SECOND MIDTERM EXAM

EC26101: MONEY, BANKING AND FINANCIAL MARKETS

FEBRUARY 25, 2004

This exam has 25 questions on five pages. Before you begin, please check to make sure that your copy has all 25 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. In a federal funds loan:

A) A bank acts as the borrower, and a non-bank corporation acts as lender.
B) A non-bank corporation acts as the borrower, and a bank acts as the lender.
C) A bank acts as the borrower, and the Federal Reserve acts as the lender.
D) The Federal Reserve acts as the borrower, and a bank acts as the lender.
E) None of the above.

2. Which of the following can be described as a Eurodollar deposit?

A) A dollar-denominated deposit held in a New York (USA) branch of Citibank.
B) A Euro-denominated deposit held in a Frankfurt (Germany) branch of Citibank.
C) A Japanese yen-denominated deposit held in a Tokyo (Japan) branch of Citibank.
D) All of the above.
E) None of the above.

3. Which of the following is false?

A) There are three types of mortgage loans made in the US today: commercial, residential, and farm mortgages.
B) In a mortgage loan, the land and/or structure purchased is used as collateral.
C) The mortgage market is the biggest segment of the US debt markets.
D) Today, about 2/3 of all mortgage loans are "securitized" and sold on the secondary market.
E) None of the above.

4. The special name that the US Government gives to the intermediate-term debt instruments that it issues is US Treasury _____.

5. State and local government bonds differ from other capital market instruments, and are especially attractive to some investors, since:

A) They make regular interest payments twice per year.
B) They can be either intermediate or long-term debt instruments.
C) Their interest payments are exempt from federal income taxes.
D) Both (A) and (C) above.
E) All three, (A), (B), and (C), above.

6. US Government Agency Bonds:

A) Are somewhat like a combination or mixture of corporate bonds and US Government bonds, since they are issued by government-sponsored corporations.
B) Are issued by the Federal National Mortgage Association ("Fannie Mae") and the Federal Home Loan Mortgage Corporation ("Freddie Mac"), which use the proceeds to buy mortgages on the secondary market.
C) Are issued by the Student Loan Marketing Association ("Sallie Mae"), which uses the proceeds to buy student loans on the secondary market.
D) Both (B) and (C) above.
E) All three, (A), (B), and (C), above.

7. _____ can be defined broadly as the time and money spent in carrying out financial transactions.

8. _____ can be defined as the uncertainty about the return that an investor will receive on any particular asset.

9. _____ refers to the problem that arises *after* a loan is made because borrowers may use their borrowed funds irresponsibly.

10. As a group, depository institutions:

A) Accept deposits, which then become their liabilities.
B) Accept deposits, which then become their assets.
C) Both (A) and (B) above.
D) None of the above.

11. Bank deposits that do not provide check-writing privileges, but still allow the funds to be withdrawn at any time, are best described as _____ deposits.

12. Which of the following qualify as thrift institutions?

A) Commercial banks.
B) Savings and Loan Associations.
C) Credit Unions.
D) Both (A) and (B) above.
E) Both (B) and (C) above.
F) All three, (A), (B), and (C), above.

13. _____ are virtually indistinguishable from savings and loan associations in terms of the banking activities that they engage in, but differ from S&Ls in that the depositors are also the owners of the bank.

14. Which of the following is false?

A) Before 1980, credit unions were not allowed to issue checking deposits.
B) Before 1980, credit unions were restricted to making mortgage loans.
C) Before 1980, savings and loan associations were not allowed to issue checking deposits.
D) Before 1980, savings and loan associations were restricted to making mortgage loans.
E) None of the above.

15. The assets held by life insurance companies include:

A) Corporate bonds.
B) Mortgages.
C) Life insurance policies.
D) Both (A) and (B) above.
E) All three, (A), (B), and (C), above.

16. A _____ is a type of contractual savings institution that acquires funds in the form of contributions made by employees and employers and uses those funds primarily to buy corporate stocks and bonds.

17. Mutual funds:

A) Allow small investors to minimize risk by holding a more diversified portfolio (combination) of assets.
B) Acquire funds by selling shares to individuals.
C) Use funds mainly by investing in corporate stocks and bonds.
D) Both (A) and (C) above.
E) All three, (A), (B), and (C), above.

18. In terms of the dollar value of the assets they hold, _____ are the largest type of depository institution and, for that matter, the largest type of financial intermediary overall.

19. A loan that provides the borrower with an amount of funds (principal) that must be repaid to the lender at maturity along with an additional amount (interest) is called a _____ loan.

20. Consider a corporate bond with $1000 face value, $100 annual coupon payment, and ten-year maturity. The interest rate of 0.10, or 10%, calculated by dividing the $100 annual coupon payment by the $1000 face value is called the _____ rate for this bond.

21. A discount bond with one year to maturity sells for $900 today. If the investor earns $100 in interest from buying this bond today and holding it to maturity, then it must be that the discount bond has a face value of

A) $800.
B) $900.
C) $1000.
D) $1100.
E) None of the above.

22. Another name for a discount bond is a _____ bond.

23. The concept of present value captures the idea that a dollar received in the future is _____ valuable than a dollar received today.

24. A simple loan of $100 requires the borrower to repay $100 principal plus $10 interest one year from now. For this loan, the simple interest rate can be calculated as:

A) $110 - $10 = $100.
B) $110 - $100 = $10.
C) $\frac{\$100}{\$100+\$10} = \frac{\$100}{\$110} = 0.909 = 90.9\%$.
D) $100 - $90 = $10.
E) None of the above.

25. If the simple interest rate is i, then the present value of \$1 received n years from now is:

A) $\$1 + i^n$.
B) $\$1 + (1+i)^n$.
C) $\$1 \times i^n$.
D) $\$1 \times (1+i)^n$.
E) None of the above.