

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 05

EXERCISE 6: 8 Questions (8 Points Total)

DUE: Tues, Oct 11, 2005, 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 6** 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. There is no Web Exercise question for Exercise 6.
- (3) Each question Q1 through Q8 is worth 1 point.

Q1 (1 point). In a primary bond market, the demand curve for bonds slopes downward to the right because, at a HIGHER bond price, the yield to maturity is _____, which discourages _____ from demanding as many bonds for purchase.

- A. higher; lenders
- B. lower; lenders
- C. higher; borrowers
- D. lower; borrowers

Q2 (1 Point). According to the theory in Mishkin Chapter 5, when the price of bonds is BELOW the equilibrium price level, then there is an _____ bonds and the price of bonds can be expected to _____.

- A. excess demand for; rise
- B. excess demand for; fall
- C. excess supply of; fall
- D. excess supply of; rise
- E. none of the above.

Q3 (1 Point). If there currently is an EXCESS SUPPLY of Iowa State bonds, then the theory in Mishkin Chapter 5 predicts that (all else equal) the current price of these bonds is _____ the equilibrium price level and hence will _____.

- A. below; be bid upwards by borrowers until demand equals supply
- B. above; be bid upwards by borrowers until demand equals supply
- C. below; be bid upwards by lenders until demand equals supply
- D D. above; be bid downwards by lenders until demand equals supply

Q4 (1 Point). According to Mishkin (Chapter 5), key factors that are likely to cause the SUPPLY curve for bonds to shift LEFT (fewer bonds supplied for each bond price P) include

- A. a lower government budget deficit.
- B. a decrease in the expected profitability of capital investment.
- C. a decrease in the expected inflation rate.
- D. only A and B above.
- E E. all of the above.

Q5 (1 Point). Consider a collection of fifteen-year bonds newly issued for sale today (October 4, 2005). According to the theory presented in Mishkin (Chapter 5), if there is a sudden DECREASE today (October 4, 2005) in the yield to maturity that borrowers and lenders EXPECT will hold for these bonds at the FUTURE date of January 1, 2006, then (all else remaining equal) one would expect to see _____ in the demand for these bonds today by lenders because of _____.

- A. a decrease; a lower expected capital gain from Jan 1, 2006 through Jan 1, 2007.
- B B. an increase; a higher expected capital gain from today through Jan 1, 2006.
- C. a decrease; a lower expected capital gain from today through Jan 1, 2006
- D. an increase; a higher expected capital gain from Jan 1, 2006 through Jan 1, 2007.

Q6 (1 Point). Suppose the market for corporate bonds is currently in equilibrium. However, new data on corporate profits convinces people to revise **DOWNWARD** their expectations regarding the future inflation rate. Then the theory in Mishkin Chapter 5 predicts that (all else equal) the effect on the bond market today will be ____ in the equilibrium price of corporate bonds and ____ in the equilibrium quantity of corporate bonds sold.

- A. either an increase or decrease; a definite increase
- B. a definite decrease; either an increase or decrease
- C. a definite increase; either an increase or decrease
- D. a definite increase; a definite decrease

Q7 (1 Point). As discussed in Mishkin (Chapter 7), in the one-period valuation model for stock shares the current price of a stock share is assumed to be equal to the present value of

- A. all future dividend payments to the shareholder
- B. next period's dividend payment to the shareholder plus next period's expected share price.
- C. all future company revenues.
- D. next period's dividend payment to the shareholder.
- E. next period's expected share price.

Q8 (1 Point). As discussed in Mishkin (Chapter 7), in the generalized dividend valuation model for stock shares the current price of a stock share is assumed to be equal to the present value of

- A. all future dividend payments to the shareholder.
- B. next period's dividend payment to the shareholder plus next period's expected share price.
- C. all future company revenues.
- D. next period's dividend payment to the shareholder.
- E. next period's expected share price.