SECOND MIDTERM EXAM

EC26102: MONEY, BANKING AND FINANCIAL MARKETS

FEBRUARY 25, 2004

This exam has 25 questions on five pages. Before you begin, please check to make sure that your copy has all 25 questions and all five pages.

All questions will receive equal weight in determining your exam score.

Please answer all questions on the answer sheet provided.

1. The Federal Funds Rate:

A) Is the official interest rate at which banks can borrow from the Federal Reserve.
B) Is the interest rate that the Federal Reserve pays on the funds that banks deposit at the Federal Reserve.
C) Is the interest rate that one bank pays to another bank on a loan of deposits at the Federal Reserve.
D) Is the interest rate that banks pay on most, but not all, federally insured deposits.
E) None of the above.

2. Which are the following can be described as a Eurodollar deposit:

A) A US dollar deposit at Citibank's London (UK) branch.
B) A US dollar deposit at Fleet Bank's branch in the Cayman Islands.
C) A US dollar deposit at Deutsche Bank in Frankfurt, Germany.
D) Both (A) and (C) above.
E) All three, (A), (B), and (C), above.

3. A loan to an individual or business that is used to buy land, houses, or other structures is called a __________ loan.

4. Commercial paper differs from corporate bonds, since:

A) Commercial paper is short-term, whereas corporate bonds are intermediate-term or long-term.
B) Commercial paper pays interest implicitly by selling at a discount, while corporate bonds typically make explicit, regular interest payments twice per year.
C) Commercial paper is typically issued by commercial banks, whereas corporate bonds are issued by corporations.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C), above.

5. Which of the following applies to commercial and consumer loans?

A) They are loans, originally made by banks, to businesses and households.
B) They trade in very active secondary markets, which first developed during the 1970s and 1980s.
C) They can be considered capital market instruments.
D) Both (A) and (C) above.
E) All three, (A), (B), and (C), above.

6. US Treasury Bonds:

A) Are somewhat like a combination or mixture of corporate bonds and US Government bonds, since they are issued by government-sponsored corporations.
B) Are issued by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), which use the proceeds to buy mortgages on the secondary market.
C) Are issued by the Student Loan Marketing Association ("Sallie Mae"), which uses the proceeds to buy student loans on the secondary market.
D) Both (B) and (C) above.
E) None of the above.

7. When a bank uses the same loan contract over and over again, it minimizes transaction costs by taking advantage of __________.

8. When a bank makes many different types of loans to many different types of borrowers, it is engaging in the process of risk sharing via __________.

9. __________ refers to the problem that arises *before* a loan is made because the least creditworthy borrowers also tend to be the ones who most actively seek out loans.

10. As a group, depository institutions:

A) Accept deposits, which then become their assets.
B) Make loans, which then become their liabilities.
C) Both (A) and (B) above.
D) None of the above.

11. Certificates of deposit (CD's), both small and large, qualify as

A) Checking deposits.
B) Savings deposits.
C) Time deposits.
D) Both (B) and (C) above.
E) None of the above.

12. Commercial banks:

A) Accept checking, savings, and time deposits.
B) Make commercial, consumer, and mortgage loans.
C) Buy US Government securities and municipal bonds.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C) above.

13. __________ are depository institutions that are specifically set up to serve well-defined groups of people, such as the employees of a large firm or the members of a trade union.

14. Which of the following is false?

A) Before 1980, mutual savings banks were not allowed to issue checking deposits.
B) Before 1980, mutual savings banks were restricted to making mortgage loans.
C) Before 1980, savings and loan associations were not allowed to issue checking deposits.
D) Before 1980, savings and loan associations were restricted to making mortgage loans.
E) None of the above.

15. Which of the following is false?

A) Life insurance companies, fire and casualty insurance companies, and pension funds all qualify as contractual savings institutions.
B) As a group, contractual savings institutions acquire funds at periodic or regular intervals.
C) The timing and magnitude of flows of funds into a contractual savings institution are known with greater certainty that the timing and magnitude of flows of funds into a depository institution.
D) Both (A) and (C) above.
E) None of the above.

16. Ford Motor Credit, a financial intermediary that sells commercial paper and bonds and uses the proceeds to make loans to people who want to buy Ford cars and trucks, is one of the best-known examples of a __________ in the US economy.

17. Money market mutual funds are *unlike* other mutual funds in that they:

A) Invest mainly in short-term debt instruments instead of corporate stocks and bonds.
B) Often allow shareholders to write checks against the value of their shareholdings.
C) Have grown spectacularly over the past three decades.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C), above.

18. In terms of the total dollar value of the assets they hold, thrift institutions have declined in importance since 1970. This is mainly due to the fact that:

A) Thrift institutions continue to be restricted in terms of the kinds of deposits they can accept.
B) Thrift institutions continue to be restricted in terms of the kinds of loans they can make.
C) Large numbers of Savings and Loan Associations went bankrupt during the late 1980s and early 1990s, when the industry went through a major crisis.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C), above.

19. A loan that provides the borrower with $1,000, which is to be repaid by making annual payments of $126 per year for the next 25 years is called a __________ loan or a “fully amortized” loan.

20. Debt instruments, including most corporate bonds and all US Treasury bonds, that make regular interest payments each year until maturity, when a larger amount (called face or par value) is returned, are called __________ bonds.

21. A discount bond makes no regular interest payments; instead, it pays interest implicitly by:

A) Selling today for a price that is below (at a discount from) face value.
B) Having a face value that is below (at a discount from) the purchase price.

22. Which of the following are examples of debt instruments that work like discount bonds?

A) Bankers Acceptances.
B) US Treasury bills.
C) US Treasury bonds.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C), above.
F) None of the above.

23. The concept of present value captures the idea that a dollar received in the future is __________ valuable than a dollar received today.

24. If you start with \$100, if the simple interest rate on one-year loans is i, and if you make a series of simple loans for n consecutive years, how much do you have at the end of those n years?

A) $\$100 + i^n$.
B) $\$100 + (1+i)^n$.
C) $\$100 \text{ x } i^n$.
D) $\$100 \text{ x } (1+i)^n$.
E) None of the above.

25. If the simple interest rate is i, then the present value of \$1 received n years from now is

A) $\$1 \text{ x } i^n$.
B) $\$1 \text{ x } (1+i)^n$.
C) $\dfrac{\$1}{(1+i)^n}$.
D) $\dfrac{\$1}{(1+n)^i}$.
E) None of the above.