

# Chapter 1 Why Study Money, Banking, and Financial Markets?

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Markets in which funds are transferred from those who have excess funds available to those who have a shortage of available funds are called
  - A) fund-available markets.
  - B) derivative exchange markets.
  - C) commodity markets.
  - D) financial markets.
  
- 2) The bond markets are important because they are
  - A) the markets where foreign exchange rates are determined.
  - B) the markets where all borrowers get their funds.
  - C) the markets where interest rates are determined.
  - D) easily the most widely followed financial markets in the United States.
  
- 3) The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of \$100 per year) is commonly referred to as the
  - A) interest rate.
  - B) inflation rate.
  - C) exchange rate.
  - D) aggregate price level.
  
- 4) High interest rates might \_\_\_\_\_ purchasing a house or car but at the same time high interest rates might \_\_\_\_\_ saving.
  - A) encourage; discourage
  - B) discourage; discourage
  - C) discourage; encourage
  - D) encourage; encourage
  
- 5) A rising stock market index due to higher share prices
  - A) increases people's wealth, but is unlikely to increase their willingness to spend.
  - B) increases people's wealth and as a result may increase their willingness to spend.
  - C) decreases people's wealth, but is unlikely to increase their willingness to spend.
  - D) decreases the amount of funds that business firms can raise by selling newly-issued stock.
  
- 6) Fear of a major recession causes stock prices to fall, everything else held constant, which in turn causes consumer spending to
  - A) remain unchanged.
  - B) increase.
  - C) decrease.
  - D) cannot be determined.
  
- 7) Banks are important to the study of money and the economy because they
  - A) channel funds from investors to savers.
  - B) create inflation.
  - C) have been a source of rapid financial innovation.
  - D) are the only important financial institution in the U.S. economy.
  
- 8) Financial institutions search for \_\_\_\_\_ has resulted in many financial innovations.
  - A) regulations
  - B) respect
  - C) higher risk
  - D) higher profits
  
- 9) The delivery of financial services electronically is called
  - A) e-possible.
  - B) e-commerce.
  - C) e-finance.
  - D) e-business.

- 10) \_\_\_\_\_ theory relates the quantity of money and monetary policy to changes in aggregate economic activity and inflation.  
 A) Financial                              B) Systemic                              C) Monetary                              D) Fiscal
- 11) Which of the following is a true statement?  
 A) The aggregate price level is measured as the rate of change in the inflation rate.  
 B) The inflation rate is measured as the rate of change in the federal government budget deficit.  
 C) The average price of goods and services in an economy is called the aggregate price level.  
 D) Money or the money supply is defined as Federal Reserve notes.
- 12) Countries that experience very high rates of inflation may also have  
 A) balanced budgets.                              B) rapidly growing money supplies.  
 C) constant money supplies.                              D) falling money supplies.
- 13) \_\_\_\_\_ policy involves decisions about government spending and taxation.  
 A) Systemic                              B) Fiscal                              C) Financial                              D) Monetary
- 14) Which of the following is most likely to result from a stronger dollar?  
 A) U.S. goods exported abroad will cost more in foreign countries and so foreigners will buy more of them.  
 B) U.S. goods exported abroad will cost less in foreign countries, and so foreigners will buy more of them.  
 C) Americans will purchase fewer foreign goods.  
 D) U.S. goods exported abroad will cost more in foreign countries, and so foreigners will buy fewer of them.
- 15) From 1980 to 1985 the dollar appreciated relative to the British pound. Holding everything else constant, one would expect that, when compared to 1980,  
 A) Britons imported more wine from California in 1985.  
 B) fewer Britons traveled to the United States in 1985.  
 C) Americans exported more wheat to England in 1985.  
 D) more Britons traveled to the United States in 1985.
- 16) Everything else held constant, a decrease in the value of the dollar relative to all foreign currencies means that the price of foreign goods purchased by Americans  
 A) remains unchanged.  
 B) increases  
 C) decreases.  
 D) either increases, decreases, or remains unchanged.
- 17) Nominal GDP is output measured in \_\_\_\_\_ prices while real GDP is output measured in \_\_\_\_\_ prices.  
 A) fixed; fixed                              B) current; fixed                              C) current; current                              D) fixed; current
- 18) If the aggregate price level at time  $t$  is denoted by  $P_t$ , the inflation rate from time  $t - 1$  to  $t$  is defined as  
 A)  $\pi_t = (P_{t+1} - P_t) / P_t$                               B)  $\pi_t = (P_{t+1} - P_{t-1}) / P_{t-1}$   
 C)  $\pi_t = (P_t - P_{t-1}) / P_{t-1}$                               D)  $\pi_t = (P_t - P_{t-1}) / P_t$
- 19) If the CPI is 120 in 1996 and 180 in 2002, then between 1996 and 2002, prices have increased by  
 A) 180%.                              B) 80%.                              C) 60%.                              D) 50%.
- 20) If the CPI in 2004 is 200, and in 2005 the CPI is 180, the rate of inflation from 2004 to 2005 is  
 A) 0%.                              B) -10%.                              C) 10%.                              D) 20%.

## Chapter 2 An Overview of the Financial System

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Which of the following statements about the characteristics of debt and equity is false?
  - A) They can both be long-term financial instruments.
  - B) They both enable a corporation to raise funds.
  - C) They both involve a claim on the issuer's income.
  - D) They can both be short-term financial instruments.
  
- 2) Which of the following statements about financial markets and securities is true?
  - A) The maturity of a debt instrument is the number of years (term) to that instrument's expiration date.
  - B) A debt instrument is intermediate term if its maturity is ten years or longer.
  - C) A bond is a long-term security that promises to make periodic payments called dividends to the firm's residual claimants.
  - D) A debt instrument is intermediate term if its maturity is less than one year.
  
- 3) Equity holders are a corporation's \_\_\_\_\_. That means the corporation must pay all of its debt holders before it pays its equity holders.
  - A) underwriters
  - B) brokers
  - C) residual claimants
  - D) debtors
  
- 4) \_\_\_\_\_ work in the secondary markets matching buyers with sellers of securities.
  - A) Underwriters
  - B) Brokers
  - C) Claimants
  - D) Dealers
  
- 5) When secondary market buyers and sellers of securities meet in one central location to conduct trades the market is called a(n)
  - A) barter market.
  - B) common market.
  - C) exchange.
  - D) over-the-counter market.
  
- 6) A short-term debt instrument issued by well-known corporations is called
  - A) municipal bonds.
  - B) corporate bonds.
  - C) commercial paper.
  - D) commercial mortgages.
  
- 7) Which of the following instruments are traded in a capital market?
  - A) Corporate bonds
  - B) Repurchase agreements
  - C) U.S. Treasury bills
  - D) Negotiable bank CDs
  
- 8) Bonds that are sold in a foreign country and are denominated in the country's currency in which they are sold are known as
  - A) country bonds.
  - B) equity bonds.
  - C) foreign bonds.
  - D) Eurobonds.
  
- 9) The process of indirect finance using financial intermediaries is called
  - A) resource allocation.
  - B) financial intermediation.
  - C) direct lending.
  - D) financial liquidation.
  
- 10) Economies of scale enable financial institutions to
  - A) avoid adverse selection problems.
  - B) reduce transactions costs.
  - C) avoid the asymmetric information problem.
  - D) reduce moral hazard.

- 11) An example of economies of scale in the provision of financial services is
- A) spreading the cost of borrowed funds over many customers.
  - B) investing in a diversified collection of assets.
  - C) spreading the cost of writing a standardized contract over many borrowers.
  - D) providing depositors with a variety of savings certificates.
- 12) Financial intermediaries provide customers with liquidity services. Liquidity services
- A) are another term for asset transformation.
  - B) make it easier for customers to conduct transactions.
  - C) are a result of the asymmetric information problem.
  - D) allow customers to have a cup of coffee while waiting in the lobby.
- 13) The process where financial intermediaries create and sell low-risk assets and use the proceeds to purchase riskier assets is known as
- A) risk sharing.
  - B) risk aversion.
  - C) risk selling.
  - D) risk neutrality.
- 14) Reducing risk through the purchase of assets whose returns do not always move together is
- A) intervention.
  - B) intermediation.
  - C) discounting.
  - D) diversification.
- 15) Typically, borrowers have superior information relative to lenders about the potential returns and risks associated with an investment project. The difference in information is called
- A) risk sharing.
  - B) asymmetric information.
  - C) moral selection.
  - D) adverse hazard
- 16) If bad credit risks are the ones who most actively seek loans and, therefore, receive them from financial intermediaries, then financial intermediaries face the problem of
- A) moral hazard.
  - B) costly state verification.
  - C) free-riding.
  - D) adverse selection.
- 17) Although the dominance of \_\_\_\_\_ over \_\_\_\_\_ is clear in all countries, the relative importance of bond versus stock markets differs widely.
- A) financial intermediaries; government agencies
  - B) financial intermediaries; securities markets
  - C) government agencies; financial intermediaries
  - D) government agencies; securities markets
- 18) \_\_\_\_\_ are financial intermediaries that acquire funds by selling shares to many individuals and using the proceeds to purchase diversified portfolios of stocks and bonds.
- A) Mutual funds
  - B) Insurance companies
  - C) Finance companies
  - D) Investment banks
- 19) An investment bank helps \_\_\_\_\_ issue securities.
- A) the United States government
  - B) foreign governments
  - C) a corporation
  - D) the SEC
- 20) An investment bank purchases securities from a corporation at a predetermined price and then resells them in the market. This process is called
- A) underhanded.
  - B) underwriting.
  - C) undertaking.
  - D) understanding.

## Chapter 3 What Is Money?

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question

- 1) A person's house is part of her  
A) money.                      B) liabilities.                      C) wealth.                      D) income.
- 2) \_\_\_\_\_ is used to make purchases while \_\_\_\_\_ is the total collection of pieces of property that serve to store value.  
A) Wealth; income                      B) Money; income                      C) Income; money                      D) Money; wealth
- 3) When we say that money is a stock variable, we mean that  
A) money never loses purchasing power.  
B) it is sold in the equity market.  
C) we must attach a time period to the measure.  
D) the quantity of money is measured at a given point in time.
- 4) When compared to exchange systems that rely on money, disadvantages of the barter system include:  
A) lowering the cost of exchange to those who would specialize.  
B) lowering the cost of exchanging goods over time.  
C) encouraging specialization and the division of labor.  
D) the requirement of a double coincidence of wants.
- 5) Which of the following statements best explains how the use of money in an economy increases economic efficiency?  
A) Money increases economic efficiency because it decreases transactions costs.  
B) Money increases economic efficiency because it discourages specialization.  
C) Money cannot have an effect on economic efficiency.  
D) Money increases economic efficiency because it is costless to produce.
- 6) If there are five goods in a barter economy, one needs to know ten prices in order to exchange one good for another. If, however, there are ten goods in a barter economy, then one needs to know \_\_\_\_\_ prices in order to exchange one good for another.  
A) 20                      B) 25                      C) 30                      D) 45
- 7) If there are four goods in a barter economy, then one needs to know \_\_\_\_\_ prices in order to exchange one good for another.  
A) 8                      B) 6                      C) 5                      D) 4
- 8) Dennis notices that jackets are on sale for \$99. In this case money is functioning as a \_\_\_\_\_.  
A) payments-system ruler                      B) unit of account  
C) medium of exchange                      D) store of value
- 9) As a store of value, money  
A) must be currency.                      B) does not earn interest.  
C) cannot be a durable asset.                      D) is a way of saving for future purchases.

