ECON4110: Money, Banking and the Macroeconomy
Midterm Exam 1

Name___________________________________
SSN_____________________________________

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

1) Which of the following is NOT a significant cost that a barter system imposes on an economy?
   A) Many prices must be maintained for each good.
   B) The costs arising from the problem of finding two people who each want what the other produces.
   C) Only agricultural goods may be traded.
   D) Specialization of labor is hindered.

2) Money eliminates the need for
   A) specialization.  B) people to have a double coincidence of wants.
   C) the market system.  D) any government role in the economy.

3) When economists refer to the role of money as a medium of exchange, they mean that
   A) worn out currency is easily exchanged at a bank.
   B) money is a generally accepted means of payment for settlement of trade in goods and services.
   C) currency may be exchanged for gold at offices of the U.S. Treasury.
   D) money is of medium importance in explaining the workings of the economy.

4) The purchasing power of money
   A) rises when prices fall.  B) is set by the Fed in January of each year.
   C) rises when prices rise.  D) is constant.

5) Suppose you can buy more with one dollar in the year 2005 than you could have in the year 2000. Then we can say that
   A) there must have been inflation between 2000 and 2005.
   B) there must have been deflation between 2000 and 2005.
   C) the economy must have been growing slowly between 2000 and 2005.
   D) the economy must have been growing rapidly between 2000 and 2005.

6) The total payment to a lender for a simple loan is
   A) i(1 + i).  B) P(1 + i).  C) P.  D) P + i.

7) Suppose First National Bank makes a one-year simple loan of $10,000 at 5% interest to Acme Widget. At the end of one year, Acme Widget will pay First National
8) Suppose Acme Widget issues a one-year discount bond with a face value of $10,000, and received $9434, repaying $10,000 after one year. The interest rate on this bond would be
   A) 6%.          B) 5.66%.         C) 4.34%.       D) 10%.

9) Which of the following is NOT true of a fixed payment loan?
   A) The borrower is left with a substantial unpaid principal at the maturity of the loan.
   B) The payments made by the borrower include both interest and principal.
   C) The borrower is required to make regular periodic payments to the lender.
   D) Home mortgages are an example of fixed payment loans.

10) If you deposit $5000 in a savings account at an annual interest rate of 10%, how much will you have in the account at the end of seven years?
    A) $10,718          B) $9744          C) $850          D) $5500

11) $1 received n years from now has a value today of
    A) $(1 + i)^n/i$.          B) $(1 + i)/i$.        C) $1/(1 + i)$.       D) $1/(1 + i)^n$.

12) At an interest rate of 6%, what is the present value of $10,000 to be received five years from now?
    A) $10,000          B) $13,382          C) $5000          D) $7473

13) If the interest rate is 8%, what would you expect to pay for a discount bond paying $10,000 in ten years?
    A) $21,589          B) $9259          C) $10,000          D) $4632

14) A one-year discount bond with a par value of $10,000 sold today, at issuance, for $9500 has a yield to maturity of
    A) 5.26%.          B) 9.50%.         C) 5.00%.        D) 10.00%.

15) What is the price of a coupon bond that has annual coupon payments of $85, a par value of $1000, a yield to maturity of 10%, and a maturity of three years?
    A) $962.70          B) $211.38          C) $1255.00        D) $898.84

16) A bond’s price and its yield to maturity are inversely related because
    A) discounting future payments at a higher rate increases the present value of the payments.
    B) a fall in a bond’s price will lower its par value and hence its yield to maturity.
    C) an increase in the yield to maturity will lower a bond’s coupon rate and hence its price.
    D) discounting future payments at a higher rate reduces the present value of the payments.

17) Which of the following statements about the total rate of return is NOT correct?
    A) The total rate of return may be greater or less than the rate of capital gain.
    B) The total rate of return may never be negative.
    C) The total rate of return may be greater or less than the current yield.
    D) The total rate of return is greater is the coupon, holding everything else constant.

18) Which of the following is the correct expression for the expected real interest rate?
    A) $r = ip^e$          B) $r = i + p^e$        C) $r = i - p^e$        D) $r = i/p^e$
19) In the market for loanable funds, the buyer is considered to be
   A) the lender or the borrower, depending upon the use to which the funds are put.
   B) the lender or the borrower, depending upon whether interest rates are rising or falling.
   C) the borrower.
   D) the lender.

20) In the market for loanable funds the price of the funds exchanged is
   A) the interest rate. B) the volume of bonds purchased.
   C) the volume of bonds sold. D) the price of bonds.

21) A one-year discount bond with a face value of $10,000 that is currently selling for $8000 has an interest rate of
   A) 2.5%. B) 20%. C) 80%. D) 25%

22) The demand for bonds is
   A) represented by a downward-sloping line when the interest rate is on the vertical axis and the quantity of bonds demanded is on the horizontal axis.
   B) equivalent to the supply of loanable funds.
   C) equivalent to the demand for loanable funds.
   D) represented by an upward-sloping line when the price of bonds is on the vertical axis and the quantity of bonds demanded is on the horizontal axis.

23) The bond supply curve
   A) is represented by a downward sloping line when the price of bonds is on the vertical axis and the quantity of bonds supplied is on the vertical axis.
   B) shows the quantity of bonds lenders are willing to supply as bond prices change.
   C) shows the quantity of bonds borrowers are willing to supply as bond prices change.
   D) shows the quantity of bonds lenders are willing to supply as interest rates change.

24) If there is an excess demand for loanable funds at a given interest rate, then
   A) the price of bonds will rise.
   B) the price of bonds will fall.
   C) the interest rate will fall.
   D) the price of bonds may rise or fall depending upon the reasons for the excess demand for loanable funds.

25) As wealth increases in the economy, savers are
   A) willing to hold more cash relative to their holdings of bonds.
   B) willing to lend more at any given interest rate.
   C) willing to lend less at any given interest rate.
   D) willing to buy fewer bonds at any given price.

26) The demand curve for bonds would be shifted to the left by
   A) a decrease in the information costs of bonds relative to other assets.
   B) a decrease in expected inflation.
   C) an increase in the liquidity of bonds relative to other assets.
   D) an increase in expected returns on other assets.
27) Suppose that Congress passes an investment tax credit. The likely result will be
   A) supply curve for loanable funds will shift to the left.
   B) the equilibrium interest rate will fall.
   C) demand curve for loanable funds will to the left.
   D) the supply curve for bonds will shift to the right.

28) If the federal government decreases its purchases and doesn’t decrease taxes, the bond supply schedule shifts to the
   A) left and the equilibrium interest rate rises.       B) right and the equilibrium interest rate falls.
   C) left and the equilibrium interest rate falls.     D) right and the equilibrium interest rate rises.

29) A small open economy
   A) will always be a net borrower from abroad.
   B) is unable to affect the world real interest rate by its borrowing and lending decisions.
   C) is almost never able to borrow abroad.
   D) will always be a net lender abroad.

30) Financial instruments with high information costs
   A) will have lower prices than similar instruments with low information costs.
   B) will have lower yields than U.S. Treasury securities.
   C) will usually be more liquid than similar instruments with low information costs.
   D) may not be offered for sale in some states.

31) Government obligations, such as Treasury bills and bonds, have
   A) low liquidity and high information costs.         B) low liquidity and low information costs.
   C) high liquidity and high information costs.       D) high liquidity and low information costs.

32) When the yield curve is downward-sloping
   A) long-term yields are higher than short-term yields.
   B) the inflation rate is expected to rise.
   C) the bond market is anticipating the U.S. Treasury may default on its obligations.
   D) short-term yields are higher than long-term yields.

33) Which of the following is NOT true of the yield curve for U.S. Treasury securities?
   A) Typically, it slopes upward.
   B) It depicts the relationship among yields on securities of different maturities.
   C) Typically, it slopes downward.
   D) Typically, it shifts up or down rather than twists.

34) A change in the dollar value of the British pound from $1.60 to $1.50 represents
   A) an increase in the pound price of British goods.
   B) an increase in the dollar price of British goods.
   C) an appreciation of the dollar relative to the pound.
   D) an appreciation of the pound relative to the dollar.
35) When a country’s nominal exchange rate depreciates, the price of
A) that country’s goods abroad increases.
B) that country’s goods produced and sold at home decreases.
C) that country’s goods abroad decreases.
D) foreign goods sold in the country decreases.

36) Suppose that a slice of pepperoni pizza costs one pound in London and two dollars in San Francisco. If the real exchange rate is one-third of a slice of U.S. pizza for one slice of British pizza, how many pounds should you receive in exchange for one dollar?
A) 1/3  B) 3  C) 2  D) 1.5

37) When a country’s real exchange rate depreciates
A) it can trade its goods for fewer units of foreign goods.
B) its nominal exchange rate must also have appreciated.
C) its nominal exchange rate must have depreciated.
D) it can trade its goods for more units of foreign goods.

38) Which of the following would cause the nominal exchange rate to depreciate?
A) the foreign inflation rate increases  B) the government budget deficit increases
C) the real exchange rate appreciates  D) the domestic inflation rate increases

39) If oranges sell for $100 per crate in the United States and 4000 pesos per crate in Mexico, the law of one price indicates that you should be able to exchange one dollar for
A) 4 pesos.  B) 40 pesos.  C) 0.025 peso.  D) 400 pesos.

40) The theory of purchasing power parity assumes that
A) inflation rates are roughly the same in most countries.
B) movements in nominal exchange rates are the result of movements in real exchange rates.
C) movements in nominal exchange rates are the result of movements in relative price levels.
D) real exchange rates are volatile.

41) According to the theory of purchasing power parity, if the inflation rate in England is greater than the inflation rate in Japan, the
A) nominal value of the pound will appreciate against the yen, but only if the two countries are on the gold standard.
B) nominal value of the yen will appreciate against the pound.
C) law of one price has been violated.
D) nominal value of the pound will appreciate against the yen.

42) Which of the following is the correct expression for the value of $1 invested in a foreign security for one year?
A) \(1 - if + \frac{\Delta EX^e}{EX}\)  B) \(1 + if - \frac{\Delta EX^e}{EX}\)  C) \(1 - if - \frac{\Delta EX^e}{EX}\)  D) \(1 + if + \frac{\Delta EX^e}{EX}\)
43) When deciding between domestic and foreign financial investments, investors typically consider
A) shifts in the relative demand for foreign and domestic goods.
B) domestic and foreign inflation rates and expected changes in the exchange rate.
C) domestic and foreign interest rates and expected changes in the exchange rate.
D) domestic and foreign budget deficits.

44) If the nominal interest rate parity condition is NOT met,
A) the return from holding domestic assets must exceed the expected return from holding foreign assets.
B) the return from holding domestic assets must be less than the expected return from holding foreign assets.
C) imports will exceed exports.
D) the return from holding domestic assets must be greater or less than the expected return from holding foreign assets.

45) The most important derivative instruments are
A) corporate bonds.  B) government bonds.
C) futures and options contracts.  D) common stocks.

46) If market participants believe that the wheat crop is likely to be unusually small,
A) the spot price of wheat is likely to be below the futures price of wheat.
B) it will not be possible to find a seller of a futures contract in wheat.
C) it will not be possible to find a buyer of a futures contract in wheat.
D) the spot price of wheat is likely to be above the futures price of wheat.

47) Hedgers are primarily interested in
A) betting on anticipated changes in prices.
B) reducing the spread between bid and ask prices on bonds.
C) increasing market liquidity.
D) reducing their exposure to the risk of price fluctuations.

48) The price at which an option may be exercised is called the
A) equilibrium price.  B) strike price.  C) market price.  D) fixed price.

49) Suppose that Acme Widget is currently selling for $100 per share and you own a call option to buy Acme Widget at $75 per share. The intrinsic value of your option is
A) $100.
B) $75.
C) $25.
D) is not possible to determine in the absence of information on values of the share price of Acme Widget between now and the expiration date of the call.

50) If you buy a futures contract for U.S. Treasury bills and on the delivery date the interest rate on T-bills is lower than you expected, you will have
A) gained money on your long position.  B) lost money on your short position.
C) gained money on your short position.  D) lost money on your long position.
1) Answer: C
2) Answer: B
3) Answer: B
4) Answer: A
5) Answer: B
6) Answer: B
7) Answer: D
8) Answer: A
9) Answer: A
10) Answer: B
11) Answer: D
12) Answer: D
13) Answer: D
14) Answer: A
15) Answer: A
16) Answer: D
17) Answer: B
18) Answer: C
19) Answer: C
20) Answer: A
21) Answer: D
22) Answer: B
23) Answer: C
24) Answer: B
25) Answer: B
26) Answer: D
27) Answer: D
28) Answer: C
29) Answer: B
30) Answer: A
31) Answer: D
32) Answer: D
33) Answer: C
34) Answer: C
35) Answer: C
36) Answer: D
37) Answer: A
38) Answer: D
39) Answer: B
40) Answer: C
41) Answer: B
42) Answer: B
43) Answer: C
44) Answer: D
45) Answer: C
46) Answer: A
47) Answer: D
48) Answer: B
49) Answer: C
50) Answer: D