

ANSWER KEY – VERSION B

ECONOMICS 353
MIDTERM EXAM 1-VERSION B

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IMPORTANT INSTRUCTIONS:

On side 1 of your bubble sheet, give your FIRST AND LAST NAME and STUDENT ID NUMBER. Also, in the top margin write ECON 353: FIRST MIDTERM EXAM - VERSION B.

Answer all 50 multiple-choice questions below by marking answers on your answer bubble sheet **using a number 2 pencil**. Each question is worth 1 point. Read each question carefully before answering.

At the end of the exam, please turn in your filled-in answer bubble sheet and be prepared to show an official photo ID of yourself (e.g., student ID, driver's license) if asked.

Caution: Do your own work, do not assist others in any way during the exam, and keep your eyes focused only on your own exam. USE OF ANY ELECTRONIC OR MECHANICAL DEVICE (E.G., CALCULATORS) DURING THE EXAM IS STRICTLY PROHIBITED. Any behavior to the contrary will be considered cheating and will not be tolerated. Cheating will result in an automatic F on the exam, and further sanctions may be applied in line with university policy.

****IF YOU THINK ANY QUESTIONS ARE UNCLEAR OR AMBIGUOUS:** Ask the instructor during the exam for clarification. If this does not resolve the issue, do the following:

- (1) Write your specific comments on the following pages along side the statement(s) of the question(s) about which you have concerns.
- (2) Indicate here the numbers of the questions you have commented on:

- (3) Write your name and student ID number where indicated below.

STUDENT NAME_____

STUDENT ID NUMBER_____

- (4) At the end of the exam, give this exam question packet to the instructor for special handling.

Good Luck!

- Q1.** As discussed in class in relation to Empirical Data Packet #2, a major concern of U.S. government policy makers is that a large portion of the spending contributing to the current U.S. federal deficit _____
- A A.** is in the form of mandatory spending (i.e., spending required by law, such as social security benefit entitlements)
 - B.** is in the form of discretionary spending (i.e., spending that can be changed by Congressional appropriations bills, such as the budget for the Department of Defense)
 - C.** is in the form of questionable foreign aid.
 - D.** has been shown to be due to corruption and inefficient management practices.
- Q2.** Which of the following items would NOT be counted as part of U.S. Gross Domestic Product (GDP) in 2011: _____
- A.** your 2011 purchase of a Ford Mustang sports car newly produced in 2011 by the Ford Motor Company in a Michigan plant.
 - B.** your 2011 purchase of BF Goodrich tires newly produced in the U.S. for use on your 2008 Ford Mustang.
 - C C.** Ford's purchase of BF Goodrich tires for its Ford Mustangs newly produced in 2011 in its Michigan plant.
 - D.** the 2011 purchase by a UK citizen of a Ford Mustang newly produced in 2011 by the Ford Motor Company in a Michigan plant.
- Q3.** The key difference between NOMINAL GDP and REAL GDP for an economy is that _____
- A.** nominal GDP includes production outside the borders of the U.S. whereas real GDP does not.
 - B.** nominal GDP includes earnings from financial assets whereas real GDP does not.
 - C C.** real GDP is corrected for price movements whereas nominal GDP is not.
 - D.** nominal GDP includes sales of financial assets whereas real GDP includes only sales of real assets.
 - E.** nominal GDP is the initial measure of output and real GDP is the final revised measure of output.
- Q4.** The REAL GDP for an economy during any time period T is a measure of _____
- A.** the growth of the economy during T.
 - B.** the strength of the economy's currency during T.
 - C.** the trade balance of the economy during T.
 - D D.** the size of the economy during T.

- Q5.** The AGGREGATE PRICE LEVEL for an economy for any time period T _____
- A.** is the total value of all goods and services sold in the economy during T
 - B B.** is the average price of goods and services in the economy during T
 - C.** is the total sum of prices for goods and services in the economy during T
 - D.** is the average cost of the assets owned by citizens of the economy at the end of T
 - E.** is the aggregate value of the economy's money supply in T.
- Q6.** By definition, a RECESSION is a period of time during which _____.
- A.** inflation is high
 - B.** the current account is in deficit
 - C.** the real money supply is low
 - D D.** real GDP is declining
 - E.** real wages are low
- Q7.** If the prices of the goods and services purchased by a typical U.S. urban household have INCREASED over the past ten years, one can expect to see _____
- A.** a corresponding increase in the Consumer Sentiment Index (CSI).
 - B.** a corresponding decrease in the GDP Deflator.
 - C C.** a corresponding increase in the Consumer Price Index (CPI).
 - D.** a corresponding increase in real GDP.
- Q8.** The U.S. government budget DEFICIT measures the extent to which _____
- A A.** U.S. government expenditures exceed U.S. government tax revenues.
 - B.** the U.S. government is relying on foreign borrowing.
 - C.** U.S. government tax revenues exceed U.S. government expenditures.
 - D.** the U.S. capital account is in deficit.

- Q9.** According to U.S. time series data presented in Mishkin (Chapter 1) and Empirical Data Packet #1, _____
- A.** U.S. stock prices dramatically increased between 1980 and 2000.
 - B.** average inflation rates and average money growth rates exhibit positive correlation in the sense that a higher value for one tends to be associated with a higher value for the other (and vice versa).
 - C.** the U.S. aggregate price level dramatically increased between 1950 and 2010.
 - D.** all of the above.
 - E.** none of the above.
- Q10.** According to U.S. time series data presented in Mishkin (Chapter 1) and Empirical Data Packet #1, the FEDERAL FUNDS RATE _____
- A.** closely tracks long-term interest rates, such as the rate on Corporate Baa Bonds (secondary market).
 - B.** closely tracks short-term interest rates, such as the rates on 3-month and 6-month Treasury bills (secondary market).
 - C.** closely tracks the interest rate on 30-year mortgages.
 - D.** closely tracks the growth rate in the money supply (M1).
- Q11.** If the U.S. dollar (USD) has WEAKENED (DEPRECIATED) against the euro, this means that _____
- A.** there has been a decrease in the euro-to-USD exchange rate, i.e., each USD is worth fewer euros.
 - B.** there has been a decrease in the USD-to-euro exchange rate, i.e., each euro is worth fewer USDs.
 - C.** there has been a decrease in the U.S. inflation rate relative to the European inflation rate.
 - D.** there has been an increase in the U.S. inflation rate relative to the European inflation rate.
- Q12.** Which of the following is most likely to result when the U.S. dollar (USD) STRENGTHENS (APPRECIATES) against the Mexican peso: _____
- A.** the U.S. will definitely be better off.
 - B.** U.S. goods exported to Mexico will cost less in Mexico, so Mexicans will buy more of them.
 - C.** U.S. goods exported to Mexico will cost more in Mexico, so Mexicans will buy fewer of them.
 - D.** U.S. citizens will buy fewer Mexican goods.

Q13. If the price of a stock that you own has increased over the past year, this implies (all else equal) that _____

- A. your income has increased, which could encourage you to consume more.
- B B.** your wealth has increased, which could encourage you to consume more.
- C. the inflation rate has increased, which could encourage you to consume less.
- D. a speculative bubble is under way, hence you had better sell this stock.

Q14. High interest rates might _____ the purchase of a house or a car but at the same time high interest rates might also _____ saving.

- A. encourage; discourage
- B B.** discourage; encourage
- C. encourage; encourage
- D. discourage; discourage

Q15. Types of FINANCIAL INTERMEDIARIES include _____

- A. commercial banks.
- B. life insurance companies.
- C. money market mutual funds.
- D D.** all of the above.
- E. only B and C above.

Q16. By definition, an ASSET is _____

- A. a standardized commodity bought and sold in organized exchanges.
- B. any commodity in physical form.
- C C.** anything of durable value.
- D. any claim against real income.

Q17. Debt instruments (e.g., bonds) are ____ for the issuer and ____ for the purchaser.

- A. put options; call options
- B. primary assets; secondary assets
- C. assets; liabilities
- D. liquid assets; illiquid assets
- E E.** liabilities; assets

Q18. Key ways in which a broker DIFFERS from a dealer include ____

- A. brokers facilitate financial asset trades.
- B. brokers take positions in the financial assets they trade.
- C C.** brokers make profits by charging commissions to users of their services.
- D. all of the above.
- E. only B and C above.

Q19. A key DISTINCTION between financial intermediaries (FIs) and dealers is ____

- A. FIs are key players in direct finance.
- B. an FI earns most of its profits through commissions charged for its services.
- C. FIs “make the market” for financial assets in the sense that they separately post bid (buy) prices and asked (sell) prices for these assets, and they are willing to hold purchased assets for later resale.
- D D.** FIs engage in financial asset transformation, i.e., they issue new short-term debt instruments (e.g., deposit accounts) to savers and secure newly issued longer-term debt instruments (e.g., mortgages) from borrowers using the funds received from the savers.
- E. FIs are key players in auction markets.

Q20. U.S. dollar deposits in foreign banks outside the U.S. or in foreign branches of U.S. banks are ____

- A. referred to as foreign dollars.
- B. illegal.
- C C.** referred to as Eurodollars.
- D. subject to special oversight by the Federal Reserve Board.
- E. typically found to be owned by people trying to evade U.S. tax liabilities.

Q21. A type of financial player that has a major role in ensuring the sale of corporate bonds in PRIMARY markets is _____

- A** A. an investment banker.
- B. a specialized trader on a stock exchange.
- C. a commercial banker.
- D. a savings and loan officer.
- E. a Securities and Exchange Commissioner.

Q22. Which of the following are PRIMARY markets: _____

- A** A. Auction markets conducted by the U.S. Treasury for U.S. Treasury bills.
- B. The New York Stock Exchange.
- C. The foreign exchange market.
- D. The over-the-counter market for U.S. government bonds
- E. Only B, C, and D above

Q23. Corporations do NOT acquire new funds when their securities are sold _____

- A. in a domestic primary market.
- B. as initial public offerings.
- C** C. in a secondary market.
- D. directly in an overseas primary market.
- E. through investment banks.

Q24. Equity instruments are traded in the _____

- A. bond market.
- B** B. capital market.
- C. money market.
- D. commodities market.

Q25. Which of the following statements are TRUE: _____

- A.** In case of bankruptcy, the claims of a corporation's debt holders are settled (paid off) before the claims of its preferred stock holders.
- B.** Corporate debt payments are pre-determined contractual payments that do not depend on the financial conditions of the corporation, except when the corporation declares bankruptcy.
- C.** Holders of a corporation's debt do not normally participate in the management of the corporation except under conditions of duress (e.g., bankruptcy proceedings).
- D D.** All of the above.
- E.** Only B and C above.

Q26. By definition, SECURITIES are financial assets _____

- A.** that have been approved for sale by the Federal Reserve Board.
- B.** whose earnings have been underwritten ("made secure") by some government agency.
- C C.** that have been transformed into relatively liquid marketable assets by means of various legally enforceable guarantees provided either by the original issuer of the asset or by other parties.
- D.** that have received at least a BBB rating in accordance with Standard & Poor's rating system.
- E.** whose market value is derived from some underlying pool of financial assets that have been packaged together and sold in the form of shares.

Q27. The LIQUIDITY of a financial asset is a measure of _____

- A A.** the ease with which the financial asset can be converted into a means of payment for goods and services.
- B.** the likelihood that the original issuer of the asset will go into default (liquidation).
- C.** the degree to which the riskiness of the asset has been spread across many investors.
- D.** the number of assets of this type that are currently held by private investors.
- E.** the market value of all financial assets of this type currently held by private investors.

Q28. Which of the following statements are TRUE: _____

- A.** The maturity of a financial asset is the length of time to the financial asset's expiration date.
- B.** A U.S. Treasury bill has a maturity of one year or less.
- C.** A stock share has no maturity.
- D D.** All of the above statements are true.
- E.** Only A and B above.

Q29. Which of the following are instances of DIRECT finance: _____

- A A.** The Coca Cola Company sells newly issued corporate bonds to the King of Saudi Arabia.
- B B.** In 2011 you buy U.S. Treasury bonds in the U.S. government bond market that were originally issued in 2008.
- C C.** A pension fund manager buys U.S. Treasury bills in a secondary market.
- D D.** You make a deposit to a deposit account at a commercial bank.
- E E.** All of the above.

Q30. Which of the following are instances of INDIRECT finance: _____

- A A.** The U.S. government buys commercial paper on a secondary market.
- B B.** You obtain a mortgage loan from Second Ames Bank.
- C C.** You buy PepsiCo stock shares on the New York Stock Exchange.
- D D.** All of the above.
- E E.** Only A and C above.

Q31. If a financial intermediary that has entered into a mortgage contract with a corporation has no way of checking what the corporation subsequently does with its borrowed funds, then the corporation could have _____

- A A.** a free-riding problem.
- B B.** a risk diversification problem.
- C C.** an adverse selection problem.
- D D.** an interest rate risk problem.
- E E.** a moral hazard problem.

Q32. The main purpose of the disclosure requirements of the Securities and Exchange Commission (SEC) is _____

- A A.** to prevent bank panics.
- B B.** to increase the information available to investors engaging in securities trades.
- C C.** to improve the ability of monetary policy authorities to control the economy.
- D D.** to insure investors in securities against financial losses.
- E E.** to discourage investors from investing in securities trading.

- Q33.** The reason monetary policy makers are keenly interested in the VELOCITY OF MONEY, defined as the ratio $V = \text{GDP}/M$ of nominal gross domestic product (GDP) to the money supply (M), is that _____
- A.** a higher value for V implies a higher GDP growth rate.
 - B B.** the constancy of V over time would imply the Fed could control nominal GDP by controlling the money supply M.
 - C.** a higher value for V implies a higher inflation rate.
 - D.** a higher value for V implies a strengthening (appreciation) of the U.S. dollar.
- Q34.** By definition, MONEY is _____
- A.** anything that functions as a unit of account.
 - B.** financial claims in the form of coins or paper bills.
 - C.** a stream of income.
 - D D.** any generally accepted means of payment for goods and services and for repayment of debts, by social custom.
 - E.** any government-issued paper that must be accepted in repayment of debt, by law.
- Q35.** If the U.S. aggregate price level were to double, then (all else equal) the real value of a dollar would _____
- A.** double.
 - B B.** fall by 50 percent.
 - C.** more than double.
 - D.** rise but not double due to diminishing returns.
 - E.** none of the above.
- Q36.** The conversion of a pure barter economy to one that uses money tends to increase efficiency because _____
- A.** it encourages people to specialize in the production of goods for which they have a comparative advantage.
 - B.** it reduces the number of prices needed to support trading (assuming the economy has four or more tradeable goods).
 - C.** it increases the need to rely on “double coincidence of wants”.
 - D.** all of the above.
 - E E.** only A and B above.

Q37. Which of the following statements about FIAT MONEY are TRUE: _____

- A. fiat money is backed, i.e., it is collateralized by some precious commodity.
- B. fiat money is legal tender – i.e., by law, citizens must accept it as repayment for debts.
- C. fiat money is paper money.
- D. only A and B above.
- E. only B and C above.

Q38. The particular U.S. agency charged with the responsibility for carrying out monetary policy in the U.S. is _____

- A. the Federal Deposit Insurance Corporation (FDIC).
- B. the Monetary Policy Oversight Board (MPOB).
- C. the Federal Reserve System (Fed).
- D. the Office of the Comptroller of the Currency (OCC).
- E. the U.S. Secret Service.

Q39. U.S. monetary policy makers worry about being able to accurately measure and control the money supply because _____

- A. management of the money supply (as well as interest rates) is thought to be important for ensuring the well-being of the U.S. economy.
- B. they are obliged by law to keep close track of the flow of money through the economy.
- C. their prime responsibility is to use money supply changes to keep the national debt in check.
- D. their prime responsibility is to use money supply changes to ensure the re-election of the President who appointed them to office.

Q40. Economists have no single precise measure of money because _____

- A. the money supply data supplied by private commercial banks is confidential information (not to be released publicly), by law.
- B. the Federal Reserve System does not allow the public release of money supply data on the grounds that this release would encourage speculative trading.
- C. the “moneyness” (liquidity) of an asset is a matter of degree.
- D. economists are sharply divided on ideological grounds about the definition of “money.”

- Q41.** Which of the following financial assets are NOT included in the M1 measure of the U.S. money supply: ____
- A. checkable deposit accounts at banks.
 - B. currency.
 - C. money market mutual fund shares.
 - D. small-denomination time deposits.
 - E E.** both C and D.
- Q42.** If a person sells a 30-year U.S. Treasury bond back to the U.S. government in return for currency, then ____
- A. M1 stays the same and M2 increases.
 - B. M1 increases and M2 stays the same.
 - C. M1 stays the same and M2 increases.
 - D D.** M1 increases and M2 increases.
- Q43.** According to the Ex 4 required readings, a MOBILE MONEY SYSTEM is a money system that permits participants ____.
- A. to deposit, transfer, and withdraw funds at small mobile government-provided banking facilities that the government systematically moves around the country.
 - B. to carry money into or out of a country without limit and without any imposed fees.
 - C. to carry money freely from one part of the country to another, with government-provided insurance.
 - D D.** to deposit, transfer, and withdraw funds via text messages on their cellphones.
- Q44.** According to the Ex 4 required readings, the experiences of ____ with a mobile money system first launched in pilot-project form in 2007 have been very successful, and it is hoped that the more recent launch of a mobile money system in ____ in 2010 will also be successful.
- A. Haiti; Dominican Republic
 - B B.** Kenya; Haiti
 - C. Iraq; Afghanistan
 - D. Vietnam; Iraq

- Q45.** In his summary overview of the U.S. financial crisis of 2007-2009, Charles Jones (Ex 1 required reading) lists several major shocks to the economy as proximate (near) causes of the crisis. These shocks include ____.
- A.** a sudden sharp *increase* in housing prices starting around mid-2006.
 - B.** a sudden sharp *decrease* in housing prices starting around mid-2006.
 - C.** a sudden sharp *increase* in global savings starting around mid-2006.
 - D.** a sudden sharp *decrease* in global savings starting around mid-2006.
- Q46.** In his summary overview of the U.S. financial crisis of 2007-2009, Charles Jones (Ex 1 required reading) stresses that the growing percentage of _____ in the portfolios of financial institutions prior to 2007 resulted in a _____
- A.** stock shares; speculative bubble on stock share prices due to market psychology (“animal spirits”).
 - B.** derivative financial instruments based on subprime residential mortgages; high level of systemic (aggregate) risk because the values of all of these assets depended on U.S. housing prices continuing to rise.
 - C.** long-term government bonds; debt crisis due to the inability of the U.S. government to sell more bonds.
 - D.** corporate commercial paper; moral hazard problem because the corporations were not being adequately monitored in order to detect and prevent undesirable behaviors that could increase default risk.
- Q47.** According to the required notes for Mishkin Chapter 2:Part B, INVESTMENT BANKING activities in the U.S. have traditionally included UNDERWRITING, which refers to ____.
- A.** the guaranteeing to corporations of a price on their initial public offerings (IPOs) of newly issued securities.
 - B.** a guarantee provided to a corporation’s stockholders against loss of their asset value in case the corporation goes bankrupt.
 - C.** assistance provided to corporations with the writing of their legal documents sent out to shareholders.
 - D.** assistance offered to corporations with the writing of the terms of sale for their initial public offerings of newly issued securities.

Q48. According to the required Ex 2 readings, a major reason why the big U.S. investment banks Goldman Sachs and Morgan Stanley changed their status from “investment banks” to “bank holding companies” in 2008 is

- A.** to avoid the stigma associated with the collapse of other investment banks such as Bear Stearns and Lehman Brothers.
- B.** to avoid scrutiny of their business practices in Senate hearings.
- C C.** this change permitted both firms to gain increased access to emergency funds from the Federal Reserve.
- D.** to gain increased control over commercial banks.

Q49. According to Shiller (Ex 3 required reading), the term “IRRATIONAL EXUBERANCE” ____.

- A.** was first used in 1929 to describe the run-up in stock market prices just before the Great Depression.
- B B.** was first used in 1996 by Alan Greenspan to describe a situation in which stock market prices appeared to have been bid up to unusually high and unsustainable levels not justified by market fundamentals (e.g., actual profit conditions).
- C.** was first used in 1998 by stock analysts worried about the growing “dot.com” bubble on technical Internet stocks.
- D.** was first used in 2000 by Shiller to refer to his growing concern about the dramatic increase in U.S. housing prices.

Q50. As seen in the Ex 3 required reading, a PRICE-EARNINGS RATIO ____.

- A.** is the ratio of the average price of goods in an economy to the average earnings of the households who purchase these goods.
- B.** is the ratio of the average price of stocks in an economy to the average earnings of the households who purchase these stocks.
- C C.** is the ratio of the average price of a particular specified collection of corporate stocks to the average per-share net earnings of the corporations whose stocks are represented in this collection.
- D.** is the ratio of the average price of a corporation’s products to the profits earned on the sale of these products.