Econ 330 – Exam 1
Name ______________________________
ID ________________________________
Section Number ____________________

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

1) If during the past decade the average rate of monetary growth has been 5% and the average inflation rate has been 5%, everything else held constant, when the Federal Reserve announces that the new rate of monetary growth will be 10%, the adaptive expectation forecast of the inflation rate is 1) _______

A) 10%. B) 5%.
C) more than 10%. D) between 5 and 10%.

2) The interest rate on Treasury Inflation Protected Securities is a direct measure of 2) _______

A) the nominal interest rate. B) the real interest rate.
C) the rate of deflation. D) the rate of inflation.

3) A $1000 face value coupon bond with a $60 coupon payment every year has a coupon rate of 3) _______

A) 10 percent. B) .6 percent. C) 5 percent. D) 6 percent.

4) The ________ is below the coupon rate when the bond price is ________ its par value. 4) _______

A) yield to maturity; above B) discount rate; above
C) discount rate; below D) yield to maturity; below

5) A particularly attractive feature of the ________ is that it tells you what the market is predicting about future short-term interest rates by just looking at the slope of the yield curve. 5) _______

A) liquidity premium theory B) segmented markets theory
C) separable markets theory D) expectations theory

6) When the interest rate on a bond is ________ the equilibrium interest rate, in the bond market there is excess ________ and the interest rate will ________. 6) _______

A) above; demand; rise B) below; supply; fall
C) above; supply; rise D) above; demand; fall

7) Holding all other factors constant, the quantity demanded of an asset is 7) _______

A) negatively related to its liquidity relative to alternative assets.
B) negatively related to its expected return relative to alternative assets.
C) positively related to wealth.
D) positively related to the risk of its returns relative to alternative assets.

8) Everything else held constant, if the tax-exempt status of municipal bonds were eliminated, then 8) _______

A) the interest rate on municipal bonds would exceed the rate on Treasury bonds.
B) the interest rate on municipal bonds would equal the rate on Treasury bonds.
C) the interest rates on municipal bonds would still be less than the interest rate on Treasury bonds.
D) the interest rates on municipal, Treasury, and corporate bonds would all increase.

9) When the growth rate of the money supply increases, interest rates end up being permanently lower if 9) _______

A) the expected inflation effect is larger than the liquidity effect.
B) the liquidity effect is larger than the other effects.
C) there is slow adjustment of expected inflation.
D) there is fast adjustment of expected inflation.

10) A monetary expansion ________ stock prices due to a decrease in the ________ and an increase in the ________, everything else held constant. 10) _______

A) increases; required rate of return; dividend growth rate
B) reduces; future sales price; expected rate of return
C) increases; required rate of return; future sales price
D) reduces; current dividend; expected rate of return

11) The yield to maturity is ________ than the ________ rate when the bond price is ________ its face value. 11) _______

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

12) When talking about a coupon bond, face value and ________ mean the same thing. 12) _______

A) coupon value
B) amortized value
C) discount value
D) par value

13) A ________ yield curve predicts a future increase in inflation. 13) _______

A) steeply upward sloping
B) slight upward sloping
C) flat
D) downward sloping

14) The Federal Reserve has recently announced that they will raise the fed funds interest rate when the unemployment rate falls below _______, and 2-year inflation expectations rise above ______. 14) _______

A) 6.5%; 2.5%
B) 5.0%; 2.0%
C) 7.5%; 3.5%
D) 7.0%; 3.0%

15) Stock returns reached 30% in 2013 because of all the following except: 15) _______

A) rising investor optimism as economic growth hit 4.1% in the 3rd quarter.
B) monetary policy pushing bond yields lower.
C) profit to GDP ratios reaching their highest levels in 70 years.
D) investors lowering their equity risk premium.

16) When the expected inflation rate increases, the real cost of borrowing ________ and bond supply ________, everything else held constant. 16) _______

A) increases; decreases
B) increases; increases
C) decreases; decreases
D) decreases; increases

17) Using the one-period valuation model, assuming a year-end dividend of $0.11, an expected sales price of $110, and a required rate of return of 10%, the current price of the stock would be 17) _______

A) $121.12.
B) $100.11
C) $100.10.
D) $110.11.

18) An increase in the liquidity of corporate bonds will ________ the price of corporate bonds and ________ the yield of Treasury bonds, everything else held constant. 18) _______

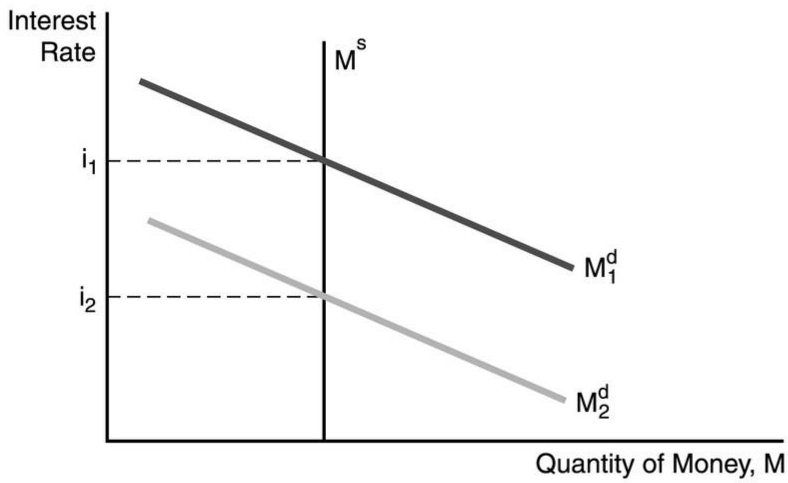
A) increase; increase
B) reduce; reduce
C) reduce; increase
D) increase; reduce

19) If fluctuations in interest rates become smaller, then, other things equal, the demand for stocks ________ and the demand for long-term bonds ________. 19) ______

A) decreases; decreases
B) increases; decreases
C) increases; increases
D) decreases; increases

20) In the one-period valuation model, the value of a share of stock today depends upon 20) ______

A) the future value of dividends and the actual sales price.
B) the present value of both the dividends and the expected sales price.
C) the actual value of the dividends and expected sales price received in one year.
D) only the present value of the future dividends.



21) In the figure above, one factor not responsible for the decline in the demand for money is 21) ______

A) a decline in the expected inflation rate.
B) a decline the price level.
C) an increase in income.
D) a decline in income.

22) If $22,050 is the amount payable in two years for a $20,000 simple loan made today, the interest rate is 22) ______

A) 5 percent.
B) 10 percent.
C) 22 percent.
D) 25 percent.

23) If a security pays $55 in one year and $133 in three years, its present value is $150 if the interest rate is 23) ______

A) 5 percent.
B) 10 percent.
C) 12.5 percent.
D) 15 percent.

24) In the United States during the late 1970s, the nominal interest rates were quite high, but the real interest rates were negative. From the Fisher equation, we can conclude that expected inflation in the United States during this period was 24) ______

A) irrelevant.
B) negative.
C) low.
D) high.

25) A bank's tangible equity includes all the following except: 25) ______

A) Cumulative Perpetual Preferred Stock
B) Loan Loss Allowance
C) Retained Earnings
D) Equity

26) The bond demand curve is ________ sloping, indicating a(n) ________ relationship between the price and quantity demanded of bonds. 26) ______

A) downward; direct
B) upward; direct
C) downward; inverse
D) upward; inverse

27) Assume Tom wants to save $5,000 a year for the next 20 years, and the interest rate will be 6% each year. Calculate the future value of this ordinary annuity. 27) ______

A) $183,928 B) $177,651 C) $203,843 D) $195,612

28) When the price of a bond is ________ the equilibrium price, there is an excess demand for bonds and price will ________. 28) ______

A) above; fall B) below; fall C) below; rise D) above; rise

29) The bond supply curve is ________ sloping, indicating a(n) ________ relationship between the price and quantity supplied of bonds. 29) ______

A) downward; inverse B) downward; direct
C) upward; direct D) upward; inverse

30) For a 3-year simple loan of $10,000 at 10 percent, the amount to be repaid is 30) ______

A) $10,030. B) $10,300. C) $13,000. D) $13,310.

31) When the Treasury bond market becomes less liquid, other things equal, the demand curve for corporate bonds shifts to the ________ and the demand curve for Treasury bonds shifts to the ________. 31) ______

A) left; left B) left; right C) right; left D) right; right

32) If the liquidity effect is smaller than the other effects, and the adjustment to expected inflation is slow, then the 32) ______

A) interest rate will initially fall but eventually climb above the initial level in response to an increase in money growth.
B) interest rate will fall.
C) interest rate will initially rise but eventually fall below the initial level in response to an increase in money growth.
D) interest rate will rise.

33) What is the return on a 5 percent coupon bond that initially sells for $1,000 and sells for $900 next year? 33) ______

A) 10 percent B) 5 percent C) -10 percent D) -5 percent

34) Using the Gordon growth formula, if D_1 is $1.00, k_e is 10% or 0.10, and g is 5% or 0.05, then the current stock price is 34) ______

A) $10. B) $20. C) $30. D) $40.

35) As default risk decreases, the expected return on corporate bonds ________, and the return becomes ________ uncertain, everything else held constant. 35) ______

A) decreases; more B) increases; less C) increases; more D) decreases; less

36) If you expect the inflation rate to be 15 percent next year and a one-year bond has a yield to maturity of 7 percent, then the real interest rate on this bond is 36) ______

A) 7 percent. B) 22 percent. C) -15 percent. D) -8 percent.

37) If there is an excess demand for money, individuals ________ bonds, causing interest rates to ________. 37) ______

A) buy; fall B) buy; rise C) sell; rise D) sell; fall

38) When the Fed decreases the money stock, the money supply curve shifts to the ________ and the interest rate ________, everything else held constant. 38) ______

A) left; falls B) left; rises C) right; rises D) right; falls

39) If the yield curve slope is flat for short maturities and then slopes steeply upward for longer maturities, the liquidity premium theory (assuming a mild preference for shorter-term bonds) indicates that the market is predicting 39) ______

A) constant short-term interest rates in the near future and a decline further out in the future.
B) a decline in short-term interest rates in the near future and a rise further out in the future.
C) a rise in short-term interest rates in the near future and a decline further out in the future.
D) constant short-term interest rates in the near future and further out in the future.

40) The interest rate that describes how well a lender has done in real terms after the fact is called the 40) ______

A) ex ante real interest rate. B) ex ante nominal interest rate.
C) ex post real interest rate. D) ex post nominal interest rate.

41) A change in perceived risk of a stock changes 41) ______

A) the expected dividend growth rate. B) the current dividend.
C) the required rate of return. D) the expected sales price.

42) The Great Regression caused over 500 banks to fail in the U.S. Which of the following is not one of the characteristics of a failed bank? 42) ______

A) Used traditional funding sources
B) Chartered for less than 10 years
C) Used traditional funding sources
D) Participated in out-of-territory commercial real estate loans

43) Everything else held constant, a decrease in marginal tax rates would likely have the effect of ________ the demand for municipal bonds, and ________ the demand for U.S. government bonds. 43) ______

A) decreasing; increasing B) decreasing; decreasing
C) increasing; increasing D) increasing; decreasing

44) If a perpetuity has a price of $500 and an annual interest payment of $25, the interest rate is 44) ______

A) 2.5 percent. B) 5 percent. C) 7.5 percent. D) 10 percent.

45) Everything else held constant, when real estate prices are expected to decrease 45) ______

A) the demand curve for bonds shifts to the right and the interest rate falls.
B) the supply curve for bonds shifts to the right and the interest rate falls.
C) the demand curve for bonds shifts to the left and the interest rate rises.
D) the demand curve for bonds shifts to the left and the interest rate falls.

46) In Keynes's liquidity preference framework, as the expected return on bonds increases (holding everything else unchanged), the expected return on money ________, causing the demand for ________ to fall. 46) ______

A) rises; money B) falls; money C) falls; bonds D) rises; bonds

47) When I purchase a 10 percent coupon bond, I calculate a yield to maturity of 8 percent. If I hold this bond to maturity, then my return on this asset is 47) ______

A) 8 percent.
B) 12 percent.
C) 10 percent.
D) there is not enough information to determine the return.

48) Which of the following factors is not pushing down the long term Treasury yields? 48) ______

A) emerging market turmoil
B) Euro-Zone debt crisis
C) recession fears
D) inflation expectations

49) Everything else held constant, if the expected return on U.S. Treasury bonds falls from 10 to 5 percent and the expected return on GE stock rises from 7 to 8 percent, then the expected return of holding GE stock ________ relative to U.S. Treasury bonds and the demand for GE stock ________. 49) ______

A) falls; rises
B) rises; rises
C) rises; falls
D) falls; falls

50) Of the four effects on interest rates from an increase in the money supply, the initial effect is, generally, the 50) ______

A) price level effect.
B) expected inflation effect.
C) income effect.
D) liquidity effect.

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