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

1) Economists define risk as
   A) the difference between the return on common stock and the return on corporate bonds.
   B) the degree of uncertainty of an asset’s return.
   C) the ease with which an asset can be exchanged for other assets or for goods and services.
   D) the difference between the interest rate borrowers pay and the interest rate lenders receive.

2) In the United States monetary policy is carried out by
   A) the President.  
   B) the Federal Reserve System.
   C) Congress.  
   D) Congress and the President acting together.

3) Which of the following assets is the most liquid?
   A) a house  
   B) a checking account  
   C) a painting by Picasso  
   D) a share of common stock

4) A system of barter has substantial transactions costs because
   A) taxes under such a system are generally a large fraction of the value of output.
   B) the uncertainties of trade result in high legal fees being incurred to draw up binding contracts.
   C) traders must spend considerable time searching for trading partners.
   D) the uncertainties of trade result in high insurance premiums.

5) Money as a medium of exchange refers only to
   A) checks at commercial banks.  
   B) gold coins.
   C) anything that is generally accepted as payment for goods and services.
   D) currency.

6) When economists refer to the role of money as a store of value, they mean that
   A) the value of money falls only when the quantity of money in circulation falls.
   B) money never loses its value, unlike other assets.
   C) money allows value to be stored easily.
   D) the value of money falls only when the quantity of money in circulation rises.

7) Wealth is
   A) the sum of the value of assets minus value of liabilities.  
   B) a flow variable.
   C) the sum of the value of assets.
   D) equal to income.
8) When prices rise, the purchasing power of money
   A) is unaffected.
   B) rises.
   C) may rise, fall, or be unaffected depending upon circumstances.
   D) falls.

9) Which of the following is an example of a commodity money?
   A) dollar bills  B) British pound notes  C) gold coins  D) Japanese yen notes

10) The amount of funds the borrower receives from the lender with a simple loan is called the

11) A coupon bond involves
    A) interest payments from the borrower to the lender periodically during the life of the loan, but no payment
        by the borrower to the lender of the face value of the loan at maturity.
    B) periodic payments by the borrower to the lender that include principal, but not interest.
    C) interest payments from the borrower to the lender periodically during the life of the loan and payment by
        the borrower to the lender of the face value of the loan at maturity.
    D) periodic payments by the borrower to the lender that include both principal and interest.

12) The yield to maturity on a one-year discount bond equals
    A) \( \frac{F - D}{D} \).
    B) \( \frac{F - D}{F} \).
    C) \( \frac{D - F}{D} \).
    D) \( \frac{D - F}{F} \).

13) If, while you are holding a coupon bond, its market price falls, you can be sure that
    A) the coupon payment you are receiving must have been reduced.
    B) the interest rate on other similar bonds must have fallen.
    C) the par value of the bond must have declined.
    D) the interest rate on other similar bonds must have risen.

14) If the current price of a bond is greater than its face value,
    A) an investor will receive a capital gain by holding the bond until maturity.
    B) the coupon rate must be equal to the current yield.
    C) the coupon rate must be less than the current yield.
    D) the yield to maturity must be less than the coupon rate.

15) How is the interest rate that prevails in the bond market determined?
    A) By the decision of the president, in consultation with Congress.
    B) By the interaction of stock prices and bond prices.
    C) By the Board of Governors of the New York Stock Exchange.
    D) By demand for and supply of bonds.

16) A one-year discount bond with a face value of $10,000 has an interest rate of 5%. What is its price?
    A) $9523.81  B) $9500  C) $9625.25  D) $9800
17) The supply curve of loanable funds slope up because
   A) at higher bond prices more loanable funds will be supplied.
   B) an increase in the interest rate makes lenders more willing and able to supply more funds.
   C) higher interest rates reduce the inflation rate.
   D) a decrease in the interest rate makes lenders more willing and able to supply more funds.

18) The demand curve for loanable funds slopes down because.
   A) a decrease in the interest rate makes borrowers more willing and able to demand more funds.
   B) at lower bond prices more loanable funds will be supplied.
   C) lower interest rates reduce the inflation rate.
   D) an increase in the interest rate makes borrowers more willing and able to demand more funds.

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

20) The supply curve for loanable funds would be shifted to the left by
   A) an increase in wealth.
   B) an increase in the riskiness of bonds relative to other assets.
   C) an increase in the expected return on bonds.
   D) a decrease in expected inflation.

21) When a company whose ability to repay its obligations in full is uncertain borrows funds
   A) it will have to issue debt with longer maturities than would a company with a lower probability of default.
   B) it must offer investors higher yields to compensate them for the risk they take in buying their bonds or making loans.
   C) its bonds will sell for higher prices than would the bonds of a company with a lower probability of default.
   D) it must do so through financial markets rather than through financial intermediaries.

22) The default risk premium fluctuates mainly
   A) because bond rating agencies tend to be inconsistent in their ratings of bonds.
   B) because risk-neutral investors will often become risk-averse as time passes.
   C) as new information about a borrower's creditworthiness becomes available.
   D) because taxes tend to rise over the long run.

23) Financial instruments with high information costs
   A) may not be offered for sale in some states.
   B) will have lower prices than similar instruments with low information costs.
   C) will usually be more liquid than similar instruments with low information costs.
   D) will have lower yields than U.S. Treasury securities.
24) When a country’s nominal exchange rate appreciates, the price of
   A) that country’s goods abroad decreases.
   B) that country’s goods abroad increases.
   C) foreign goods sold in the country increases.
   D) that country’s goods produced and sold at home increases.

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

26) International capital mobility refers to
   A) the ease with which investors move funds among international financial markets.
   B) the ease with which cash may be transferred from one country to another without having to be converted into a foreign currency.
   C) the ease with which manufacturing equipment can be transported across countries.
   D) the ease with which exchange rates may be adjusted to reflect changes in the relative economic strengths of countries.

27) Forward transactions
   A) provide reduced tax payments.
   B) provide risk sharing.
   C) entail small information costs.
   D) provide substantial liquidity.

28) The buyer of a futures contract
   A) has the obligation to receive the underlying financial instrument at the specified future date.
   B) assumes the short position.
   C) has the obligation to deliver the underlying financial instrument at the specified date.
   D) may, at his or her option, deliver or receive the underlying financial instrument at the specified date.

29) A lender who is worried that its cost of funds might rise during the term of a loan it has made, can hedge against this rise by
   A) buying call options on Treasury bills.
   B) increasing the amount of money which it lends.
   C) buying futures contracts on Treasury bills.
   D) selling futures contracts on Treasury bills.

30) Profits from speculation arise because of
   A) disagreements among traders about future prices of a commodity or financial instrument.
   B) the illiquidity of markets for derivative instruments.
   C) the high information costs in markets for derivative instruments.
   D) the spread between the bid and ask prices on bonds.
1) Answer: B
2) Answer: B
3) Answer: B
4) Answer: C
5) Answer: C
6) Answer: C
7) Answer: A
8) Answer: D
9) Answer: C
10) Answer: C
11) Answer: C
12) Answer: A
13) Answer: D
14) Answer: D
15) Answer: D
16) Answer: A
17) Answer: B
18) Answer: A
19) Answer: D
20) Answer: B
21) Answer: B
22) Answer: C
23) Answer: B
24) Answer: B
25) Answer: C
26) Answer: A
27) Answer: B
28) Answer: A
29) Answer: D
30) Answer: A