

ANSWER OUTLINE

ECONOMICS 353

L. Tesfatsion/Fall 07

EXERCISE 6: 8 Questions (8 Points Total)

DUE: Tues, Oct 16, 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 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 the treatment of bond markets in Mishkin Chapter 5, an important assumption behind the plotting of demand (or supply) curves for bonds is that

- A. the Yield-to-Maturity i moves directly with the bond price P along each curve, in the sense that P increases if and only if i increases (and vice versa).
- B. all economic variables APART from the bond price P , the Yield-to-Maturity i , and the bond quantities demanded (or supplied) are assumed to take on constant values along each curve.
- C. demand curves slope down and supply curves slope up.
- D. only A and C
- E. only B and C

Q2 (1 Point). According to Mishkin Chapter 5, when the price of bonds EXCEEDS the bond market 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). As discussed in Mishkin (Chapter 5), a supply curve plotted with price P on the vertical axis and quantity B on the horizontal axis is said to SHIFT TO THE RIGHT if

- A. for every given price P , the amount B of quantity supplied increases.
- B. the price P and the amount B of quantity supplied both decrease.
- C. for every given price P , the amount B of quantity supplied decreases.
- D. the price P and the amount B of quantity supplied both increase.
- E. the price P decreases and the amount B of quantity supplied increases.

Q4 (1 Point). According to Mishkin Chapter 5, a decrease in the bond price P will result in _____ the bond DEMAND curve, and an increase in the expected inflation rate will result in _____ the bond DEMAND curve.

- A. a downward movement along; a shift to the right of
- B. a shift to the left of; a downward movement along
- C. a shift to the right of; a shift to the left of
- D. a downward movement along; a shift to the left of

Q5 (1 Point). According to Mishkin (Chapter 5), key factors that are likely to cause the SUPPLY curve for bonds to SHIFT TO THE LEFT include

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

Q6 (1 Point). Consider a collection of thirty-year bonds to be newly issued for sale today. According to the theory presented in Mishkin (Chapter 5), if there is a sudden INCREASE today in the Yield-to-Maturity i that borrowers and lenders EXPECT will hold for these bonds one year from today, then (all else remaining equal) one would expect to see _____ in the DEMAND for these bonds TODAY because of _____.

- A. a decrease; a lower expected capital gain over the coming year.
- B. an increase; a higher expected capital gain over the remaining maturity of the bond.
- C. an increase; a higher expected capital gain over the coming year.
- D. a decrease; a lower expected capital gain over the remaining maturity of the bond.

Q7 (1 Point). Suppose the market for U.S. Treasury bonds is currently in equilibrium. However, new data showing an increased weakness of the dollar against the euro convinces people to revise UPWARD their expectations TODAY regarding the inflation rate in the U.S. OVER THE NEXT COMING YEAR. Then the theory in Mishkin Chapter 5 predicts that (all else equal) the effect on the U.S. Treasury bond market TODAY will be ____ in the equilibrium price of U.S. Treasury bonds and ____ in the equilibrium quantity of U.S. Treasury 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 decrease; a definite decrease

Q8 (1 Point). The theory developed in Mishkin Chapter 5 is considered to be a SHORT-TERM theory of bond markets because

- A. only money-market bond instruments (maturities of less than a year) are considered.
- B. predictions are obtained for movements in the bond market equilibrium price only in response to short-term changes in shift factors.
- C. predictions are obtained for movements in the bond market equilibrium price in response to shifts in single factors while assuming that all other important shift factors remain constant.
- D. the holding periods for bond buyers are assumed to be for short periods of time.