

Chapter 1

Practice Problems

MULTIPLE CHOICE. Choose the one alternative that best completes the statement or answers the question.

- 1) Financial markets promote economic efficiency by _____ 1) _____
A) creating inflation.
B) channeling funds from savers to investors.
C) reducing investment.
D) channeling funds from investors to savers.
- 2) Channeling funds from individuals with surplus funds to those desiring funds when the saver does not purchase the borrower's security is known as _____ 2) _____
A) redistribution. B) financial intermediation.
C) taxation. D) barter.
- 3) _____ theory relates the quantity of money and monetary policy to changes in aggregate economic activity and inflation. 3) _____
A) Financial B) Monetary C) Fiscal D) Systemic
- 4) There is a _____ association between inflation and the growth rate of money _____. 4) _____
A) positive; demand B) positive; supply
C) negative; supply D) negative; demand
- 5) Budget deficits can be a concern because they might _____ 5) _____
A) lead to a slower rate of money growth. B) ultimately lead to higher inflation.
C) lead to lower interest rates. D) lead to higher bond prices.
- 6) Budget deficits are important because deficits _____ 6) _____
A) can result in higher rates of monetary growth.
B) cause bank failures.
C) always cause interest rates to fall.
D) always cause prices to fall.
- 7) A financial crisis is _____ 7) _____
A) typically followed by an economic boom.
B) a major disruption in the financial markets.
C) a feature of developing economies only.
D) not possible in the modern financial environment.
- 8) Banks are important to the study of money and the economy because they _____ 8) _____
A) are the only important financial institution in the U.S. economy.
B) have been a source of rapid financial innovation.
C) create inflation.
D) channel funds from investors to savers.
- 9) Financial intermediaries _____ 9) _____
A) produce nothing of value and are therefore a drain on society's resources.
B) can hurt the performance of the economy.
C) hold very little of the average American's wealth.
D) provide a channel for linking those who want to save with those who want to invest.

- 10) Banks, savings and loan associations, mutual savings banks, and credit unions 10) _____
 A) are no longer important players in financial intermediation.
 B) since deregulation now provide services only to small depositors.
 C) produce nothing of value and are therefore a drain on society's resources.
 D) have been adept at innovating in response to changes in the regulatory environment.
- 11) Financial institutions search for _____ has resulted in many financial innovations. 11) _____
 A) higher profits B) respect C) regulations D) higher risk
- 12) Banks and other financial institutions engage in financial intermediation, which 12) _____
 A) has no effect on economic performance.
 B) can benefit economic performance.
 C) can hurt the performance of the economy.
 D) involves borrowing from investors and lending to savers.
- 13) Financial institutions that accept deposits and make loans are called 13) _____
 A) finance companies. B) exchanges.
 C) over-the-counter markets. D) banks.
- 14) The financial intermediaries that the average person interacts with most frequently are 14) _____
 A) exchanges. B) over-the-counter markets.
 C) banks. D) finance companies.
- 15) Which of the following is not a financial institution? 15) _____
 A) a business college B) a credit union
 C) a pension fund D) a life insurance company
- 16) Financial markets promote greater economic efficiency by channeling funds from _____ to _____ 16) _____
 A) borrowers; savers B) savers; borrowers
 C) investors; savers D) savers; lenders
- 17) Well-functioning financial markets promote 17) _____
 A) growth. B) inflation.
 C) unemployment. D) deflation.
- 18) A key factor in producing high economic growth is 18) _____
 A) well-functioning financial markets. B) high interest rates.
 C) stock market volatility. D) eliminating foreign trade.
- 19) Markets in which funds are transferred from those who have excess funds available to those who 19) _____
 have a shortage of available funds are called
 A) derivative exchange markets. B) financial markets.
 C) commodity markets. D) fund-available markets.
- 20) _____ markets transfer funds from people who have an excess of available funds to people who 20) _____
 have a shortage.
 A) Derivative exchange B) Financial
 C) Commodity D) Fund-available

- 21) Poorly performing financial markets can be the cause of _____
 A) wealth. B) financial stability.
 C) financial expansion. D) poverty.
- 22) The bond markets are important because they are _____
 A) the markets where interest rates are determined.
 B) the markets where all borrowers get their funds.
 C) easily the most widely followed financial markets in the United States.
 D) the markets where foreign exchange rates are determined.
- 23) The price paid for the rental of borrowed funds (usually expressed as a percentage of the rental of \$100 per year) is commonly referred to as the _____
 A) aggregate price level. B) exchange rate.
 C) inflation rate. D) interest rate.
- 24) Compared to interest rates on long-term U.S. government bonds, interest rates on three-month Treasury bills fluctuate _____ and are _____ on average.
 A) less; higher B) more; higher C) less; lower D) more; lower
- 25) The interest rate on Baa (medium quality) corporate bonds is _____, on average, than other interest rates, and the spread between it and other rates became _____ in the 1970s.
 A) higher; smaller B) lower; larger C) higher; larger D) lower; smaller
- 26) Everything else held constant, a decline in interest rates will cause spending on housing to _____
 A) either rise, fall, or remain the same. B) fall.
 C) remain unchanged. D) rise.
- 27) High interest rates might _____ purchasing a house or car but at the same time high interest rates might _____ saving.
 A) encourage; encourage B) discourage; encourage
 C) discourage; discourage D) encourage; discourage
- 28) An increase in interest rates might _____ saving because more can be earned in interest income.
 A) encourage B) discourage C) invalidate D) disallow
- 29) Everything else held constant, an increase in interest rates on student loans _____
 A) reduces the cost of a college education. B) increases the cost of a college education.
 C) has no effect on educational costs. D) increases costs for students with no loans.
- 30) High interest rates might cause a corporation to _____ building a new plant that would provide more jobs.
 A) consider B) contemplate C) complete D) postpone
- 31) The stock market is important because it is _____
 A) the market where most borrowers get their funds.
 B) where interest rates are determined.
 C) where foreign exchange rates are determined.
 D) the most widely followed financial market in the United States.

- 32) Stock prices are _____ 32) _____
 A) extremely volatile.
 B) relatively stable trending downward at a moderate rate.
 C) unstable trending downward at a moderate rate.
 D) relatively stable trending upward at a steady pace.
- 33) A rising stock market index due to higher share prices _____ 33) _____
 A) increases people's wealth, but is unlikely to increase their willingness to spend.
 B) decreases people's wealth, but is unlikely to increase their willingness to spend.
 C) decreases the amount of funds that business firms can raise by selling newly-issued stock.
 D) increases people's wealth and as a result may increase their willingness to spend.
- 34) When stock prices fall _____ 34) _____
 A) an individual's wealth may decrease but their willingness to spend is not affected.
 B) an individual's wealth may decrease and their willingness to spend may decrease.
 C) an individual's wealth is not affected nor is their willingness to spend.
 D) a business firm will be more likely to sell stock to finance investment spending.
- 35) Changes in stock prices _____ 35) _____
 A) occur in regular patterns.
 B) affect firms' decisions to sell stock to finance investment spending.
 C) do not affect people's wealth and their willingness to spend.
 D) are unimportant to decision makers.
- 36) An increase in stock prices _____ the size of people's wealth and may _____ their willingness _____ 36) _____
 to spend, everything else held constant.
 A) decreases; decrease
 B) increases; decrease
 C) decreases; increase
 D) increases; increase
- 37) Low stock market prices might _____ consumers willingness to spend and might _____ _____ 37) _____
 businesses willingness to undertake investment projects.
 A) decrease; increase
 B) increase; decrease
 C) increase; increase
 D) decrease; decrease
- 38) Fear of a major recession causes stock prices to fall, everything else held constant, which in turn _____ 38) _____
 causes consumer spending to
 A) remain unchanged.
 B) decrease.
 C) increase.
 D) cannot be determined.
- 39) A share of common stock is a claim on a corporation's _____ 39) _____
 A) expenses.
 B) debt.
 C) liabilities.
 D) earnings and assets.
- 40) On _____, October 19, 1987, the market experienced its worst one-day drop in its entire history _____ 40) _____
 with the DJIA falling by 22%.
 A) "Woeful Wednesday"
 B) "Black Monday"
 C) "Terrible Tuesday"
 D) "Freaky Friday"

- 41) The decline in stock prices from 2000 through 2002 41) _____
A) increased individual wealth.
B) reduced individuals' willingness to spend.
C) had no effect on individual spending.
D) increased individuals' willingness to spend.
- 42) The Dow reached a peak of over 11,000 before the collapse of the _____ bubble in 2000. 42) _____
A) high-tech B) banking C) housing D) manufacturing

Answer Key

Testname: UNTITLED1

- 1) B
- 2) B
- 3) B
- 4) B
- 5) B
- 6) A
- 7) B
- 8) B
- 9) D
- 10) D
- 11) A
- 12) B
- 13) D
- 14) C
- 15) A
- 16) B
- 17) A
- 18) A
- 19) B
- 20) B
- 21) D
- 22) A
- 23) D
- 24) D
- 25) C
- 26) D
- 27) B
- 28) A
- 29) B
- 30) D
- 31) D
- 32) A
- 33) D
- 34) B
- 35) B
- 36) D
- 37) D
- 38) B
- 39) D
- 40) B
- 41) B
- 42) A