

Principles of Macroeconomics

Exam IIIa

Mark the best answer on the scantron. *Do not mark on this exam. Show your calculations on the scantron.*

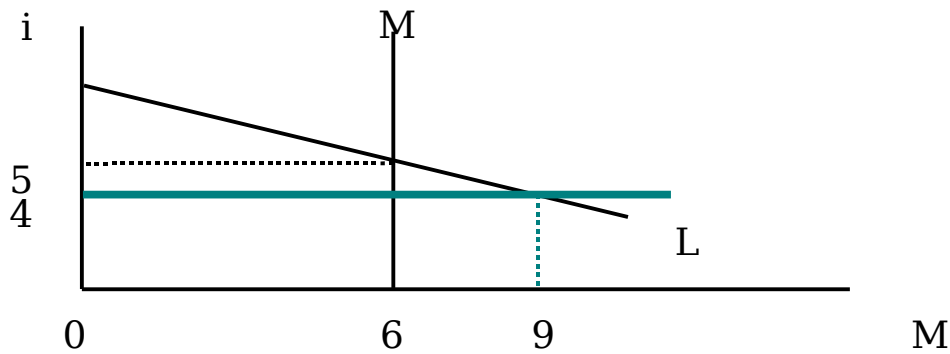
1. Which of the following are functions of money?
 - I. transactions
 - II. medium of exchange
 - III. store of value
 - IV. unit of account
 - a) I, II, III, & IV
 - b) I
 - c) II, III, IV
 - d) I, III
 - e) None of the above

2. The _____ is the sum of currency, demand deposits, and travelers checks.
 - a) M-1
 - b) M-2
 - c) M-3
 - d) L
 - e) None of the above

3. Money demand motives are _____ and _____.
 - a) store of value, unit of account
 - b) savings, investment
 - c) consumption, savings
 - d) transactions, asset
 - e) None of the above

4. The relationship between nominal and real interest rates (ignoring risk) is
 - a) $\text{Real}/\text{Inflation} = \text{Nominal}$
 - b) $\text{Real} * \text{Inflation} = \text{Nominal}$
 - c) $\text{Real} - \text{Inflation} = \text{Nominal}$
 - d) $\text{Real} + \text{Inflation} = \text{Nominal}$
 - e) None of the above

5. Which of the following equations best describes the Quantity Theory of Money?
 - a) $M/Q = P$
 - b) $Q = M$
 - c) $MV = PQ$
 - d) $M/K = PQ$
 - e) None of the above



6. What is the equilibrium money supply?
 - a) 0
 - b) 6
 - c) 9
 - d) indeterminate
 - e) None of the above
7. What is the equilibrium interest rate?
 - a) 0%
 - b) 4%
 - c) 5%
 - d) 9%
 - e) None of the above
8. At $i = 4\%$ and M_0 , there is an excess _____ of _____.
 - I. excess supply of bonds
 - II. excess supply of money
 - III. excess demand for bonds
 - IV. excess demand for money
 - a) I, III
 - b) I, IV
 - c) II, III
 - d) II, IV
 - e) None of the above
9. Under the _____, the slope of the yield curve reflects the increasing risk as time to maturity increases.
 - a) expectations hypothesis (theory)
 - b) market segment hypothesis
 - c) liquidity preference hypothesis
 - d) yield curve hypothesis
 - e) None of the above
10. As inflation increases, nominal interest rates _____.
 - a) remain constant
 - b) are indeterminate
 - c) increase
 - d) decrease
 - e) None of the above

11. Banks borrow _____ and lend _____.
- a) long term, short term
 - b) short term, long term
 - c) long term, long term
 - d) short term, short term
 - e) None of the above
12. _____ is a measure of interest rate sensitivity.
- a) Duration
 - b) Disintermediation
 - c) Interest spread
 - d) Fractional reserve banking
 - e) None of the above
13. The primary functions of the Federal Reserve Bank are:
- I. Serve as Federal Government's fiscal agent
 - II. Conduct monetary policy
 - III. Supervise banking and credit system
 - IV. Maintain financial system stability
- a) I, II, III, & IV
 - b) II, III
 - c) II, III, IV
 - d) I
 - e) None of the above
14. The primary function of the FDIC is to _____.
- a) insure banks
 - b) insure depositors
 - c) conduct monetary policy
 - d) control money supply
 - e) None of the above
15. Increasing the reserve requirement is an example of _____ policy.
- a) expansionary fiscal
 - b) expansionary monetary
 - c) contractionary fiscal
 - d) contractionary monetary
 - e) None of the above

Use the following data for questions 16 – 20.

Polk Bank

Cash	140	Demand Deposits	300
Securities	100	Time Deposits	600
Loans	860	Debt	100
Fixed Assets	100	Capital	200
Total	1200	Total	1200
Reserve Ratio	20%	Capital Ratio	10%

16. What is the amount of legal or actual reserves?

- a) 140
- b) 120
- c) 240
- d) 200
- e) None of the above

17. What is the amount of free or excess reserves?

- a) 100
- b) 200
- c) 120
- d) 60
- e) None of the above

18. What is the amount of required reserves?

- a) 90
- b) 60
- c) 30
- d) 180
- e) None of the above

19. What is the amount of deposits?

- a) 300
- b) 600
- c) 900
- d) 1200
- e) None of the above

20. Given a reserve ratio of 20%, an initial injection of \$10 million will yield an increase in money supply of _____.

- a) \$10 million
- b) \$2 million
- c) \$5 million
- d) \$50 million
- e) None of the above

21. A loan for a bank is a financial _____, while that same loan for the car buyer is a financial _____.

- a) asset, asset
- b) liability, liability
- c) asset, liability
- d) liability, asset
- e) None of the above

22. _____ are certificates of ownership in a firm and have limited liability.

- a) Common stock
- b) Bonds
- c) Certificates of Deposit
- d) Options
- e) none of the above

23. In the major financial markets, pricing is determined by a(n) _____ process.

- a) asking
- b) auction
- c) income
- d) auditing
- e) None of the above

24. Mutual funds issue _____ and buy _____.

- a) assets, liabilities
- b) shares, assets
- c) liabilities, assets
- d) assets, shares
- e) None of the above

25. Supply of bonds and credit are determined by _____.

- I. investment demand
 - II. savings
 - III. income
 - IV. deficit
- a) II
 - b) II & III
 - c) I, II, III, IV
 - d) I, IV
 - e) None of the above

26. Increasing interest rates, holding present value constant, _____ future value
- a) decreases
 - b) increases
 - c) stabilizes
 - d) randomly moves
 - e) None of the above
27. The value of a financial asset is primarily determined by _____.
- a) savings
 - b) consumption
 - c) income
 - d) capital spending
 - e) None of the above
28. A(n) _____ is a periodic equal cash flow stream made at the beginning of a period.
- a) lump sum
 - b) rent
 - c) ordinary annuity
 - d) annuity due
 - e) None of the above
29. As interest rates increase, stock prices tend to _____.
- a) decrease
 - b) increase
 - c) remain stable
 - d) randomly move
 - e) None of the above
30. Bond prices _____ when interest rates decrease.
- a) decrease
 - b) increase
 - c) do not change
 - d) rise then fall
 - e) None of the above

Macroeconomics Exam IIIa Key

- 1 C The three functions of money are: medium of exchange, store of value, and unit of account.
- 2 A Basically, cash plus checks
- 3 D Transactions and assets
- 4 D For lenders to make a profit they must recover the cost of inflation
- 5 C Money Activity = GDP; as $MV = PQ$
- 6 B Supply is the vertical line, so read number on horizontal axis.
- 7 C Where supply intersects demand, read number on vertical axis.
- 8 B Bond and cash markets move in opposite directions; excess supply (demand) of cash = excess demand (supply) in bonds.
- 9 C Market expectations says the yield curve incorporates future interest rate movements. Market segmentation says
- 10 C For lenders to make a profit they must recover the cost of inflation
- 11 B Banks accept deposits (short-term) to make loans (long-term).
- 12 D Disintermediation is moving funds out of banking into the market. Interest spread is the difference between interest rates earned on asset and the interest rate paid on liabilities. Fractional reserve banking is simply the money expansion process that occurs with lending
- 13 A The Fed as the government's bank handles all of its transactions as well as overseeing the banking system and credit markets via regulation and monetary policy.
- 14 B Deposit insurance only serves depositors.
- 15 D Increasing reserves causes banks to restrict credit.
- 16 C $140 + 100 = 240$; Reserves = Cash + Securities
- 17 D $240 - 180 = 60$; Total Reserves – Required Reserves = Free Reserves
- 18 D $900 * 20\% = 180$; Required Reserves = Deposits * Reserve Ratio
- 19 C $300 + 600 = 900$; Checking Deposits + Time Deposits
- 20 D $\$10 * 1 / .20 = \50 ; Injection * Money Multiplier
- 21 C All financial contracts are an asset to one party and a liability to the other.
- 22 A All other financial instruments do not grant an ownership interest.
- 23 B Asking is what sellers will pay, Income is not a process, auditing is a verification process, not a market process.
- 24 B The proceeds from issuing shares are used to purchase assets that eventually provide income to pay dividends to shareholders.
- 25 B Income determines savings, savings determines investment funds
- 26 B FV and interest rates move in the same direction, as FV is an accumulation of past interest rates.
- 27 C No income means the assets is worthless regardless of other factors

- 28 D Payments made at beginning are due, end are ordinary
- 29 A Stock prices and interest rates *tend* to have an inverse relationship
- 30 B Bond prices and interest rates have an inverse relationship