

Answers

Econ 353, Spring 2012

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Practice questions for Chapter 2 and 3

1 . Which of the following are traded in capital markets?

market for long term assets

- A. a share of a mutual fund
- B. a US Treasury Bill
- C. a 6-month negotiable CD
- D. a perpetuity (consol)
- E. a) and d) above

2 . Which of the following statements about the characteristics of debt and equity are true?

- A. They can both be short-term financial assets.
- B. They can both be long-term financial assets.
- C. They are both claims on the issuer's income.
- D. They are both claims on the issuer's residual (profit) income
- E. b) and c) above

3 . Which of the following financial intermediaries is (are) not a depository institution?

- A. an index fund
- B. a life insurance company
- C. a savings and loan association
- D. a growth fund
- E. a), b) and d) above

4 . The primary assets of a pension fund are

- A. mortgages
- B. corporate bonds and stocks
- C. money market instruments
- D. consumer and business loans

5 . The Federal Deposit Insurance Corporation regulates

- A. savings and loan associations
- B. mutual savings banks
- C. credit unions
- D. all of the above
- E. a) and b) above

6 . Which of the following statement(s) about financial markets and securities is (are) true?

- A. A corporation acquires new funds only when its securities are first sold in the primary market.
- B. Capital market securities are usually more widely traded than money market securities and so tend to be more liquid.
- C. Few common stocks are traded over-the counter, although the over-the-counter markets have grown in recent years.
- D. all of the above
- E. a) and c) above

7 . UK bonds sold in the US and denominated in US dollars are called eurobonds.

- A. True
- B. False

8 . Federal funds are

- A. loans made by banks to each other
- B. funds raised by the federal govt. in the bond market
- C. loans made by the FED to banks
- D. none of the above

9 . Pick the zero coupon bonds from the list below.

- I. US Treasury Notes
- II. US Treasury Bills
- III. US Treasury Bonds
- IV. US Savings Bonds

bonds which pay only a face value (FV) at maturity.

- A. II
- B. II and IV
- C. I and II
- D. I, II and IV

10 . A person with medical insurance has an incentive to lead an unhealthy lifestyle. To the insurance company, this poses a problem of

- A. moral hazard
- B. adverse selection
- C. asymmetric information
- D. both a) and b) above

11 . Which of the following properties must an object have in order to function well as a medium of exchange:

- I. It must be rare and in limited supply (like diamonds)
- II. Same units must have same value
- III. It must be universally acceptable as a means of payment
- IV. It must be made of paper
- V. It must be divisible.

- A. I, II and III
- B. II, III and V
- C. I, II, III and V
- D. all of the choices

12 . Scenario

When a government first introduces paper currency, it sometimes ties the value of this paper currency to a precious metal, such as gold or silver, or to another country's paper currency.

12 . 1 . True or False: The government might do this because fiat money has little or no value outside of its use as a medium of exchange.

- A. True
- B. False

12 . 2 . An economy called Chimrata decrees that its citizens use a currency called chimras. Further, the government of Chimrata guarantees that it will exchange 10 chimras for one ounce of gold.

One of Chimrata's citizens, Penelope, purchases three bunches of grapes for two chimras. The price of grapes, therefore, equals _____ per bunch. Suppose instead of paying in chimras, Penelope pays in gold. She takes her two chimras and exchanges them for _____.

- A. 0.67 chimras; 0.2 ounces of gold
- B. 2 chimras; 2 ounces of gold
- C. 3 chimras; 3 ounces of gold
- D. 5 chimras; 10 ounces of gold
- E. 6 chimras; 20 ounces of gold

3 bunches of grapes = 2 chimras.
1 bunch = $\frac{2}{3}$ chimras

12 . 3 . Suppose that Chimrata changes the conversion from 10 chimras per ounce of gold to 5 chimras per ounce. Now, when Penelope exchanges two chimras for gold, she will receive _____. The purchasing power of chimras has _____.

- A. 2 ounces of gold; remained unchanged
- B. 0.2 ounces of gold; increased
- C. 0.4 ounces of gold; increased
- D. 3 ounces of gold; decreased
- E. 10 ounces of gold; decreased

Purchasing power of paper currency = $\frac{1}{P}$, where P = general price level.

F. 20 ounces of gold; remained unchanged

13 . Which of the following is not money?

- form of e-money ←
- A. Paper currency
 - B. Checks *issued against balances in checking accounts which are part of M1*
 - C. Stored value cards
 - D. Credit cards
 - E. All these choices

14 . Consider the following assets:

- I. Time deposits
- II. Checkable deposits
- III. Savings accounts
- IV. Currency

Based on the assets listed above, which of the following correctly orders these assets from most liquid to least liquid?

- A. I, II, III, IV
- B. II, III, I, IV
- C. II, I, III, IV
- D. III, IV, II, I
- E. IV, II, I, III
- F. IV, II, III, I

15 . The _____ measures the amount of money in the U.S. economy, using ^{two} ~~three~~ different measures known as the monetary aggregates: M1, M2, and ~~M3~~.

- A. Federal Reserve
- B. International Monetary Fund
- C. U.S. Treasury
- D. World Bank
- E. Bureau of Economic Analysis

16 . The narrowest measure of money is _____ because it includes the assets with the highest _____, while ^{M2} ~~M3~~ includes the assets with the highest _____.

- A. M1; liquidity; interest rates
- B. M2; purchasing power; inflation rates
- ~~C. M3; purchasing power; inflation rates~~

17 . In a barter economy with N goods, the number of relative prices that a trader must know is

- A. $2N$
- B. $N(N-1)/2$
- C. $N(N/2)$
- D. N

18 . If an individual moves money from his checking account to his savings account,

- A. M1 decreases but M2 remains the same
- B. M1 decreases, M2 decreases
- C. M1 increases, M2 increases
- D. M1 stays the same, M2 increases

19 . Which of the sequences accurately describes the evolution of the payments system across most economies in the world?

- A. barter; metallic coins; checks; paper currency; electronic funds transfer;
- B. barter; checks; paper money; metallic coins; electronic funds transfer
- C. barter; paper currency; metallic coins; checks; electronic funds transfer;
- D. barter; metallic coins; paper currency; checks; electronic funds transfer;

20 . Which of the following characteristics does the US \$1 bill possess?

- I. It is unbacked by gold or silver.
 - II. It is a debt of the Federal Reserve.
 - III. It pays an annual interest.
 - IV. It is legal tender.
 - V. It is a debt of the Federal Reserve which has a maturity period just like T-bonds.
- A. I, II, III and V.
 - B. II and IV
 - C. I, II, and IV.
 - D. II and V

Scenario

In the economy of Etania, the people use a rare type of shell as money.

21. A young woman named Chenoa earns 100 shells per month. These 100 shells are _____. Each month, she hides 20 of her shells in a safe place so that she can use them in the future. When she does this, Chenoa is using these shells as _____. She spends the remaining 80 shells on food and clothing.

- A. Income, a store of value
- B. A medium of exchange, a unit of account
- C. A unit of account, a medium of exchange
- D. A store of value, wealth

22. Chenoa sees that a pound of maize costs 20 shells and decides that this is too expensive. In this case, Chenoa uses money as a _____. She decides to purchase vegetables instead. Chenoa spends 40 shells on five pounds of vegetables. When she exchanges her shells for the vegetables, Chenoa uses shells as _____.
- A. Unit of account, a medium of exchange
 - B. Store of value, income
 - C. Medium of exchange, a store of value
 - D. Store of value, wealth

23. In addition to using them as money, Chenoa strings some of her shells into necklaces that she wears as decoration. From this, you can conclude that in Etania, shells are _____.
- A. Fiat money
 - B. Precious metal
 - C. Paper currency
 - D. Commodity money

Scenario

* In the economy of Etania, changes in climate cause more of the previously rare shells to wash up onto the shore. The number of goods produced in Etania remains the same. → money supply has increased.

24. The increased number of shells will cause _____ in the purchasing power $= 1/p$ of money.
- A. A decrease
 - B. No change
 - C. An increase
- Quantity theory of money!*

$$\bar{M} = k \cdot P \cdot \bar{Y}$$

$$\bar{M} \uparrow \quad P \uparrow \quad \text{if } \bar{Y} \text{ is fixed.}$$

25. Chenoa used to keep 20 shells every month in a safe place for future use. As a result of the weather change, shells are ___ desirable to Chenoa as a _____.
- A. more; store of value
 - B. less; store of value
 - C. more; medium of exchange
 - D. less; unit of account

26. After the weather change, Chenoa must carry 45 shells instead of 40 to buy vegetables. Chenoa's _____ has (have) increased and shells are less desirable as a _____.
- A. transaction costs; medium of exchange
 - B. transaction costs; unit of account
 - C. transaction costs; store of value

D. income; store of value