

Answer Outline

ECONOMICS 353

L. Tesfatsion/Fall 06

EXERCISE 5: Eight Questions (8 Points Total) DUE: Tuesday, October 3, 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 **Econ 353-Ex5** 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 all eight questions Q1 through Q8, below, which are in multiple choice format. Each question is worth 1 point.

Q1 (1 point). Which of the following are true for a (ZERO COUPON) DISCOUNT BOND with a face value F :

- A. The interest rate is always zero.
- B. Treasury bills take this form.
- C. The purchase price is usually less than F .
- D. All of the above.
- E. Only B and C above.

Q2 (1 point). Which of the following properties are true for a COUPON BOND?

- A. The borrower makes a coupon payment every payment period plus a payment of the face value at maturity.
- B. The borrower makes the same fixed payment in every payment period during the life of the bond.
- C. Residential mortgages are frequently of this type.
- D. Only B and C above.
- E. Only A and C above.

Q3 (1 point). To claim that a lottery winner who is to receive \$1 million per year for the next twenty years has just won \$20 million dollars is misleading, since it ignores

- A. moral hazard
- B. par value
- C. risk aversion
- D. the discounting of future dollar awards
- E. interest rate risk

Q4 (1 point). If a security pays \$55 at the end of one year and \$133 at the end of three years, then its present value is \$150 (rounded off to the nearest dollar) if the INTEREST RATE is

- A. 5 percent
- B B.** 10 percent
- C. 12.5 percent
- D. 15 percent

Q5 (1 point). An increase in the length of time to a promised future payment _____ the present value of the payment calculated in terms of any positive interest rate.

- A A.** decreases
- B. increases
- C. has no effect on
- D. is irrelevant to

Q6 (1 point). The interest rate that equates the present value of payments received from a debt instrument to its current value is

- A. the simple interest rate
- B. the current yield
- C C.** the yield to maturity
- D. the real interest rate
- E. the coupon rate

Q7 (1 point). A coupon bond with a face value of \$8,000, an (annual) coupon payment of \$400, a 2-year maturity, and a purchase price of \$7,304.87 has a COUPON RATE of

- A. 1 percent
- B B.** 5 percent
- C. 8 percent
- D. 10 percent
- E. 12 percent

Q8 (1 point). If a security pays \$110 at the end of next year and \$121 at the end of two years, what is its YIELD TO MATURITY if it currently sells for \$200?

- A. 9 percent
- B B.** 10 percent
- C. 11 percent
- D. 12 percent