)** a press conference, where the financial press can ask questions regarding the Fed's view of the economy.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#14**

Which statement best completes the following sentence; "The U.S. dollar is to the fifty states as the euro is to the \_\_\_\_\_."

- A) European Central Bank
- B) European System of Central Banks
- C) National Central Banks
- ✓D) euro area**

**Feedback:**

**LOD: 2**

**The European Central Bank.**

**Q#15**

The Agreement to form a European monetary union was formalized in the Treaty of:

- A) Milan.
- B) Paris
- C) Versailles.
- ✓D) Maastricht.**

**Feedback:**

**LOD: 1**

**The European Central Bank.**

**Q#16**

One key difference concerning the communications from the Fed's FOMC and the European System's Governing Council is that the:

**✓A) president and vice-president of the Governing Council hold a news conference after their regular monthly meetings; the leaders of the FOMC hold no such conference.**



- B)** leaders of the FOMC answer questions from the financial press immediately after their meetings
- C)** Governing Council meetings are open to the public; the FOMC meetings are not.
- D)** the Chairman of the Fed lets his position be known before the FOMC meeting, where the President of the Governing Council does not.

**Feedback:**

**LOD: 2**

**The European Central Bank**

## Quiz # 32

**Q#1**

The U.S. Federal Reserve system was created in response to:

- A)** pressure from banks for more regulatory control over their actions.
- B)** demand from the U.S. Treasury for the introduction of a national currency (to replace the banknotes that were issued by state-chartered banks
- ✓C)** into the 1920s).
- D)** a series of 21 financial panics between 1870 and 1920.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#2**

Which of the following banks must belong to the Federal Reserve System?

- A)** all commercial banks
- B)** all savings banks
- ✓C)** all nationally chartered banks
- D)** all state chartered banks

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#3**

As a result of a 1980 change in banking law, state-chartered banks that are not members of the Federal Reserve system now:

- A) may hold their reserves in interest-bearing securities instead of in non-interest-bearing deposits at the Fed.
- B) **have the same reserve requirements as member banks.**
- C) receive lower interest rates on reserve holdings than do member banks.
- D) may no longer hold reserves at the Fed.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#4**

The boundaries of the Federal Reserve Districts:

- A) are altered every 5 years to reflect changing population density patterns in the U.S.
- B) **were set in 1914.**
- C) are altered every 5 years so that there are approximately an equal number of banks in each Federal reserve District.
- D) change annually in response to changing economic and population patterns.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#5**

The 12 Federal Reserve Banks that make up the Federal Reserve System are:

- A) federally chartered banks.
- B) private, non-profit organizations.
- C) owned by the commercial banks in their districts.

✓D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#6**

As the bank for the U.S. government, the Federal Reserve:

- A) issues new currency and destroys old currency.
- B) maintains bank accounts for the U.S. Treasury.
- C) manages U.S. Treasury borrowings.
- ✓D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#7**

As a bankers' bank, the Federal Reserve Banks of the Federal Reserve System:

- A) hold reserve deposits for banks in their districts.
- B) provide check-clearing and electronic fund transfer services.
- C) provide discount loans.
- ✓D) All of the above are correct.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#8**

The largest Federal Reserve District (in terms of geographical size) is serviced by the:

- A) New York Fed.
- B) Atlanta Fed.
- C) Dallas Fed.
- ✓D) San Francisco Fed.

**Q#9**

The discount rate today is, in practice, most directly set by the:

- A) FOMC.**
- B) President of the New York Fed.
- C) U.S. President.
- D) Comptroller of the Currency.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#10**

One of the factors designed to help provide autonomy for the Fed is:

- A) a 14-year nonrenewable term for members of the Board of Governors.**
- B) lifetime appointment for members of the Board of Governors.
- C) that the U.S. Constitution prohibits congressional control of the Fed.
- D) that the Fed is owned and controlled by the member banks, guaranteeing that the Fed engages in actions that benefit these banks.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#11**

Which of the following is *not* one of the duties of the Board of Governors?

- A) setting the reserve requirement
- B) administering consumer credit laws
- C) supervising and regulating the Federal Reserve District Banks
- D) establishing the exchange rate between the dollar and other currencies**

**Q#12**

The interest rate that the FOMC most directly attempts to control is the:

- A) prime rate.
- ✓ B) **federal funds rate.**
- C) mortgage interest rate
- D) student-loan interest rate.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#13**

The Fed may stimulate the economy by:

- A) raising the real interest rate.
- ✓ B) **lowering the real interest rate.**
- C) lowering the nominal interest rate, even if the real interest rate rises.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#14**

Under normal circumstances, the FOMC meets to establish monetary policy:

- A) once a week.
- ✓ B) **roughly every six weeks.**
- C) every six months.
- D) once a year.

**Feedback:**

**LOD: 1**

**The Structure of the Federal Reserve System.**

**Q#15**

The policy objectives provided by Congress to the Fed:

- A) provide a detailed statement of specific policy targets for inflation, unemployment, and economic growth.
- B) require that the Fed focus its efforts solely on maintaining a low inflation-rate target.
- C) require the Fed to focus solely on maintaining a low unemployment rate.
- ✓D) **only state broad policy objectives, but do not provide specific policy targets.**

**Feedback:**

**LOD: 2**

**The Structure of the Federal Reserve System.**

**Q#16**

Monetary policy in the countries that participate in the European Monetary Union is determined by the:

- A) Federal Reserve Board of Governors.
- B) Parliaments of each of the member countries.
- C) central banks for each of the member countries, each of which pursues a separate monetary policy.
- ✓D) **the European Central Bank.**

**Feedback:**

**LOD: 1**

**The European Central Bank.**

**Q#17**

The actual implementation of monetary policy in the European Monetary Union is conducted by the:

- ✓A) **central banks of the member countries.**
- B) European Central Bank.
- C) FOMC.
- D) Treasuries of the Member nations.

**Feedback:**

**LOD: 1**

**The European Central Bank**

## **Quiz # 33**

**Q#1**

A central bank's balance sheet would categorize each of the following as liabilities EXCEPT:

- A) currency.
- ✓ B) gold.
- C) securities.
- D) accounts of the commercial banks.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#2**

Which of the following is not an asset of a central bank?

- A) securities held by the central bank
- B) loans provided to commercial banks
- C) foreign exchange reserves held by the central bank
- ✓ D) currency issued by the central bank

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#3**

A liability of the central bank in functioning as a Banker's Bank is:

- A) currency.
- B) securities.

- C) loans.
- ✓ D) accounts of commercial banks.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#4**

If the Federal Reserve is to be independent, the quantity of securities it purchases is determined by:

- A) Congress.
- ✓ B) the Federal Reserve itself.
- C) the amount the public wants to purchase at the going price.
- D) the Treasury.

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q#5**

The central bank's balance sheet shows three basic assets. Which are needed so that the central bank can perform its role as the government's bank?

- ✓ A) securities and foreign exchange reserves
- B) securities and loans
- C) foreign exchange reserves and loans
- D) Securities, foreign exchange reserves, and loans are all needed for the central bank to serve as the government's bank.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet**

**Q#6**

For the Federal Reserve, the largest liability on the balance sheet is:

- ✓ A) non-bank currency.
- B) reserves.



- C) government accounts.
- D) Treasury certificates.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#7**

Reserves are:

- A) liabilities of the commercial and central banks.
- B) assets of the U.S. Treasury.
- C) assets of the central bank and liabilities of the commercial bank.
- D) assets of the commercial banks and liabilities of the central bank.

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q#8**

Monetary policy operations for central banks are run through changes in the liability category of:

- A) reserves.
- B) government's accounts.
- C) currency.
- D) gold.

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q#9**

The monetary base is the sum of:

- A) reserves and M2.
- B) M1 and reserves.

- C) non-bank currency, reserves, and M1.
- ✓D) non-bank currency and reserves.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#10**

One advantage a central bank has over other businesses, including banks, is that it:

- A) receives all of its funding from the government.
- B) doesn't have stockholders.
- ✓C) can control its balance sheet at will.
- D) doesn't have a board of directors.

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#11**

An open market purchase of U.S. Treasury securities by the Fed will cause the Fed's balance sheet to show:

- A) a decrease in the asset of securities and a decrease in the liability of reserves.
- B) a decrease in the liability of reserves.
- C) no change in the size of the balance sheet; however, the composition of assets will change from securities to cash.
- ✓D) an increase in the asset category of securities and an increase in the liability category of reserves.

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#12**

If the required reserve rate is ten percent and banks do not hold any excess reserves and there are no changes in currency holdings, a \$4 million open market purchase by the Fed will result in deposit creation of:

- ✓ A) \$40 million.
- B) \$36 million.
- C) \$20 million.
- D) \$18,000,000.

**Q#13**

If required reserves are expressed by RR, the required reserve rate by  $r_D$  and deposits by D, the simple deposit expansion multiplier is expressed as \_\_\_\_\_.

- A)  $r_D D$
- B)  $(1/r_D) D$
- ✓ C)  $1/r_D$
- D)  $r_D$  times 10

**Feedback:**

**LOD: 2**

**The Deposit Expansion Multiplier.**

**Q#14**

The term for the process of turning reserves into bank deposits is called:

- ✓ A) multiple deposit creation.
- B) saving.
- C) investing.
- D) risk spreading.

**Feedback:**

**LOD: 1**

**The Deposit Expansion Multiplier.**

**Q#15**

Which of the following best completes the statement: "If people decrease their currency holdings, all else the same, the monetary base...":

- ✓ A) does not change but the quantity of M2 will increase.

- B) the monetary base increases as does the quantity of M2.
- C) the monetary base decreases as does the quantity of M2.
- D) there is no change to either the monetary base or M2.

**Q#16**

If banks hold more excess reserves, all else the same, the money supply will:

- A) rise.
- ✓ B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**

**LOD: 3**

**The Monetary Base and the Money Supply.**

**Q#17**

Let  $M$  = the quantity of money,  $m$  the money multiplier,  $MB$  the Monetary Base,  $C$  = Currency,  $D$  = Deposits,  $R$  = Reserves. If  $RR$  equals required reserves; and  $ER$  equals excess reserves; then  $m$  would equal:

- ✓ A)  $M/MB$ .
- B)  $R/ER$ .
- C)  $C + D$ .
- D)  $C + D - ER$ .

**Feedback:**

**LOD: 3**

**The Monetary Base and the Money Supply**

## **Quiz # 34**

**Q#1**

A central bank's liabilities include:

- A) securities held by the central bank.

- B) foreign exchange reserves held by the central bank.
- C) loans to commercial banks by the central bank.
- ✓ D) commercial bank reserve deposits in the central bank.**

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#2**

Securities held by a central bank are part of the bank's

- ✓ A) assets.**
- B) liabilities.
- C) reserve holdings.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#3**

When the Fed issues additional discount loans, holding everything else constant, the Fed's:

- ✓ A) assets and liabilities both rise.**
- B) assets and liabilities both decline.
- C) assets rise and its liabilities fall.
- D) assets fall and its liabilities rise.

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q#4**

The Fed controls the federal funds rate primarily by adjusting which component of its assets?

- ✓ A) securities**

- B) reserves
- C) foreign exchange reserves
- D) currency

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q#5**

The Fed controls the federal funds rate primarily by adjusting which component of its liabilities?

- A) securities
- ✓ B) reserves
- C) the government account
- D) currency

**Feedback:**

**LOD: 2**

**The Central Bank's Balance Sheet.**

**Q6**

The monetary base consists of:

- A) currency held by the public only.
- B) currency held by the public + checkable deposits.
- C) reserves only.
- ✓ D) currency held by the public + reserves.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#7**

Reserves consists of:

- A) vault cash only.

- B) deposits at Fed only.
- ✓ C) vault cash + deposits at Fed.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Central Bank's Balance Sheet.**

**Q#8**

Which of the following is *not* a part of the monetary base?

- A) vault cash
- B) currency in the hands of the public
- C) reserve deposits at the Fed
- ✓ D) checkable deposits

**Feedback:**

**LOD: 3**

**The Central Bank's Balance Sheet.**

**Q#9**

When the Fed expands the money supply:

- ✓ A) both its liabilities and its assets increase.
- B) both is liabilities and its assets decrease.
- C) its liabilities increase and its assets decrease.
- D) its liabilities decrease and its assets increase.

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#10**

Which of the following does not directly increase the Fed's liabilities?

- A) an open market security purchase
- B) an increase in the volume of discount loans.

- C) the purchase of additional foreign exchange by the Fed.
- ✓ D) an increase in the ratio of currency to deposits.

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#11**

Bank reserves are:

- A) an asset for banks and for the Fed.
- B) a liability for banks and for the Fed.
- ✓ C) an asset for banks and a liability for the Fed.
- D) a liability for banks and an asset for the Fed.

**Feedback:**

**LOD: 1**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#12**

If there are no offsetting transactions, a foreign exchange purchase by the Fed will cause the monetary base to:

- ✓ A) rise.
- B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#13**

If the Fed increases the amount of discount loans, the Fed's assets will \_\_\_\_\_ and its liabilities will \_\_\_\_\_.

- ✓ A) increase; increase
- B) decrease; decrease



- C) increase; decrease
- D) decrease; increase

**Feedback:**

**LOD: 2**

**Changing the Size and the Composition of the Balance Sheet.**

**Q#14**

The maximum amount of money that may be created by an individual bank is the bank's:

- A) excess reserves.
- B) total reserves.
- C) required reserves.
- D) excess reserves x simple deposit expansion multiplier.

**Feedback:**

**LOD: 2**

**Deposit Expansion Multiplier.**

**Q#15**

Suppose that currency holdings remain constant and that banks hold no excess reserves, If the reserve requirement is 10%, a \$500,000 open market purchase by the Fed will cause the money supply to:

- A) increase by a maximum of \$500,000.
- B) increase by a maximum of \$5,000,000.
- C) decrease by a maximum of \$500,000.
- D) decrease by a maximum of \$5,000,000.

**Feedback:**

**LOD: 2**

**Deposit Expansion Multiplier.**

**Q#16**

A given change in the monetary base will have a larger impact on the money supply when:

- A) banks hold a larger proportion of excess reserves.

**✓ B) the public holds a smaller proportion of their wealth in currency and a larger proportion of their wealth in checkable deposits.**

C) the reserve requirement is higher.

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Monetary Base and the Money Supply**

**Q#17**

One of the difficulties faced by the Fed in controlling the money supply is that the Fed:

**✓ A) can control the monetary base, but the size of the money supply is also affected by the decisions of households and banks.**

B) has little control over the monetary base even though it has tight control over the money multiplier.

C) has no control of influence over either the monetary base or the money multiplier.

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Monetary Base and the Money Supply**

## **Quiz # 35**

**Q#1**

Central banks today place most of their focus on:

A) the unemployment rate.

B) the quantity of M2.

**✓ C) interest rates.**

D) controlling the size of the money multiplier.

**Feedback:**

**LOD: 1**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#2**

Which of the following statements is most correct?

- A) The Fed can control both the monetary base and the interest rate.
- B) The Fed can control the size of the monetary base but not the federal funds rate.
- C) The Fed cannot control the size of the monetary base but can control the federal funds rate.

**✓D) The Fed can control the size of the monetary base or the federal funds rate, but not both.**

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#3**

Which of the following statements is *most* correct?

- A) The FOMC sets the federal funds rate.
- B) The discount rate is the primary policy tool of the FOMC.
- C) The difference between the target and actual federal funds rate is the dealer's spread.

**✓D) The FOMC sets the target federal funds rate.**

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#4**

If the market federal funds rate were below the target rate, the response from the Fed would likely be to:

- ✓A) sell U.S. Treasury securities.**
- B) change the target rate.
- C) purchase U.S. Treasury securities.
- D) raise the discount rate.

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#5**

If the Fed uses open market operations to increase reserves in the banking system, the federal funds rate is expected to:

- A) rise.
- ✓ B) fall.
- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**

**LOD: 2**

**Federal Reserve's Monetary Policy Toolbox**

**Q#6**

The Fed could make the market federal funds rate equal the target rate by:

- A) mandating that all loans be transacted at the target rate.
- ✓ B) entering the federal funds market as a borrower and a lender.
- C) setting the discount rate below the federal funds rate.
- D) raising the required reserve rate.

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#7**

Which of the following statements is *most* correct?

- ✓ A) Over the last 10 years the deviations between the target and market federal funds rate have decreased.
- B) The market federal funds rate always equals the target federal funds rate.
- C) Over the last 10 years the deviations between the target and market federal funds rate have increased.

D) There doesn't appear to be any relationship at all between the target and market federal fund rates.

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#8**

Discount lending ties into the Fed's function of:

- A) open market operations.
- ✓ B) **servicing as the lender of last resort.**
- C) servicing as the government's bank.
- D) a and c

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#9**

The fact that for most of its history the Fed was reluctant to make discount loans actually:

- A) pushed the discount rate above the target federal funds rate.
- B) proved to be a very stabilizing force for financial markets.
- ✓ C) **was at times a destabilizing force for financial markets.**
- D) resulted in banks in very poor financial shape as being the only ones borrowing from the Fed.

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#10**

The use of *lagged reserve accounting* usually makes the demand for reserves:

- A) highly unpredictable to the point of volatility.
- B) nearly constant with hardly any change at all.
- ✓ C) **predictable.**

- D) subject to daily changes by the Fed.

**Feedback:**

**LOD 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#11**

One key difference between the Fed and the European Central Bank (ECB) in their reserve requirements is that the:

- ✓ A) ECB pays interest on required reserves.
- B) ECB doesn't pay interest on reserves and the Fed does.
- C) reserve requirements of the ECB are determined annually.
- D) reserve requirements of the ECB are at a much higher rate than the

Fed's.

**Feedback:**

**LOD: 1**

**Operational Policy at the European Central Bank.**

**Q#12**

For the European Central Bank (ECB) the equivalent of the FOMC's *target* federal funds rate is the:

- ✓ A) target refinancing rate.
- B) European target federal funds rate.
- C) European inter-bank target discount rate.
- D) London Inter-Bank Offer Rate.

**Feedback:**

**LOD: 1**

**Operational Policy at the European Central Bank.**

**Q#13**

Which of the following statement is most true regarding monetary policy tools?

- A) The Fed currently uses a monetary supply quantity tool for monetary policy.
- B) The required reserve rate is the most easily observable monetary policy tool.

C) The federal funds rate is not the best tool because it fails the *controllable* test of a good monetary policy tool.

✓ D) The central bank may set an interest rate target or a money supply target, but cannot generally achieve both.

**Feedback:**

**LOD 2**

**Linking Tools to Objectives: Making Choices.**

**Q#14**

A good definition for *intermediate targets* of monetary policy would be:

✓ A) instruments that are not under the direct control of the central banks but lie between operational instruments and objectives.

B) instruments under the *direct* control of central bankers but one step removed from operational targets.

C) the quantity or non-price targets of monetary policy.

D) a price but non-quantifiable target that is difficult for the market to anticipate.

**Feedback:**

**LOD 2**

**Linking Tools to Objectives: Making Choices.**

**Q#15**

During the 1990s many countries developed a monetary policy framework that focused on *inflation targeting*. This is an example of policymakers:

A) bypassing intermediate targets and focusing directly on an objective.

B) focusing exclusively on an intermediate target.

C) focusing on a single numerical target.

✓ D) a and c

**Feedback:**

**LOD 2**

**Linking Tools to Objectives: Making Choices.**

Consider the following formula for the Taylor rule:

Target federal funds rate =  $2\frac{1}{2}$  + current inflation +  $\frac{1}{2}$ (inflation gap) +  $\frac{1}{2}$ (output gap)

**Q#16**

If the current rate of inflation is 3%, the target rate of inflation is 2%, and output is 3% above its potential, the target federal funds rate would be:

- A) 7.5%.
- B) 10.0%.
- C) 8.0%.
- D) 3.5%.

**Feedback:**

**LOD: 3**

**A Guide to Central Bank Interest Rates: The Taylor Rule**

## Quiz # 36

**Q#1**

In selecting a target for monetary policy, the Fed may control:

- A) **the federal funds rate or the monetary base, but not both.**
- B) the federal funds rate, but not the monetary base.
- C) both the money supply and the federal funds rate.
- D) neither the money supply nor the federal funds rate.

**Feedback:**

**LOD: 1**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#2**

The Fed's most commonly used monetary policy tool is:

- A) the reserve requirement.
- B) **open market operations**
- C) the discount rate.



- D) capital requirements.

**Feedback:**

**LOD: 1**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#3**

If the Fed wishes to engage in a contractionary monetary policy, it may:

- A) raise the target federal funds rate.**
- B) lower the target federal funds rate.
- C) lower the reserve requirement.
- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#5**

If the Fed raises the target federal funds rate, it may attempt to achieve this by:

- A) buying government securities.
- B) selling government securities.**
- C) lowering the reserve requirement
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#5**

The federal funds market is a market in which:

- A) banks with excess reserves loan reserves to other banks that have reserve shortfalls.**
- B) Treasury bonds are bought and sold by households, banks, and other financial institutions.
- C) the government deficit is financed.

- D) state and local governments borrow from the federal government.

**Feedback:**

**LOD: 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#6**

If the federal funds rate exceeds the target rate, the Fed:

- A) actively participates in the federal funds market by buying and selling reserves in the federal funds market.
- B) uses its policy tools to affect the volume of reserves in the banking system.
- C) requires that all banks charge the target rate when they make loans to other banks in the federal funds market.
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**The Federal Reserve's Monetary Policy Toolbox.**

**Q#7**

Loans made by banks in the federal funds market are:

- A) secured by government securities.
- B) insured by the FDIC.
- C) unsecured.
- D) insured by the Fed.

**Feedback:**

**LOD: 2**

**Federal Reserve's Monetary Policy Toolbox.**

**Q#8**

If the Fed uses open-market operations to reduce reserves in the banking system, the federal funds rate is expected to:

- A) rise.
- B) fall.

- C) remain unchanged.
- D) change in an unpredictable manner.

**Feedback:**

**LOD: 2**

**Federal Reserve's Monetary Policy Toolbox**

**Q#9**

For most of the Fed's history, its practice of discouraging discount lending tended to:

- A) help to stabilize the interbank market for reserves.
- ✓ B) **destabilize the interbank market for reserves.**
- C) have no effect on the interbank market for reserves.
- D) sometimes stabilize, but sometimes destabilize the interbank market for reserves.

**Feedback:**

**LOD: 2**

**Federal Reserve's Monetary Policy Toolbox**

**Q#10**

Short-term discount loans made to sound banks that have temporary reserve shortfalls are referred to as:

- ✓ A) **primary credit.**
- B) secondary credit.
- C) tertiary credit.
- D) seasonal credit.

**Feedback:**

**LOD: 1**

**Federal Reserve's Monetary Policy Toolbox**

**Q#11**

Today, the primary use of the reserve requirement is to:

- A) control the size of the money supply.
- ✓ B) **stabilize the demand for reserves.**

C) provide a low-cost source of funds for the Federal Reserve System (since the Fed does not pay interest on reserve deposits).

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Federal Reserve's Monetary Policy Toolbox**

**Q#12**

One difference between the conduct of monetary policy by the European Central Bank (ECB) and the Fed is that:

A) the Fed focuses solely on a money supply target while the ECB focuses on an interest-rate target.

**✓ B) the Fed conducts its monetary policy at one site (the NY Fed) while the ECB conducts monetary policy in a decentralized manner through each member nation's central bank.**

C) The Fed is independent of the fiscal authorities while ECB policy is dictated by the fiscal policies of the member states.

D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Operational Policy at the European Central Bank.**

**Q#13**

Desirable characteristics of a monetary policy instrument include:

A) it is easily observed.

B) it is controllable and may be quickly altered.

C) it is tightly linked to the policymakers' objectives.

**✓ D) All of the above are correct.**

**Feedback:**

**LOD: 1**

**Linking Tools to Objectives: Making Choices.**

**Q#14**

Interest-rate targets have become more commonly adopted by central banks in recent decades because:

- A) such a policy tends to be less destabilizing than a monetary aggregate target.**
- B) this policy rule is required by fiscal policymakers in most countries.**
- C) the adoption of a monetary aggregate target always resulted in high rates of money growth.**
- D) None of the above is correct.**

**Feedback:**

**LOD: 2**

**Linking Tools to Objectives: Making Choices.**

Consider the following formula for the Taylor rule:

Target federal funds rate =  $2\frac{1}{2}$  + current inflation +  $\frac{1}{2}$ (inflation gap) +  $\frac{1}{2}$ (output gap)

**Q#15**

If the current rate of inflation is 4%, the target rate of inflation is 3%, and output is 2% above its potential, the target federal funds rate would be:

- A) 7.5%.**
- B) 10.0%.**
- C) 8.0%.**
- D) 9.0%.**

**Feedback:**

**LOD: 3**

**Guide to Central Bank's Interest Rates: The Taylor Rule**

**Quiz # 37**

**Q#1**

If capital flows freely between countries and a country has a fixed exchange rate, you know that the country:

- A) exports more than it imports.
- B) must have ample gold reserves.
- C) must have a strong monetary policy.
- ✓ D) cannot have a domestic monetary policy.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#2**

If inflation in country B exceeds inflation in country A, purchasing power parity implies that:

- A) the currency of country A should depreciate relative to the currency of country B.
- ✓ B) the currency of country B will depreciate relative to the currency of country A.
- C) the inflation rate in country A will rise to match the inflation rate in country B.
- D) the inflation rate in country B will fall to match the inflation rate in country A.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#3**

If the inflation rate in country A is 4.5% and the inflation rate in country B is 3.0% we should expect the *percentage change* in the number of units of country A's currency per unit of country B's currency to be:

- A) + 50.0%.
- B) -0.5%.
- ✓ C) +1.5%.
- D) +75%.

**Feedback:**

**LOD: 3**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#4**

Which of the following statements is most correct?

**A) A central bank cannot have both a fixed exchange rate and an independent inflation policy.**

**B) A central bank can select between a fixed exchange rate and an independent inflation policy, provided fiscal policy cooperates.**

**C) The central banks of most industrialized countries focus on fixed exchange rates.**

**D) While most central banks of industrialized countries favor fixing exchange rates, their primary concern is domestic inflation.**

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#5**

If arbitrage occurs across countries with a flexible exchange rate when the bonds in each country are identical and there are no barriers to capital flows:

**A) the interest rates on the bonds will be identical.**

**B) the prices of the bonds will be identical.**

**C) the expected returns are the same.**

**D) the inflation rates in each country will be identical.**

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#6**

Consider the following: an investor in the U.S. is pondering a one-year investment. She can purchase a domestic bond for \$5000 that has an interest rate of  $i$ ; she can also purchase a bond in England for 7500 British pounds (£) that bond pays an interest rate of  $i^*$ . The current exchange rate is \$1.50/£. She considers the bonds to be of equal risk. *If  $i = i^*$  the expected returns are not equal.* What do you know?

**A) The exchange rate must be flexible.**

- B) The bonds initially sold for different prices.
- C) c). Arbitrage doesn't work.
- D) The exchange rate is fixed between the U.S. and Britain.

**Feedback:**

**LOD: 3**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#7**

Which of the following best characterizes the United States?

- A) a controlled domestic interest rate, a closed capital market and a flexible exchange rate
- B) a controlled domestic interest rate, an open capital market and a fixed exchange rate
- C) no control over the domestic interest rate, an open capital market and a flexible exchange rate
- D) a controlled domestic interest rate, an open capital market and a flexible exchange rate

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#8**

If the Fed decides to maintain a fixed euro/dollar exchange rate, when it buys euros:

- A) banking system reserves will decrease.
- B) the domestic money supply will decrease.
- C) there will be pressure on domestic interest rates to decrease.
- D) All of the above.

**Feedback:**

**LOD: 2**

**Mechanics of Exchange-Rate Management.**

**Q#9**

A *sterilized* foreign exchange intervention would:



- A) not alter the central bank's holdings of international reserves.
- B) alter the liability side of the central bank's balance sheet but leave the asset side unchanged.
- C) leave the central bank's balance sheet unchanged.
- ✓D) alter the asset side of a central bank's balance sheet but leave the domestic monetary base unchanged.**

**Feedback:**

**LOD: 2**

**Mechanics of Exchange-Rate Management.**

**Q#10**

Fixing an exchange rate between two countries makes the most sense when:

- A) both countries use the same national language.
- B) the countries' macroeconomic fluctuations are negatively correlated.
- ✓C) the countries' macroeconomic fluctuations are positively correlated.**
- D) one country has a lot of international reserves and the other doesn't.

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#11**

A country that suffers from bouts of high inflation and wants to fix its exchange rate should tie its currency to the currency of a:

- A) larger country.
- ✓B) country with a strong reputation for low inflation.**
- C) country with similar inflation performance.
- D) country that is still on the gold standard.

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#12**

If the U.S. were to revert to a gold standard, trade deficits would:

- A) result in gold reserves in the U.S. increasing.
- B) quickly disappear.
- ✓ C) result in higher domestic interest rates.
- D) result in high inflation.

**Feedback:**

**LOD: 3**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#13**

In 1997 there was a speculative attack on the Thai *baht*. This resulted from:

- ✓ A) the belief by speculators that the Thai central bank didn't have U.S. dollar reserves to maintain the current fixed rate.
- B) the belief by speculators that the Thai central bank was run by corrupt officials.
- C) the revelation that the Thai central bank had depleted its gold reserves.
- D) the overthrow of the Thai president and the central bank.

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#14**

The Bretton Woods System failed in 1971 due to:

- A) very low rates of inflation in the U.S.
- B) the lack of capital mobility across international borders.
- ✓ C) the desire on the part of participating countries to have an independent monetary policy.
- D) All of the above.

**Feedback:**

**LOD: 2**

**Fixed Exchange-Rate Regimes.**

**Q#15**

Dollarization:

- A) has the benefit of providing additional revenue in the form of seignorage to the country that dollarizes.
- B) is the same as a monetary union.
- ✓C) would enable a small emerging-market country to avoid an exchange-rate crisis.**
- D) Both a and c are correct.

**Feedback:**

**LOD: 2**

**Fixed Exchange-Rate Regimes**

**Quiz # 38**

**Q#1**

Which of the following statements is correct?

- A) The Fed engages in foreign currency transactions on a daily basis.
- B) The Fed engages in foreign currency transactions in conjunction with the meetings of the FOMC.
- ✓C) The Fed almost never engages in foreign currency transactions.**
- D) The Fed is not permitted to engage in foreign currency transactions.

**Feedback:**

**LOD: 1**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#2**

The currency of country A will depreciate relative to that of country B if:

- ✓A) the inflation rate in country B is higher than that in country A.**
- B) the inflation rate in country A is higher than that in country B.
- C) the inflation rates in the two countries are the same but country A fixes its exchange rate.

- D) Both a and c are correct.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#3**

If the inflation rate in country A is 2.5% and the inflation rate in country B is 2.0% we should expect the *percentage change* in the number of units of country A's currency per unit of country B's currency to be:

- A) + 4.5%.  
✓ B) 0.5%.  
C) +1.25%.  
D) +.8%.

**Feedback:**

**LOD: 3**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#4**

If a country like Mexico, for example, wants its inflation rate to diverge from that of the United States, then:

✓ A) if the U.S. inflation rate rises Mexico must be prepared for the peso/dollar exchange rate to decrease.

B) if the U.S. inflation rate rises Mexico must be prepared for the peso/dollar exchange rate to increase.

C) if the U.S. inflation rate falls Mexico must be prepared for the peso/dollar exchange rate to decrease.

D) None of the above; it would not be in Mexico's best interests for its inflation rate to diverge from that of the United States.

**Feedback:**

**LOD: 3**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#5**

If arbitrage occurs across countries with a fixed exchange rate when the bonds in each country are identical and there are no barriers to capital flows:

✓ A) the interest rates on the bonds will be identical.

B) the interest rate on the domestic bond will be greater than that on the foreign bond due to differences in inflation.

C) the expected return from the foreign bond will be higher.

D) the inflation rates in each country will be identical.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#6**

Consider the following: an investor in the U.S. is pondering a one-year investment. She can purchase a domestic bond for \$5,000 that has an interest rate of  $i$ ; she can also purchase a bond in England for 10,000 British pounds (£) that pays an interest rate of  $i^f$ . The current exchange rate is \$2.00/£. She considers the bonds to be of equal risk. If  $i = i^f$  but the \$/£ exchange rate is expected to fall, the investor should:

✓ A) buy the U.S. bond.

B) buy the British bond.

C) buy the British bond and hold it until after the exchange rate falls.

D) rely on arbitrage to equalize her return whichever bond she buys.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#7**

Capital controls consist of:

A) restrictions on the ability of foreigners to invest in a country.

B) obstacles that prevent the selling of investments and taking funds out of the country.

C) fixed interest rates.

✓ D) Only a and b are correct.

**Feedback:**

**LOD: 2**

**Linking Exchange-Rate Policy with Domestic Monetary Policy.**

**Q#8**

If the Fed decides to maintain a fixed euro/dollar exchange rate, and buys euros:

- A) its dollar liabilities will decrease.
- ✓ B) its dollar liabilities will increase.**
- C) there will be pressure on domestic interest rates to increase.
- D) Both b and c are correct.

**Feedback:**

**LOD: 2**

**Mechanics of Exchange-Rate Management.**

**Q#9**

Which of the following statements is correct?

- ✓ A) To sterilize a foreign exchange intervention in which it purchased a foreign bond, the Fed would sell a U.S. Treasury bond.**
- B) To sterilize a foreign exchange intervention in which it purchased a foreign bond, the Fed would buy a U.S. Treasury bond of the same face value.
- C) To sterilize a foreign exchange intervention in which it sold a foreign bond, the Fed would sell a U.S. Treasury bond of the same face value.
- D) The Fed will sterilize foreign exchange interventions that increase reserves but not those that decrease reserves.

**Feedback:**

**LOD: 2**

**Mechanics of Exchange-Rate Management.**

**Q#10**

All of the following are benefits of fixed exchange rates except:

- A) international trade is simplified.
- B) the risk associated with foreign investment is reduced.
- C) policymakers' hands are tied.
- ✓ D) it means adopting another country's interest-rate policy.**

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#11**

Speculative attacks are more likely if a country has:

- A) a flexible interest rate.
- B) capital controls.
- ✓ C) a fixed exchange rate.
- D) All of the above.

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#12**

If the U.S. were to revert to a gold standard, a U.S. current account deficit would result in:

- A) gold reserves in the U.S. decreasing.
- B) higher domestic interest rates.
- C) deflation.
- ✓ D) All of the above.

**Feedback:**

**LOD: 3**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#13**

Floating exchange rates:

- ✓ A) act as automatic macroeconomic stabilizers.
- B) require higher levels of foreign exchange reserves than do fixed exchange rates.
- C) means a country cannot control its domestic interest rates.
- D) All of the above are true.

**Feedback:**

**LOD: 2**

**The Costs, Benefits, and Risks of Fixed Exchange Rates.**

**Q#14**

Under the Bretton Woods System:

- A) each country pegged its currency to the U.S. dollar.
- B) countries held U.S. dollar reserves.
- C) there were complex capital controls.
- ✓D) All of the above.

**Feedback:**

**LOD: 2**

**Fixed Exchange-Rate Regimes.**

**Q#15**

In a country that has a currency board, its central bank:

- A) has only one job: to maintain the exchange rate.
- B) loses its role as lender of last resort.
- C) will gradually be phased out.
- ✓D) Both a and b are correct.

**Feedback:**

**LOD: 2**

**Fixed Exchange-Rate Regimes**

## **Quiz # 39**

**Q#1**

Over the long run, if central banks want to avoid high rates of inflation they need to be concerned with:

- A) unemployment.
- ✓B) money growth.



- C) real economic growth.
- D) productivity of labor.

**Feedback:**

**LOD: 1**

**Why We Care About Monetary Aggregates.**

**Q#2**

Consider the ratio of the average annual inflation rate to the average annual rate of money growth. If a country ratio's had a value greater than one that country would have:

- A) an average inflation rate greater than the average rate of money growth.**
- B) an average inflation rate less than the average rate of money growth.
- C) a high unemployment rate.
- D) an economy suffering from a recession.

**Feedback:**

**LOD: 2**

**Why We Care About Monetary Aggregates.**

**Q#3**

Inflation can be thought of as:

- A) a decrease in the price of money.**
- B) an increase in the price of money.
- C) no change in the price of money, just in the supply of money.
- D) no change in the price of money, just in the demand for money.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#4**

If  $M$  = the money supply;  $Y$  = real output,  $P$  = the price level, and  $V$  = velocity, which of the following equals the velocity of money?

- A)  $(P \cdot Y) + M$

- B)  $(P \cdot M)/Y$
- C)  $(Y \cdot M)/P$
- ✓ D)  $(P \cdot Y)/M$

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#5**

Which of the following expresses the *equation of exchange*?

- ✓ A)  $MV = PY$
- B)  $MV = Y$
- C)  $MY = PV$
- D)  $MP = VY$

**Feedback:**

**LOD: 1**

**The Quantity Theory and the Velocity of Money.**

**Q#6**

Key assumptions behind the *quantity theory of money* include:

- A) the change in nominal GDP is zero.
- B) the percentage change in the price level equals the percentage change in real GDP.
- ✓ C) **the velocity of money is constant.**
- D) the money supply is fixed.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#7**

If we let  $M^d$  represent money demand, then we can write the equation for money demand as:

- A)  $M^d = VY.$

✓B)  $M^d = (1/V) PY$ .

C)  $M^d = PY$ .

D)  $M^d = V(Y/P)$ .

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#8**

A rate of inflation that is less than the growth rate of money for a country could be explained by:

✓A) a decreasing velocity of money.

B) a contracting real economy.

C) a constant velocity of money.

D) a increasing velocity of money.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#9**

Which of the following statements is incorrect?

A) The velocity of M2 is relatively stable over long time periods.

✓B) The velocity of M2 is less stable than the velocity of M1.

C) The velocity of M2 is more volatile in the short run than the long run.

D) Fisher's assumption about money velocity being stable in the long run was incorrect.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#10**

During economic slowdowns (recessions) the velocity of money tends to:

A) move unpredictably.

- ✓ B) decrease.
- C) remain constant, as Fisher predicted.
- D) slightly increase.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#11**

The portfolio demand for money reflects:

- A) the money we hold for our everyday transactions.
- B) the money we hold to purchase stocks and bonds and other financial securities.
- ✓ C) the portion of wealth people desire to hold in the form of money.
- D) b and c

**Feedback:**

**LOD: 2**

**The Demand for Money.**

**Q#12**

The *Lucas critique* focuses specifically on:

- ✓ A) the role that economic policymaking has on people's economic behavior.
- B) the relationship between Fed policy and the money supply.
- C) the inability to measure economic time lags accurately.
- D) the moving away from the gold standard to flexible exchange rates.

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

**Q#13**

To use money growth as a short-term monetary policy instrument, a central bank must:

- A) believe the deposit expansion multiplier is volatile and unpredictable.

- B) believe that only money matters.
- C) believe that there is an unpredictable relationship between money aggregates and inflation.
- ✓ D) believe there is some stable link between the monetary base and the money aggregates.**

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

**Q#14**

One cost that potentially could result from central banks targeting money growth is:

- ✓ A) volatile interest rates.**
- B) a slowdown in financial innovation.
- C) high inflation.
- D) a very stable interest rate.

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

**Q#15**

If a central bank set an explicit inflation target it would require that it:

- A) put more emphasis on the interest rate target and less on a money target.
- B) shift its focus entirely to a nominal interest rate target.
- ✓ C) be willing to live with more volatility in the interest rate.**
- D) give up control of targeting the monetary base.

**Feedback:**

**LOD: 3**

**Targeting Money Growth in a Low-Inflation Environment.**

## **Quiz # 40**

**Q#1**

The single most important fact in monetary economics is the:

- A) positive relationship between money growth and inflation rates.**
- B) positive relationship between money growth and the real interest rate.
- C) negative relationship between money growth and the real interest rate.
- D) negative relationship between money growth and inflation rates.

**Feedback:**

**LOD: 1**

**Why We Care About Monetary Aggregates.**

**Q#2**

When a country has a high inflation rate:

- A) people tend to spend money more quickly, which helps to reduce inflation.
- B) people tend to spend money more quickly, which has the same effect on inflation as an increase in money growth.**
- C) people tend to spend money more slowly, which has the same effect on inflation as an increase in money growth.
- D) there is also typically a high unemployment rate.

**Feedback:**

**LOD: 2**

**Why We Care About Monetary Aggregates.**

**Q#3**

Inflation can be thought of as:

- A) a decrease in the value of money.**
- B) an increase in the value of money.
- C) no change in the value of money, just in the supply of money.
- D) no change in the value of money, just in the demand for money.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#4**

If  $M$  = the money supply;  $Y$  = real output,  $P$  = the price level, and  $V$  = velocity, which of the following represents nominal GDP?

- A)  $(P \cdot Y) + M$
- B)  $(P \cdot M)/Y$
- C)  $(Y \cdot M)/P$
- D)  $(P \cdot Y)$

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#5**

If the *equation of exchange* is  $MV=PY$  and we assume that velocity is constant and that real output is determined solely by economic resources and production technology, then a change in  $M$  will result in a change in:

- A)  $P$ .
- B)  $Y$ .
- C)  $PV$ .
- D)  $VY$ .

**Feedback:**

**LOD: 1**

**The Quantity Theory and the Velocity of Money.**

**Q#6**

Which of the following is *not* a key assumption behind the *quantity theory of money*?

- A) The change in nominal GDP is zero.
- B) The percentage change in the price level equals the percentage change in the money supply.
- C) The velocity of money is constant.
- D) Real growth is determined by resources and technology.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#7**

If we let  $M^d$  represent money demand and the money market is in equilibrium, then:

- A)  $M^d = VY$ .
- B)  $M^d = V(PY)$ .
- ✓ C)  $M^d V = PY$ .
- D)  $M^d = V(Y/P)$ .

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#8**

A central bank policy to stabilize inflation by keeping money growth constant would be viable only if:

- A) the velocity of money was decreasing over time.
- B) the velocity of money was increasing over time.
- ✓ C) **velocity of money was constant.**
- D) nominal GDP were constant.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#9**

Increases in velocity in the late 1970s and early 1980s can be attributed to financial innovations that:

- A) made holding money very costly.
- B) allowed individuals to economize on the amount of money they held.
- ✓ C) **Both of the above are correct.**
- D) None of the above is correct.



**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#10**

As the monetary policy strategy of the European Central Bank has evolved over time, the role of money:

- A) has become more prominent.
- ✓ B) has become less prominent.
- C) has not changed.
- D) has changed in that there is more emphasis on the equivalent of M1 than M2.

**Feedback:**

**LOD: 2**

**The Quantity Theory and the Velocity of Money.**

**Q#11**

The higher the nominal interest rate:

- A) the higher the opportunity cost of holding money.
- B) the less money people will hold for any given level of transactions.
- C) the higher the velocity of money.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 2**

**The Demand for Money.**

**Q#12**

The precautionary demand for money is usually included in the:

- ✓ A) transactions demand for money.
- B) portfolio demand for money.
- C) both the transactions demand and the portfolio demand for money.
- D) None of the above; it is a separate category.

**Feedback:**

**LOD: 2**

**The Demand for Money.**

**Q#13**

Controlling inflation:

A) is made more difficult in a high-inflation environment due to changes in velocity.

**✓ B) is made more difficult in a low-inflation environment due to changes in velocity.**

C) depends more on the resolve of the central bank in a low-inflation environment.

D) is simpler in the short run because velocity is constant.

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

**Q#14**

Changes in mortgage refinancing rates have affected the velocity of M2 because:

A) people who are refinancing take out equity in their home and deposit funds in liquid deposit accounts.

B) as mortgages are refinanced flows of funds from holders of both old and new mortgages flow through accounts that are part of M2.

**✓ C) Both of the above are correct.**

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

**Q#15**

Comparing the ECB and the Fed, it is accurate to say that:

A) the ECB puts more emphasis on the interest rate target and less on a money target.

**✓B) the ECB and the Fed differ in their emphasis on money growth but both use interest rates as their operating targets.**

C) the ECB only uses a money growth target while the Fed only uses an interest rate target.

D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Targeting Money Growth in a Low-Inflation Environment.**

## **Quiz # 41**

**Q#1**

Inflation in the long run would be determined by:

A) the exchange rate.

B) aggregate demand.

**✓C) the rate of money growth.**

D) aggregate supply.

**Feedback:**

**LOD: 1**

**Output and Inflation in the Long Run.**

**Q#2**

In the long run, if we ignore changes in velocity:

**✓A) inflation will equal money growth less the growth in potential output.**

B) inflation will equal the rate of money growth.

C) inflation will be zero.

D) inflation will equal money growth plus the growth in potential output.

**Feedback:**

**LOD: 2**

**Output and Inflation in the Long Run.**

**Q#3**

Which of the following components of aggregate expenditure is *not* sensitive to changes in the real interest rate?

- A) consumption
- B) investment
- C) net exports
- ✓ D) government purchases**

**Feedback:**

**LOD: 2**

**Monetary Policy and the Dynamic Aggregate Demand Curve.**

**Q#4**

Which of the following statements is correct?

- ✓ A) When potential output goes up, the long-run real interest rate falls.**
- B) When potential output goes up, the long-run real interest rate rises.
- C) When potential output goes down, the long-run real interest rate falls.
- D) When potential output goes up, the long-run real interest rate is not affected.

**Feedback:**

**LOD: 2**

**Monetary Policy and the Dynamic Aggregate Demand Curve.**

**Q#5**

The FOMC targets the federal funds rate, but if they are going to alter the course of the economy they must influence:

- A) the money growth rate as well.
- B) the long-term nominal interest rate as well.
- ✓ C) the real interest rate as well.**
- D) the nominal exchange rate as well.

**Feedback:**

**LOD: 2**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#6**

Policymakers who are aggressive in keeping current inflation near target will have a monetary policy reaction curve that is:

- A) steep.**
- B) flat.**
- C) downward sloping.**
- D) horizontal.**

**Feedback:**

**LOD: 2**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#7**

A shift in the monetary policy reaction curve represents:

- A) a change in the level of the real interest rate at every level of inflation.**
- B) a reaction to a change in current inflation.**
- C) A change in the level of potential output.**
- D) Both a and b are correct.**

**Feedback:**

**LOD: 2**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#8**

The dynamic aggregate demand curve slopes down because:

- A) inflation induces policymakers to raise the real interest rate, depressing various components of aggregate expenditure.**
- B) the higher the rate of inflation for a given rate of money growth, the lower the level of real balances in the economy, and therefore there are fewer purchases.**
- C) higher inflation reduces wealth, which lowers consumption.**

**✓D) all of the above are correct.**

**Feedback:**

**LOD: 2**

**The Dynamic Aggregate Demand Curve**

**Q#9**

Assuming production costs do not change, changes in product-price inflation create:

- A) shifts in the short-run aggregate supply curve.
- ✓B) movements along the short-run aggregate supply curve.**
- C) changes in the slope of the short-run aggregate supply curve.
- D) both a and c are correct.

**Feedback:**

**LOD: 2**

**Aggregate Supply**

**Q#10**

Which of the following statements is true?

- ✓A) A recessionary output gap forces inflation down.**
- B) An expansionary output gap occurs when current output is less than potential output.
- C) Output gaps are the only source of production cost changes that shift the short-run aggregate supply curve.
- D) None of the above statements is true.

**Feedback:**

**LOD: 2**

**Aggregate Supply**

**Q#11**

In the long run, output and inflation:

- A) have an inverse relationship.
- B) have a positive relationship.

✓C) are unrelated.

D) are positively related up to the point of potential output then are inversely related.

**Feedback:**

**LOD: 2**

**Aggregate Supply**

**Q#12**

The *self-correcting mechanism* to return the economy to full potential from output gaps is:

A) fiscal policy.

B) the change in aggregate demand

C) the change in the money growth rate by the central bank.

✓D) the change in the short-run aggregate supply.

**Feedback:**

**LOD: 2**

**Equilibrium and the Determination of Output and Inflation.**

**Q#13**

For an economy to be in long-run equilibrium:

A) current output must equal potential output.

B) current inflation must be steady and equal to target inflation.

C) current inflation must equal expected inflation.

✓D) All of the above; there are three conditions for long-run equilibrium.

**Feedback:**

**LOD: 1**

**Equilibrium and the Determination of Output and Inflation.**

**Q#14**

Suppose that you observe a fluctuation in the economy that resulted in output and inflation both increasing. This was likely the result of:

✓A) a rightward shift in the dynamic aggregate demand curve.

- B) a leftward shift in the dynamic aggregate demand curve.
- C) a rightward shift in the short-run aggregate supply curve.
- D) a leftward shift in the short-run aggregate supply curve.

**Feedback:**

**LOD: 2**

**Equilibrium and the Determination of Output and Inflation.**

**Q#15**

Most recessions in the past half century can be traced to:

- A) shifts in the short-run aggregate supply curve.
- B) shifts in the long-run aggregate supply curve.
- ✓ C) **shifts in the dynamic aggregate demand curve.**
- D) increases in oil prices and other production costs.

**Feedback:**

**LOD: 1**

**Equilibrium and the Determination of Output and Inflation**

## Quiz # 42

**Q#1**

Suppose that at the current level of output there are resources that are not being use. In the long run we would expect:

- ✓ A) **output to increase.**
- B) output to decrease.
- C) output not to change.
- D) output to be affected by the rate of money growth.

**Feedback:**

**LOD: 1**

**Output and Inflation in the Long Run.**



**Q#2**

If P represents the price level, M represents money and  $Y^P$  equals potential output, then in the long run:

- A)  $\% \Delta P = \% \Delta M - \% \Delta Y^P$ .
- B)  $\% \Delta P = \% \Delta M + \% \Delta Y^P$ .
- C)  $\% \Delta P = \% \Delta M / \% \Delta Y^P$ .
- D) None of the above is correct.

**Feedback:**

**LOD: 3**

**Output and Inflation in the Long Run.**

**Q#3**

Each of the following components of aggregate expenditure is sensitive to changes in the real interest rate except:

- A) consumption.
- B) investment.
- C) net exports.
- D) government purchases.

**Feedback:**

**LOD: 2**

**Monetary Policy and the Dynamic Aggregate Demand Curve.**

**Q#4**

In the short run, when monetary policymakers increase the nominal interest rate they:

- A) also increase the real interest rate.
- B) decrease the real interest rate.
- C) change the level of potential output.
- D) cause changes in government purchases.

**Feedback:**

**LOD: 2**

**Monetary Policy and the Dynamic Aggregate Demand Curve.**

**Q#5**

Which is the most important of the components of aggregate expenditure that are sensitive to changes in the real interest rate?

- A) consumption
- B) investment
- C) net exports
- D) government purchases

**Feedback:**

**LOD: 2**

**Monetary Policy and the Dynamic Aggregate Demand Curve.**

**Q#6**

The monetary policy reaction curve:

- A) has an upward slope.
- B) has a downward slope.
- C) is vertical.
- D) is horizontal.

**Feedback:**

**LOD: 1**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#7**

The less aggressive policymakers are in keeping current inflation near target, the \_\_\_\_\_ the slope of the monetary policy reaction curve.

- A) steeper
- B) flatter
- C) more negative
- D) less the impact on

**Feedback:**

**LOD: 2**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#8**

When policymakers adjust the real interest rate:

- A) they are moving along a fixed monetary policy reaction curve.
- B) they are shifting the monetary policy reaction curve.
- ✓ C) **Either a or b is possible.**
- D) None of the above is correct.

**Feedback:**

**LOD: 2**

**Inflation, the Real Interest Rate, and the Monetary Policy Reaction Curve.**

**Q#9**

Which of the following is *not* an explanation of why the dynamic aggregate demand curve slopes down?

- A) Inflation induces policymakers to raise the real interest rate, depressing various components of aggregate expenditure.
- B) The higher the rate of inflation for a given rate of money growth, the lower the level of real balances in the economy, and therefore there are fewer purchases.
- ✓ C) **Higher inflation increases wealth, which raises consumption.**
- D) Inflation causes a redistribution of wealth from the poor to the wealthy.

**Feedback:**

**LOD: 2**

**The Dynamic Aggregate Demand Curve**

**Q#10**

In the short run:

- ✓ A) **higher inflation elicits more aggregate output supplied by firms.**
- B) higher inflation elicits less aggregate output supplied by firms.
- C) lower inflation elicits more aggregate output supplied by firms.

D) higher inflation does not affect the aggregate output supplied by firms.

**Feedback:**

**LOD: 2**

**Aggregate Supply**

**Q#11**

Which of the following would cause the short-run aggregate supply curve to shift to the left?

- A) either an expansionary gap or a rise in expected future inflation
- B) either a recessionary gap or a rise in expected future inflation
- C) either an expansionary gap or a decrease in expected future inflation
- D) either a recessionary gap or a decrease in expected future inflation

**Feedback:**

**LOD: 2**

**Aggregate Supply**

**Q#12**

Suppose there is an expansionary gap. The self-correcting mechanism to return the economy to full potential would be:

- A) a rightward shift in the short-run aggregate supply curve.
- B) a leftward shift in the short-run aggregate supply curve
- C) flattening of the short-run aggregate supply curve.
- D) the short-run aggregate supply curve getting steeper.

**Feedback:**

**LOD: 2**

**Equilibrium and the Determination of Output and Inflation.**

**Q#13**

Which of the following would be true *only if* the economy were in long-run equilibrium?

- A) Current output would equal potential output.
- B) Current inflation would be steady and equal to target inflation.

C) Current inflation would equal expected inflation.

**✓D) The short-run aggregate supply curve and the dynamic aggregate demand curve would intersect.**

**Feedback:**

**LOD: 1**

**Equilibrium and the Determination of Output and Inflation.**

**Q#14**

Suppose that you observe a fluctuation in the economy that resulted in output and inflation both decreasing. This was likely the result of:

A) a rightward shift in the dynamic aggregate demand curve.

**✓B) a leftward shift in the dynamic aggregate demand curve.**

C) a rightward shift in the short-run aggregate supply curve.

D) a leftward shift in the short-run aggregate supply curve.

**Feedback:**

**LOD: 2**

**Equilibrium and the Determination of Output and Inflation.**

**Q#15**

In examining the recessions over the past half century, one can conclude that:

**✓A) the Federal Reserve was at least partly to blame for business cycle downturns.**

B) the Federal Reserve is completely to blame for business cycle downturns.

C) the Federal Reserve has been responsible for all the business cycle upturns.

D) None of the above is correct.

**Feedback:**

**LOD: 1**

**Equilibrium and the Determination of Output and Inflation**

## **Quiz # 43**

**Q#1**

Focusing on the last fifty years in U.S. history, one would say that:

- A) recessions have disappeared.
- B) the number of recessions has increased but their duration has decreased.
- C) the number of recessions has increased and their duration has increased.
- ✓D) the number of recessions has decreased.**

**Feedback:**

**LOD: 1**

**Understanding Business Cycle Fluctuations.**

**Q#2**

Which of the following would *not* be classified as a *shock*?

- A) a decrease in the price of oil.
- B) a decrease in consumer confidence.
- ✓C) an increase in demand for imports.**
- D) All of the above are considered shocks.

**Feedback:**

**LOD: 1**

**Sources of Fluctuations in Output and Inflation.**

**Q#3**

If the central bank reduces its inflation target:

- A) the monetary policy reaction curve will shift to the right.
- ✓B) the monetary policy reaction curve will shift to the left.**
- C) there will be a movement up along the monetary policy reaction curve.
- D) there will be a movement down along the monetary policy reaction curve.

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

**Q#4**

If government purchases increase and as a result push current output above potential output, monetary policymakers are likely to:

- A) raise the real interest rate.**
- B) lower the real interest rate.
- C) keep the real interest rate constant and focus on only changing the nominal interest rate.
- D) purchase Treasury securities.

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

**Q#5**

Suppose that a decline in consumer confidence shifts the dynamic aggregate demand curve to the left. Which of the following is correct?

- A) In the absence of a monetary policy response, the short-run aggregate supply curve will shift to the right.
- B) In the absence of a monetary policy response, the short-run aggregate supply curve will shift to the left.**
- C) If monetary policymakers react, the dynamic aggregate demand curve will shift to the left.
- D) In the absence of a monetary policy response, the dynamic aggregate demand curve will shift to the right.

**Feedback:**

**LOD: 3**

**Sources of Fluctuations in Output and Inflation.**

**Q#6**

*Stagflation* is associated with:

- A) a rightward shift in the short-run aggregate supply curve.
- B) a rightward shift in the dynamic aggregate demand curve.

- C) a leftward shift in the dynamic aggregate demand curve.
- ✓D) a leftward shift in the short-run aggregate supply curve.**

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

**Q#7**

Which of the following statements is *correct*?

- ✓A) Monetary policymakers cannot eliminate the effects of a supply shock.**
- B) Monetary policymakers can shift the long-run aggregate supply curve.
- C) Monetary policymakers cannot neutralize movements in aggregate demand.
- D) Shifts in the monetary policy reaction function shift the short-run aggregate supply curve.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

**Q#8**

A decrease in consumer confidence would like result in monetary policymakers:

- A) making the slope of the monetary policy reaction curve flat.
- B) shifting the monetary policy reaction curve left.
- ✓C) shifting the monetary policy reaction curve right.**
- D) making the slope of the monetary policy reaction curve steep.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

**Q#9**

An increase in taxes would:

- ✓A) cause the dynamic aggregate demand curve to shift to the left.**



- B) cause a movement down and along the existing dynamic aggregate demand curve.
- C) cause a movement up and along the existing dynamic aggregate demand curve.
- D) cause the dynamic aggregate demand curve to shift to the right.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

**Q#10**

Monetary policymakers can take advantage of the opportunity provided by positive supply shocks by:

- A) making the slope of the monetary policy reaction curve flat.
- ✓ B) shifting the monetary policy reaction curve left.
- C) raising the potential level of output.
- D) making the slope of the monetary policy reaction curve steep.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

**Q#11**

During the 1990s:

- A) the U.S. economy never suffered a single decline in output.
- B) inflation fell steadily.
- C) there was less volatility in the economy.
- ✓ D) All of the above are correct.

**Feedback:**

**LOD: 1**

**Using the Aggregate Demand-Aggregate Supply Framework.**

**Q#12**

If potential output changes:

- A) in the long run inflation must fall.
- B) in the long run inflation must rise.
- C) in the long run inflation will not change from its previous level.

**✓D) in the long run what happens to inflation depends on the actions of monetary policymakers.**

**Feedback:**

**LOD: 1**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### **Q#13**

If potential output increases and monetary policy makers respond by shifting the monetary policy reaction curve to the left, then in the long run:

- ✓A) inflation will move to a new, lower target level.**
- B) inflation will return to the previous target level.
- C) inflation will increase because the decline in the long-run real interest rate will shift the dynamic aggregate demand curve to the right.
- D) inflation will increase because the decline in the long-run real interest rate will shift the dynamic aggregate demand curve to the left.

**Feedback:**

**LOD: 3**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### **Q#14**

Real-business-cycle theory seeks to explain business cycle fluctuations by focusing on:

- A) real aggregate demand.
- B) the inflexibility of prices and wages.
- ✓C) fluctuations in potential output**
- D) changes in monetary policy.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#15

If a drop in potential output occurs, and monetary policymakers wish to keep inflation at the target level, then they must:

✓ **A) shift the monetary policy reaction curve to the left more than they would if the economy were just experiencing a recessionary gap.**

**B)** shift the monetary policy reaction curve to the left less than they would if the economy were just experiencing a recessionary gap.

**C)** shift the monetary policy reaction curve to the right more than they would if the economy were just experiencing a recessionary gap.

**D)** shift the monetary policy reaction curve to the right less than they would if the economy were just experiencing a recessionary gap.

**Feedback:**

**LOD: 3**

**Using the Aggregate Demand-Aggregate Supply Framework**

## Quiz # 44

### Q#1

Considering business cycles over the last fifty years in U.S. history, one would say that:

- ✓ **A) the lower the growth, the more likely inflation is to fall.**  
**B)** the lower the growth, the less likely inflation is to fall.  
**C)** the higher the growth, the more likely inflation is to fall.  
**D)** inflation does not change as much with growth as it used to.

**Feedback:**

**LOD: 1**

**Understanding Business Cycle Fluctuations.**

### Q#2

Which of the following is correct?

- ✓ **A)** A decrease in the price of oil would be a supply shock.  
**B)** A decrease in consumer confidence would be a demand shock.  
**C)** Shocks can cause shifts in either the demand or supply curve.  
**D) All of the above are correct.**

**Feedback:**

**LOD: 1**

**Sources of Fluctuations in Output and Inflation.**

### Q#3

If the central bank increases its inflation target:

- ✓ **A) the monetary policy reaction curve will shift to the right.**

- curve.
- B) the monetary policy reaction curve will shift to the left.
  - C) there will be a movement up along the monetary policy reaction curve.
  - D) there will be a movement down along the monetary policy reaction curve.

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

#### Q#4

If government purchases decrease and as a result push current output above potential output, monetary policymakers are likely to:

- A) raise the real interest rate.
- B) **lower the real interest rate.**
- C) keep the real interest rate constant and focus on only changing the nominal interest rate.
- D) purchase Treasury securities.

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

#### Q#5

Suppose that an increase in consumer confidence shifts the dynamic aggregate demand curve to the right. Which of the following is correct?

- A) In the absence of a monetary policy response, the short-run aggregate supply curve will shift to the right.
- B) **In the absence of a monetary policy response, the short-run aggregate supply curve will shift to the left.**
- C) If monetary policymakers react, the dynamic aggregate demand curve will shift farther to the right.
- D) Even without a monetary policy response, the dynamic aggregate demand curve will shift back to the left.

**Feedback:**

**LOD: 3**

**Sources of Fluctuations in Output and Inflation.**

#### Q#6

Stagflation is associated with:

- A) **higher inflation and lower growth.**
- B) higher inflation and higher growth.
- C) lower inflation and lower growth.
- D) lower inflation and lower growth.

**Feedback:**

**LOD: 2**

**Sources of Fluctuations in Output and Inflation.**

#### Q#7

Which of the following statements is *incorrect*?

- effects of a supply shock.  **A)** Monetary policymakers find it more difficult to deal with the supply curve.
- B)** **Monetary policymakers can shift the long-run aggregate demand.**
- C)** Monetary policymakers can neutralize movements in aggregate demand.
- D)** Shifts in the monetary policy reaction function shift the dynamic aggregate demand curve.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#8

A decrease in consumer confidence would like result in fiscal policymakers:

- A)** **cutting taxes or increasing spending.**
- B)** shifting the monetary policy reaction curve left.
- C)** shifting the monetary policy reaction curve right.
- D)** raising taxes or decreasing spending.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#9

A decrease in taxes would likely occur in response to some shock that:

- A)** **caused the dynamic aggregate demand curve to shift to the left.**
- B)** caused a movement down and along the existing dynamic aggregate demand curve.
- C)** caused a movement up and along the existing dynamic aggregate demand curve.
- D)** caused the dynamic aggregate demand curve to shift to the right.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#10

To take advantage of the opportunity provided by positive supply shocks, monetary policymakers should act to:

- A)** flatten the slope of the monetary policy reaction curve.
- B)** **shift the monetary policy reaction curve left.**
- C)** raise the potential level of output.
- D)** make the slope of the monetary policy reaction curve steeper.

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#11

The "great moderation" of the 1990s has been attributed to:

- A) luck.
- B) the increased ability of economies to absorb external economic disturbances.
- C) more effective monetary policy.
- ✓ D) **All of the above.**

**Feedback:**

**LOD: 1**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#12

In the long run an increase in potential output will mean that:

- A) in the long run inflation must fall.
- B) in the long run inflation must rise.
- C) in the long run inflation will not change from its previous level.
- ✓ D) **None of the above; what happens to inflation in the long run depends on the actions of monetary policymakers.**

**Feedback:**

**LOD: 1**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#13

For "opportunistic disinflation" to occur:

- ✓ A) **potential output must increase and monetary policy makers must respond by shifting the monetary policy reaction curve to the left.**
- B) potential output must increase and monetary policy makers must respond by shifting the monetary policy reaction curve to the right.
- C) potential output must increase and monetary policy makers must respond by shifting the dynamic aggregate demand curve to the right.
- D) None of the above is correct.

**Feedback:**

**LOD: 3**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#14

Which of the following is true about real-business-cycle theory?

- A) According to the theory, the short-run aggregate supply curve shifts slowly in response to deviations of current output from potential output.
- B) It assumes the inflexibility of prices and wages.
- C) According to the theory, any shift in the dynamic aggregate demand curve results in fluctuations in potential output with no effect on inflation.
- ✓ D) **None of the above is correct.**

**Feedback:**

**LOD: 2**

**Using the Aggregate Demand-Aggregate Supply Framework.**

### Q#15

Which of the following represents a correct action by monetary policy makers?

- A) A drop in potential output occurs, and monetary policymakers shift the monetary policy reaction curve to the left.**
- B) A drop in potential output occurs, and monetary policymakers shift the monetary policy reaction curve to the right.
- C) A recessionary gap occurs and monetary policymakers shift the monetary policy reaction curve to the right.
- D) A recessionary gap occurs and monetary policymakers shift the monetary policy reaction curve to the left.

**Feedback:**

**LOD: 3**  
**Using the Aggregate Demand-Aggregate Supply Framework**

## Quiz # 45

### Q#1

Which of the following represents the transmission of monetary policy?

- A) an increase in the demand for SUV's due to lower gas prices
- B) income tax rates change
- C) firms alter their investment plans**
- D) oil prices increase

**Feedback:**

**LOD: 1**  
**The Monetary Policy Transmission Mechanism.**

### Q#2

A tightening of monetary policy should:

- A) increase spending by households and businesses and increase net exports.
- B) raise net exports but lower spending by households and businesses.
- C) decrease spending by households and businesses as well as net exports.**
- D) increase investment and household spending but lower net exports.

**Feedback:**

**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

### Q#3

The *direct* impact on spending of short-term interest rate changes by central banks is:

- A) definitely the strongest of all transmission mechanisms.
- B) only effective for net exports but not for investment and consumption.
- C) only effective for consumption but not investment.
- D) not that powerful.**

**Feedback:**

**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

**Q#4**

The relationship between interest rates and stock prices is referred to as:

- A)** the Dow Jones mechanism of monetary policy.
- B)** **the asset-price channel of monetary policy.**
- C)** the wealth-creating mechanism of monetary policy.
- D)** the investment-spending mechanism of monetary policy.

**Feedback:**  
**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

**Q#5**

The *bank lending channel* of monetary policy focuses on:

- A)** **banks' willingness and ability to lend.**
- B)** the interest rate banks charge their largest customer.
- C)** how central bank policy influences the solvency of banks.
- D)** the deposit insurance premiums banks will end up paying.

**Feedback:**  
**LOD: 1**  
**The Monetary Policy Transmission Mechanism.**

**Q#6**

For a firm that has liabilities, a decrease in interest rates increases net worth because:

- A)** asset values will decrease.
- B)** the principal amount of the loans will decrease.
- C)** **profits will be higher due to lower interest costs.**
- D)** None of the above.

**Feedback:**  
**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

**Q#7**

Which of the following is a transmission channel of monetary policy?

- A)** **the balance-sheet channel**
- B)** the technology-price channel
- C)** the efficient-market channel
- D)** the tax-impact channel

**Feedback:**  
**LOD: 1**  
**The Monetary Policy Transmission Mechanism.**

**Q#8**

If the Fed lowers the interest-rate target and mortgage interest rates fall, the economy would be affected through:

- A)** the balance-sheet channel



- ✓
- B) **the asset-price channel**
  - C) the efficient-market channel
  - D) the tax-impact channel

**Feedback:**

**LOD: 1**

**The Monetary Policy Transmission Mechanism.**

### Q#9

The dramatic rise of inflation in the 1970s was at least partly due to the fact that:

growing rapidly.

output.

- ✓
- A) the Fed wanted high rates of inflation because output was
  - B) **the Fed was slow to identify decreases in potential**
  - C) the Fed's tight money policy of the 1970s.
  - D) potential output rose dramatically during the 1970s.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#10

If the dynamic aggregate demand curve shifts to the right, but there is no change in potential output, the appropriate response by monetary policymakers would be to:

- ✓
- A) **shift the monetary policy reaction function to the left.**
  - B) shift the monetary policy reaction function to the right.
  - C) steepen the monetary policy reaction function.
  - D) flatten the monetary policy reaction function.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#11

If the short-run and long-run aggregate supply curves shift to the right, the appropriate response by monetary policymakers would be to:

- ✓
- A) shift the monetary policy reaction function to the left.
  - B) **shift the monetary policy reaction function to the right.**
  - C) steepen the monetary policy reaction function.
  - D) flatten the monetary policy reaction function.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#12

Bonds must have positive yields because:

yields.

- ✓
- A) the U.S. Treasury guarantees all bonds to have a positive yield.
  - B) **people can always hold cash.**
  - C) the banking technology does not exist to deal with negative
  - D) All of the above.

**Feedback:**

**LOD: 1**

**The Challenges Modern Monetary Policymakers Face.**

### Q#13

A way for policymakers to avoid the problems that deflation can present and still meet their objective of price stability is to:

- A) set a target of zero inflation.
- B) set an inflation target well above 5 percent.
- C) target a nominal interest rate of zero.
- ✓ D) **set an inflation target of two to three percent.**

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#14

If the target federal funds rate reaches zero:

- A) the FOMC must stop purchasing securities since they cannot lower nominal rates below zero.
- ✓ B) **the FOMC would likely shift their focus to purchasing longer term securities.**
- C) the FOMC would likely raise the required reserve rate.
- D) the FOMC would likely raise the discount rate.

**Feedback:**

**LOD: 3**

**The Challenges Modern Monetary Policymakers Face.**

### Q#15

Some people who believe monetary policymakers should not address equity and property price bubbles, argue their position based on:

- ✓ A) **price bubbles are virtually impossible to identify when they are developing.**
- B) the policymakers have a history for poor investing decisions.
- C) their belief that government should stay out of private matters.
- D) All of the above.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#16

The movement away from bank lending towards asset-backed securities:

- A) has decreased the importance of the bank lending channel.
- B) has eliminated the bank lending channel as a mechanism for monetary policy.
- C) has increased the importance of the bank lending channel of monetary policy.
- D) will require the FOMC to rethink the quantitative impact of changing the target federal funds rate.

- ✓ E) a and d.

**Feedback:**

**LOD: 2**  
**The Challenges Modern Monetary Policymakers Face**

## Quiz # 46

### Q#1

The monetary policy transmission mechanism begins with:

- ✓ A) **changes to the central bank's balance sheet.**  
B) changes in household spending decisions.  
C) changes in exchange rates.  
D) movements in stock and bond prices.

**Feedback:**

**LOD: 1**  
**The Monetary Policy Transmission Mechanism.**

### Q#2

A decrease in short-term interest rates should:

- net exports.  
businesses.  
as net exports.  
exports.
- ✓ A) decrease spending by households and businesses and increase net exports.  
B) lower net exports but raise spending by households and businesses.  
C) **increase spending by households and businesses as well as net exports.**  
D) increase investment and household spending but lower net exports.

**Feedback:**

**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

### Q#3

The impact of monetary policy on the exchange rate and net exports is:

- exports.  
exports.
- ✓ A) predictable for the exchange rate but not for net exports.  
B) predictable for both the exchange rate and net exports.  
C) unpredictable for the exchange rate but predictable for net exports.  
D) **unpredictable for both the exchange rate and net exports.**

**Feedback:**

**LOD: 2**  
**The Monetary Policy Transmission Mechanism.**

### Q#4

A fall in the interest rate tends to push up stock prices. This is referred to as:

- ✓
- A) the Dow Jones mechanism of monetary policy.
  - B) the asset-price channel of monetary policy.**
  - C) the wealth-creating mechanism of monetary policy.
  - D) the investment-spending mechanism of monetary policy.

**Feedback:**

**LOD: 2**

**The Monetary Policy Transmission Mechanism.**

### Q#5

A change in monetary policy results in small businesses more easily finding funding for their projects. This represents the \_\_\_\_\_ channel of monetary policy transmission.

- ✓
- A) bank-lending**
  - B) asset-price
  - C) balance-sheet
  - D) interest-rate

**Feedback:**

**LOD: 2**

**The Monetary Policy Transmission Mechanism.**

### Q#6

Lower interest due to a change in monetary policy results in an increase in household net worth. This represents the \_\_\_\_\_ channel of monetary policy transmission.

- ✓
- A) bank-lending
  - B) asset-price
  - C) balance-sheet**
  - D) interest-rate

**Feedback:**

**LOD: 2**

**The Monetary Policy Transmission Mechanism.**

### Q#7

Which of the following is a *not* a transmission channel of monetary policy?

- A) bank-lending
- B) asset-price
- C) interest-rate
- D) the tax-impact channel**

**Feedback:**

**LOD: 1**

**The Monetary Policy Transmission Mechanism.**

### Q#8

An economist argues that if the Fed raises rates the prices of houses will fall. This refers to the \_\_\_\_\_ channel of monetary policy transmission.

- ✓
- A) the balance-sheet channel
  - B) the asset-price channel**
  - C) the efficient-market channel
  - D) the tax-impact channel

**Feedback:**

**LOD: 1**

**The Monetary Policy Transmission Mechanism.**

### Q#9

Which of the following is considered a "traditional" channel of monetary policy transmission?

- A) the balance-sheet channel
- B) the asset-price channel
- C) the efficient-market channel
- ✓ D) **the interest-rate channel**

**Feedback:**

**LOD: 1**

**The Monetary Policy Transmission Mechanism.**

### Q#10

If the dynamic aggregate demand curve shifts to the left, and potential output has not changed, the appropriate response by monetary policymakers would be to:

- A) shift the monetary policy reaction function to the left.
- ✓ B) **shift the monetary policy reaction function to the right.**
- C) steepen the monetary policy reaction function.
- D) flatten the monetary policy reaction function.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#11

Suppose output unexpectedly increases. Which of the following would be a correct policy response?

- ✓ A) **If the increase is the result of an increase in demand with no increase in potential output, then monetary policymakers should shift the monetary policy reaction function to the left.**
- B) If the increase is the result of an increase in demand with no increase in potential output, then monetary policymakers should shift the monetary policy reaction function to the right.
- C) If the increase is the result of rightward shifts in the short-run and long-run aggregate supply curve, then monetary policymakers should shift the monetary policy reaction function to the left.
- D) If the increase is the result of leftward shifts in the short-run and long-run aggregate supply curve, then monetary policymakers should shift the monetary policy reaction function to the right.

**Feedback:**

**LOD: 3**

**The Challenges Modern Monetary Policymakers Face.**

### Q#12

Nominal interest rates cannot fall below:

- ✓ A) **zero.**
- B) real interest rates.
- C) 2%.

- D) None of the above is correct.

**Feedback:**

**LOD: 1**

**The Challenges Modern Monetary Policymakers Face.**

### Q#13

Deflation:

- A) is good for the economy because it makes it easier for businesses to obtain financing.
- ✓ B) **is only a problem if policymakers cannot bring output back up to its potential level.**
- C) causes increases in nominal interest rates.
- D) fosters economic growth.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#14

Preventing equity and property price bubbles:

- ✓ A) **is difficult for the Fed because such bubbles are virtually impossible to identify when they are developing.**
- B) is a major goal of the Fed.
- C) is one of the simpler tasks the Fed perform in conducting monetary policy.
- D) is the responsibility of fiscal policymakers.

**Feedback:**

**LOD: 2**

**The Challenges Modern Monetary Policymakers Face.**

### Q#15

Which of the following channels of monetary policy transmission is likely to become less and less important due to changes in the structure of the financial system?

- A) the balance-sheet channel
- B) the asset-price channel
- ✓ C) **the bank-lending channel**
- D) the interest-rate channel

**Feedback:**

**LOD: 1**

**The Challenges Modern Monetary Policymakers Face**