FIRST MIDTERM EXAM

EC26101: MONEY, BANKING AND FINANCIAL MARKETS

FEBRUARY 4, 2004

This exam has 20 questions on five pages. Before you begin, please check to make sure that your copy has all 20 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. When borrowers borrow in financial markets, they do so by:

   A) Issuing securities, which then become their liabilities.
   B) Buying securities, which then become their liabilities.
   C) Issuing securities, which then become their assets.
   D) Buying securities, which then become their assets.

2. When you take $1000 and deposit it in your account at Fleet Bank, you are participating in the process of:

   A) Direct finance.
   B) Indirect finance.

3. When you borrow $1000 from Fleet Bank to buy a new car, you are participating in the process of:

   A) Direct finance.
   B) Indirect finance.

4. A contractual agreement by the issuer to pay the holder fixed dollar amounts at regular intervals until a specified date when a final payment is made. This statement best describes:

   A) A debt instrument.
   B) An equity.
   C) Both debt and equity.

5. Which of the following are debt instruments?

A) A US Government bond.
B) A bond issued by Ford Motor Company.
C) A share of IBM stock.
D) Both (A) and (B) above.
E) None of the above.

6. A short-term debt instrument is best defined as one with:

A) Maturity of one day or less.
B) Maturity of less than one month.
C) Maturity of less than six months.
D) Maturity of less than one year.
E) Maturity of less than ten years.

7. Which of the following *does not* apply to equity or to the holders of equity:

A) An equity may pay regular dividends.
B) An equity has no maturity date.
C) Equity holders own the firm.
D) Equities may be considered short, intermediate, or long-term securities.
E) None of the above.

8. Abstracting from (that is, ignoring) the rare possibility of bankruptcy, an *advantage* to holding debt rather than equity has to do with the fact that:

A) Debt holders receive fixed payments, regardless of whether the borrower's income and assets become more or less valuable over time.
B) Debt holders do not benefit from an increase in the value of the borrower's income and assets.
C) Equity holders receive larger payments when the business becomes more profitable or when the value of its assets rises.
D) None of the above.

9. When the US Government issues a new bond and sells it to JP Morgan, the transaction is said to take place in a

A) Principal market.
B) Primary market.
C) Secondary market.
D) Principal investor's market.

10. Investment banks play a key role in financial markets by *underwriting* securities. This means that investment banks

A) Help match up buyers and sellers of existing securities.
B) Hold inventories of securities and stand ready to buy from and sell to other market participants.
C) Help firms sell newly-issued securities.
D) Guarantee that firms will pay interest and principal on their debt.
E) All of the above.

11. When Merrill Lynch buys $1 million worth of US Government bonds from JP Morgan:

A) The US Government receives the entire $1 million.
B) The US Government and JP Morgan split the $1 million evenly.
C) JP Morgan receives most of the $1 million, but as the original borrower the US Government receives some of the funds as well.
D) JP Morgan receives the entire $1 million.

12. Which of the following is true?

A) Primary markets allow the original buyers of securities to sell those securities before they mature.
B) Secondary markets make securities more liquid.
C) Secondary markets make securities less liquid.
D) Both (A) and (B) above.
E) None of the above.

13. A financial market in which buyers and sellers (or their representatives) meet in a centralized location is best described as an:

A) Exchange.
B) Over-the-Counter Market.
C) On-the-Spot Market.
D) Electronic Market.
E) None of the above.

14. In a money market:

    A) Short-term debt instruments are traded.
    B) Intermediate-term debt instruments are traded.
    C) Long-term debt instruments are traded.
    D) Short-term and intermediate-term debt instruments are traded.
    E) None of the above.

15. US Treasury Bills:

    A) Are issued by banks.
    B) Do not trade in a secondary market.
    C) Tend to be viewed a being more risky than other debt instruments.
    D) Make no regular interest payments, but sell at a discount.
    E) None of the above.

16. Large certificates of deposit are "negotiable," meaning that:

    A) They make regular interest payments until maturity.
    B) They return the original purchase price at maturity.
    C) The buyer is typically able to negotiate with the seller over the price.
    D) They trade on a secondary market.
    E) None of the above.

17. Which of the following is true?

    A) Commercial paper is issued by corporations.
    B) Maturities on commercial paper rarely exceed 9-months.
    C) Commercial paper makes no regular interest payments, but sells at a discount.
    D) Commercial paper trades on a secondary market.
    E) All of the above.

18. Which of the following is true?

    A) A banker's acceptance is like a post-dated check, in that it is used to purchase goods today but does not make any payment until some future date (the maturity date).
    B) Payment on a banker's acceptance is guaranteed by the issuer's bank.
    C) Banker's acceptances almost always are created in the process of international trade.
    D) Banker's acceptances trade on a secondary market.
    E) All of the above.

Consider the following table, containing data based on market transactions during the week of January 26-30, 2004:

Key US Interest Rates	
Commercial Paper Rate	1.08%
Negotiable CD Rate	1.05%
Treasury Bill Rate	0.89%
Repurchase Agreement Rate	0.95%
Banker's Acceptance Rate	1.10%

Based on these figures, please answer these last two questions:

19. What was the interest rate paid on time drafts issued by importers, in cases where payment is guaranteed by the importer's bank?

20. What was the interest rate paid on short-term debt instruments issued by banks?