FIRST MIDTERM EXAM

EC26102: 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 lenders lend 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 buy a new $1000 US Treasury bill, you are participating in the process of:

   A) Direct finance.
   B) Indirect finance.

3. When you buy $1000 worth of General Electric stock, you are participating in the process of:

   A) Direct finance.
   B) Indirect finance.

4. A contractual agreement assigning ownership to a share in the income and assets of a business. This statement best describes:

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

5. Which of the following are equities?

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

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

A) Maturity of more than one month.
B) Maturity of more than one year.
C) Maturity of more than five years.
D) Maturity of more than ten years.
E) Maturity of thirty years or more.

7. Equity holders are a firm's residual claimants. Legally, this means:

A) Debt holders must be paid first; equity holders receive payments only if funds remain.
B) Equity holders must be paid first; debt holders receive payments only if funds remain.

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

A) Debt holders receive fixed payments, even if the borrower's income and assets become 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 smaller payments when the business becomes less profitable or when the value of its assets falls.
D) None of the above.

9. When JP Morgan sells a US Government bond to Merrill Lynch, the transaction is said to take place on a

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

10. Securities brokers play a key role in financial markets by:

A) Matching up buyers and sellers of existing securities.
B) Holding inventories of securities and standing ready to buy from and sell to other market participants.
C) Helping firms to sell newly-issued securities.
D) Guaranteeing that firms will pay interest and principal on their debt.
E) All of the above.

11. If you sell $1000 worth of shares of stock in Ford Motor Company to another investor:

A) Ford Motor Company receives the entire $1000.
B) You and Ford Motor Company split the $1000 evenly.
C) You receive most of the $1000, but as the original borrower Ford Motor Company gets some of the funds as well.
D) You receive the entire $1000.

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 less liquid.
C) Secondary markets make securities less attractive to investors.
D) Both (A) and (B) above.
E) None of the above.

13. A financial market in which buyers and sellers at different locations trade via computer networks is best described as:

A) A stock exchange.
B) An exchange.
C) An on-the-spot market.
D) A trading post.
E) None of the above.

14. In a capital market:

    A) Only short-term debt instruments are traded.
    B) Only intermediate and long-debt instruments are traded.
    C) Only equities are traded.
    D) Intermediate-term debt instruments, long-term debt instruments, and equities may be traded.
    E) None of the above.

15. US Treasury Bills:

    A) Are currently issued in 1-month, 3-month, and 6-month maturities.
    B) Make no regular interest payments, but sell at a discount.
    C) Trade on a very active secondary market.
    D) Are the safest of all short-term debt instruments.
    E) All of the above.

16. Which of the following is true?

    A) Negotiable CD’s are short-term debt instruments.
    B) Negotiable CD’s are issued by banks.
    C) Negotiable CD’s trade on a secondary market.
    D) Both (A) and (B) above.
    E) All three statement, (A), (B), and (C), above.

17. Short-term debt instruments issued by large corporations are called:

    A) Large certificates of deposit.
    B) Commercial acceptances.
    C) Commercial paper.
    D) Corporate bonds.
    E) None of the above.

18. Which of the following is true?

    A) Banker’s acceptances are very short-term loans that use Treasury bills as collateral.
    B) In the typical banker’s acceptance, a bank acts as the borrower and a nonbank corporation acts as the lender.
    C) Banker’s acceptances do not trade on a secondary market, hence must always be held to maturity.
    D) Banker’s acceptances provide banks with access to short-term funds.
    E) None 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 short-term debt issued by large US corporations?

20. What was the interest rate paid on very short-term loans using Treasury bills as collateral?