

ANSWER KEY — ANSWERS AT END

ECONOMICS 353

L. Tesfatsion/Spring Semester 2011

EXERCISE 11: Eight Questions (8 Pts Total)

DUE: Tues., April 19, 12:40pm

****PLEASE NOTE: EXERCISES ARE DUE AT THE BEGINNING OF CLASS ON THE DUE DATE. LATE EXERCISES WILL NOT BE ACCEPTED AFTER DISCUSSION OF ANSWERS HAS BEGUN – NO EXCEPTIONS****

EXERCISE INSTRUCTIONS:

- (1) Please **fill in your name and student ID number** on Side 1 of your red bubble sheet and write **353 Exercise 11** in the top margin of Side 1. (Red bubble sheets will be handed out in class each Tuesday and can also be obtained from the Econ Undergraduate Office in 174 Heady during normal business hours M-F.)
- (2) Use a number 2 pencil to **mark your answers** on Side 1 of the bubble sheet to the multiple-choice questions Q1 through Q8 below.
- (3) Each question is worth 1 point. Questions Q1 through Q8 can be answered using required course materials (ppt slides, html notes, and textbook materials) for Mishkin Chapter 9 (“Financial Crises and the Subprime Meltdown”).

Q1. Mishkin defines a FINANCIAL CRISIS to be _____.

- A. a major disruption in financial markets characterized by a sharp decline in asset prices and failures of many financial and nonfinancial firms.
- B. a speculative run on a country’s currency.
- C. a sudden loss of confidence among the depositors of a particular bank.
- D. the sudden change from being a net creditor to a net debtor nation.

Q2. A key way Mishkin’s theory of financial crises DIFFERS from traditional theories is that _____.

- A. Mishkin views financial crises as predominantly a problem of emerging market economies.
- B. Mishkin bases his theory on empirical data.
- C. Mishkin argues that financial crises can be the cause rather than simply the consequence of major disturbances in the non-financial sectors of an economy.
- D. Mishkin argues that financial crises can be prevented by the IMF.

- Q3.** According to Mishkin, key factors that can TRIGGER financial crises include
- A. increases in interest rates.
 - B. increases in lender uncertainty.
 - C. a deterioration in bank balance sheets (net worth problems).
 - D. all of the above.
- Q4.** According to Mishkin, emerging market countries are MORE likely than developed countries to have financial crises because _____.
- A. they tend to respond in an inadequate or inappropriate fashion to trigger events once they have occurred.
 - B. they are less able to prevent the occurrence of trigger events.
 - C. bank panics do not occur in developed countries.
 - D. all of the above.
 - E. only A and B above.
- Q5.** According to Mishkin, financial crises in emerging market countries DIFFER from those in developed countries such as the US in that their possible trigger events include _____.
- A. bank panics.
 - B. the unexpected failure of a large well-known company.
 - C. government fiscal imbalances, which in turn can lead to a foreign exchange crisis.
 - D. sudden stock market crashes.
- Q6.** An important factor that TRIGGERED the 1994-1995 Mexican financial crisis was _____.
- A. the failure of Mexico to ratify the North American Free Trade Agreement (NAFTA).
 - B. the failure of the IMF to provide liquidity support to Mexico.
 - C. a rise in interest rates.
 - D. a drastic fall in the price of oil.
 - E. a drastic depreciation of the peso.

Q7. According to the html notes on Mishkin Chapter 9, a key DISTINCTION between an INSOLVENT and a BANKRUPT firm is _____.

- A. an insolvent firm can no longer meet its legal obligations to its financial creditors.
- B. an insolvent firm necessarily has a negative net worth.
- C. an insolvent firm is necessarily suffering from debt deflation.
- D. an insolvent firm is required to undergo reorganization under U.S. bankruptcy law.

Q8. In 1995 the Clinton Administration went to extraordinary lengths to put together a \$49.8 billion loan guarantee for Mexico because the administration believed _____.

- A. Mexico was insolvent and in need of long-term help.
- B. this was the best way to prevent illegal immigration problems.
- C. Mexico was experiencing a severe cash-flow problem but it was not insolvent.
- D. the IMF and other international agencies were unwilling to assist Mexico.

Multiple Choice Answers: Q1-A, Q2-C Q3-D, Q4-E, Q5-C, Q6-C, Q7-B, Q8-C