

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 2007

EXERCISE 2: 6 Questions (8 Points Total)

DUE: Tues., Sept 11, 2007, 2:10pm

****IMPORTANT REMINDER: LATE ASSIGNMENTS WILL NOT BE ACCEPTED
– NO EXCEPTIONS****

EXERCISE INSTRUCTIONS:

- (1) Please **fill in your name and student ID number** on Side 1 of your bubble sheet and write **353 Exercise 2** in the top margin of Side 1.
- (2) Use a number 2 pencil to **mark your answers** on Side 1 of the bubble sheet to the first five questions Q1 through Q5, below, which are in multiple choice format.
- (3) The sixth question Q6 is a Web Exercise that asks you to research and discuss the organizational structure of three major U.S. financial markets. Please put your **name and student ID number** at the top of your answer sheet for Q6 along with **353 Exercise 2** and **separately** hand in this answer-sheet sheet for Q6 in addition to your answer bubble sheet for questions Q1 through Q5.
- (4) Each question Q1 through Q5 is worth 1 point, and Q6 is worth 3 points.

Q1 (1 point). By definition, examples of FINANCIAL assets include

- A. ATM machines.
- B. special financial knowledge acquired through working as a bank manager.
- C. 100 shares of General Motors stock.
- D. all of the above.
- E. only A and B above.

Q2 (1 Point). By definition, which (if any) of the following statements describing dealers, brokers, and financial intermediaries are TRUE?

- A. Brokers stand ready to buy or sell the assets in which they trade should gaps arise between the amount demanded and the amount supplied, a process known as “brokerage commissioning.”
- B. Financial intermediaries sell lower-risk assets with short maturities to savers and then use these funds to buy higher-risk assets with longer maturities from borrowers, a process known as “asset transformation.”
- C. Dealers sell lower-risk assets with short maturities to buyers and then use these funds to buy higher-risk assets with longer maturities from sellers, a process known as “making the market.”
- D. none of the above.

Q3 (1 Point). By definition, instances of DIRECT FINANCE include:

- A. the signing of a loan contract with Wells Fargo Bank.
- B. the purchase of a share of Whirlpool Corporation on the New York Stock Exchange.
- C. a swap of U.S. dollars for yen on the Foreign Exchange Market.
- D D.** the purchase of shares of LDK Solar Company, Ltd, during an initial public offering (IPO).
- E. none of the above.

Q4 (1 Point). By definition, a EURODOLLAR is

- A. one euro in the form of paper currency rather than coinage.
- B B.** a U.S. dollar deposited in foreign banks outside the U.S. or in foreign branches of U.S. banks.
- C. a U.S. dollar that is being held by the European Central Bank (ECB) specifically as currency reserves for Europe-U.S. trade transactions.
- D. any U.S. dollar that has been purchased by euros in the foreign currency market.
- E. the number of U.S. dollars that can be obtained in exchange for one euro.

Q5 (1 Point). A CORPORATE BOND issued by John Deere and purchased by you is ____ for John Deere and ____ for you.

- A A.** a liability; an asset
- B. an asset; a liability
- C. a real asset; a financial asset
- D. a financial asset; a real asset

**SEE THE FOLLOWING PAGE FOR
Q6: WEB EXERCISE**

Q6: Web Exercise (3 Points Total). Not Your Father's Financial Markets!

During our discussion this past week of Mishkin Chapter 2, we defined three basic organizational forms that financial markets could take: an auction; an Over-The-Counter (OTC) market (or “Dealers Market”), and an organized exchange combining both auction and OTC features. In fact, however, distinguishing the different forms of real-world financial markets can be a bit of a challenge. Financial markets tend to change their organizational forms over time and to combine auction and OTC features in a wide variety of ways.

This Web Exercise asks you to research and discuss the organizational form of three major U.S. financial markets. Each part below (A-F) should be answered briefly but carefully, and is worth 1/2 point.

Please be sure to provide the URL address for any website you use to obtain your answers to parts A-F below. Also, please limit your information gathering to websites reasonably judged to be providers of reliable information (e.g. websites maintained by government and/or well-known corporations rather than unknown writers or sources).

Your answers to Q6:Parts A-F below should be provided on a single answer sheet that is separately turned in along with your bubble sheet with answers to Q1-Q5 above.

Part A [1/2 Point]: When was the NEW YORK STOCK EXCHANGE (NYSE) first established BY THIS NAME, and what was its basic organizational form at that time?

Answer Outline for Part A: The New York Stock Exchange was first established by this name in 1863 (as a shortened form of the New York Stock & Exchange Board founded in 1817). The basic organizational form was that of an auction with floor/street trading.

Source: www.nyse.com/about/history/timeline_1860_1899_index.html

Part B [1/2 Point]: What is the CURRENT basic organizational form of this institution?

Answer Outline for Part B: The NYSE is now a hybrid market form combining electronic trading with auction floor trading. As of January 24, 2007, customers can either send orders for immediate electronic execution or route orders to the floor for trade in the auction market.

Source: www.nyse.com/about/history/1089312755484.html

Additional Remark: The NYSE is now operated by the holding company NYSE Euronext, a global international company formed by the merger of the NYSE with Archipelago Holdings, Inc., a fully electronic stock exchange, in March 2006, and with Euronext, a pan-European stock exchange, in April 2007.

Source: www.nyse.com/about/1088808971270.html

Part C [1/2 Point]: When was the NASDAQ stock market first established BY THIS NAME, and what was its basic organizational form at that time?

Answer Outline for Part C: The NASDAQ stock market was founded in 1971 as the first electronic stock exchange in the world. It was created as a means to increase the trading of *Over-The-Counter (OTC) Stocks*, meaning stocks unable to meet the listing requirements for larger exchanges, and was organized as a Dealers Market (OTC Market). The Nasdaq did not have a physical trading floor. Rather, all of its trades were made through a computer and telecommunications system. Participants bought and sold stocks through various spatially-distributed dealers (market makers) rather than from each other.

Source: www.advfn.com/StockExchanges/history/NASDAQ/NASDAQ.html

Additional Remark: NASDAQ is an acronym for “National Associate of Securities Dealers Automated Quotation.” In recent years, Nasdaq (in lower case letters) has been increasingly used as an abbreviation for the “NASDAQ stock market.”

Source: www.investopedia.com/terms/n/nasdaq.asp

Part D [1/2 Point]: What is the CURRENT basic organizational form of this institution?

Answer Outline for Part D: The Nasdaq remains an electronic stock market exchange that operates as a Dealers Market (OTC Market).

Source: www.advfn.com/StockExchanges/about/NASDAQ/NASDAQStockExchange.html

Additional Remarks: In 1998 the Nasdaq merged with the American Stock Exchange to form the NASDAQ-AMEX Market Group in order to compete better with the NYSE. However, the combined company still operates as two separate stock market exchanges. Even though the Nasdaq is operated as an OTC market, Nasdaq stocks are not generally classified as OTC stocks because the Nasdaq has become more of a stock market exchange by adding trade and volume reporting and automated trading systems. Many OTC stocks are traded through an electronic posting service known as the *OTC Bulletin Board (OTCBB)*.

Sources: (1) www.advfn.com/StockExchanges/history/NASDAQ/NASDAQ.html;

(2) www.investopedia.com/terms/o/otc.asp; and (3) www.otcbb.com/

Part E [1/2 Point]: When was the CHICAGO BOARD OF TRADE (CBOT) first established BY THIS NAME, and what was its basic organizational form at that time?

Answer Outline for Part E: The CBOT was established in 1848 for the purpose of exchanging futures contracts for agricultural commodities such as corn, wheat, oats, and soybeans. The basic organizational form of the CBOT in its early years was an *open auction (or open outcry system)* in which traders met face-to-face in a trading pit to conduct their trades.

Source: www.cbot.com/cbot/pub/page/0,3181,942,00.html

Additional Remark: A *futures contract* is a standardized, transferable, exchange-traded contract that requires delivery of a commodity, bond, currency, or stock index, at a specified price on a specified future date.

Source: www.investorwords.com/2136/futures_contract.html

Part F [1/2 Point]: What is the CURRENT basic organizational form of this institution?

Answer Outline for Part F: On July 9, 2007, the CBOT (NYSE: BOT) and the Chicago Mercantile Exchange (NYSE/Nasdaq: CME) merged to form the CME Group, Inc., the largest and most diverse futures and options exchange in the world. The CME Group, Inc., maintains a hybrid market form that permits both open auction trading and electronic trading in a wide variety of commodities and financial instruments.

Sources: (1) www.cbot.com, www.cbot.com/cbot/pub/page/0,3181,1215,00.html;

(2) www.cbot.com/cbot/pub/page/0,3181,942,00.html; (3) www.cme.com/; and

(4) www.cmegroup.com/