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

1) The term structure of interest rates is
A) the structure of how interest rates move over time.
B) the relationship among interest rates of different bonds with the same maturity.
C) the relationship among the term to maturity of different bonds.
D) the relationship among interest rates on bonds with different maturities.

2) When the default risk in corporate bonds decreases, other things equal, the demand curve for corporate bonds shifts to the _____ and the demand curve for Treasury bonds shifts to the _____.
A) right; left
B) right; right
C) left; right
D) left; left

3) When the Treasury bond market becomes more liquid, other things equal, the demand curve for corporate bonds shifts to the _____ and the demand curve for Treasury bonds shifts to the _____.
A) right; left
B) right; right
C) left; left
D) left; right

4) The risk premium on corporate bonds becomes smaller if
A) both (b) and (d) occur.
B) the liquidity of corporate bonds increases.
C) the riskiness of corporate bonds increases.
D) the riskiness of corporate bonds decreases.
E) the liquidity of corporate bonds decreases.
5) The interest rate on municipal bonds falls relative to the interest rate on Treasury securities when

A) income tax rates are raised.
B) there is a major default in the municipal bond market.
C) corporate bonds become riskier.
D) municipal bonds become less widely traded.
E) none of the above occur.

6) The liquidity premium theory of the term structure

A) suggests that markets for bonds of different maturities are completely separate because people have preferred habitats.
B) indicates that today's long-term interest rate equals the average of short-term interest rates that people expect to occur over the life of the long-term bond.
C) assumes that bonds of different maturities are perfect substitutes.
D) does none of the above.

7) Which of the following theories of the term structure is (are) able to explain the fact that interest rates on bonds of different maturities tend to move together over time?

A) The expectations theory
B) The segmented markets theory
C) The liquidity premium theory
D) Both (a) and (b) of the above
E) Both (a) and (c) of the above
8) If the expected path of one-year interest rates over the next five years is 4 percent, 5 percent, 7 percent, 8 percent, and 6 percent, then the expectations theory predicts that today's interest rate on the five-year bond is
   A) 8 percent.
   B) 4 percent.
   C) 5 percent.
   D) 6 percent.
   E) 7 percent.

9) Factors that influence interest rates on bonds include
   A) term to maturity.
   B) risk.
   C) liquidity.
   D) tax considerations.
   E) all of the above.

10) Yield curves can be classified as
    A) downward sloping.
    B) upward sloping.
    C) flat.
    D) all of the above.
    E) only (a) and (b) of the above.

11) The government institution that has responsibility for the amount of money and credit supplied in the economy as a whole is the
A) central bank.
B) monetary fund.
C) bank of settlement.
D) commercial bank.

12) The regulatory system that has evolved in the United States whereby banks are regulated at the state level, the national level, or both, is known as a

A) two-tiered regulatory system.
B) bilateral regulatory system.
C) tiered regulatory system.
D) dual banking system.

13) With the creation of the Federal Deposit Insurance Corporation, member banks of the Federal Reserve System _____ to purchase FDIC insurance for their depositors, while non-member commercial banks _____ to buy deposit insurance.

A) were required, could choose
B) were required; were required
C) could choose; were required
D) could choose; were given the option

14) The presence of so many commercial banks in the United States is most likely the result of

A) adverse selection and moral hazard problems that give local banks a competitive advantage over larger banks.
B) regulations that restrict the ability of these financial institutions to open branches.
C) consumers' strong desire for dealing with only local banks.
D) all of the above.

15) Financial innovation has caused
A) banks to suffer declines in their cost advantages in acquiring funds, although it has not caused a decline in income advantages.

B) banks to achieve competitive advantages in both costs and income.

C) banks to suffer declines in their income advantages in acquiring funds, although it has not caused a decline in cost advantages.

D) banks to suffer a simultaneous decline of cost and income advantages.

17) Moral hazard is an important feature of insurance arrangements because the existence of insurance

A) provides increased incentives for risk taking.

B) causes the private cost of the insured activity to increase.

C) is a hindrance to efficient risk taking.

D) both (a) and (b) of the above.

E) both (b) and (c) of the above.

18) The result of the too-big-to-fail policy is that _____ banks will take on _____ risks, making bank failures more likely.

A) big; greater

B) big; fewer

C) small; fewer

D) small; greater

19) Ways in which bank regulations reduce the adverse selection and moral hazard problems in banking include

A) restrictions that prevent banks from acquiring certain risky assets, such as common stocks.

B) high bank capital requirements to increase the cost of bank failure to the owners.

C) a chartering process designed to prevent crooks from getting control of a bank.

D) all of the above.

E) only (a) and (b) of the above.
20) One way for bank regulators to assure depositors that banks are not taking on too much risk is to require that banks
A) reduce its equity capital.
B) diversify its loan portfolio.
C) reduce the size of its loan portfolio.
D) do both (a) and (b) of the above.
E) do both (b) and (c) of the above.

21) The chartering process is especially designed to deal with the _____ problem, and regular bank examinations help to reduce the _____ problem.
A) adverse selection; adverse selection
B) moral hazard; moral hazard
C) moral hazard; adverse selection
D) adverse selection; moral hazard

22) Common to all the recent banking crises in the United States, Scandinavia, Latin America, Japan, Russia, and Eastern Europe was the
A) the banks' lack of expertise in screening borrowers and monitoring loans.
B) the financial liberalization that occurred in the 1980s.
C) the regulators' lack of expertise in monitoring banking activities.
D) all of the above.
E) only (a) and (b) of the above.

23) Which of the following is not an entity of the Federal Reserve System?
A) The FDIC
B) The Board of Governors
C) The Board of Advisors
D) Federal Reserve Banks
24) Banks subject to reserve requirements set by the Federal Reserve System include

A) only state chartered banks.
B) all banks whether or not they are members of the Federal Reserve System.
C) only banks with assets less than $500 million.
D) only nationally chartered banks.
E) only banks with assets less than $100 million.

25) The Board of Governors

A) effectively sets the discount rate.
B) sets margin requirements.
C) establishes, within limits, reserve requirements.
D) does all of the above.
E) does only (a) and (b) of the above.

26) The Federal Reserve entity that determines monetary policy strategy is the

A) Board of Governors.
B) Shadow Open Market Committee.
C) Federal Open Market Committee.
D) chairman of the Board of Governors.

27) Factors that provide the Federal Reserve with a high degree of autonomy include

A) a source of revenue free from the appropriations process.
B) 14-year terms for members of the Board of Governors.
C) a four-year term for the chairman of the Board of Governors that does not coincide with the president's four-year term.
D) all of the above.
E) only (a) and (b) of the above.
28) According to the author of your textbook, the Fed is
A) severely constrained in its policy making by the congressional threat to reduce Fed independence.
B) remarkably free of the political pressures that influence other government agencies.
C) more responsive to the political pressures that influence other government agencies.
D) both (a) and (c) of the above.

29) The theory of bureaucratic behavior suggests that the Federal Reserve will
A) try to gain regulatory power over more banks.
B) devise clever strategies in an effort to avoid blame for poor economic performance.
C) try to avoid a conflict with the President and Congress over increases in interest rates.
D) do each of the above.

30) Federal Reserve independence is thought to
A) introduce a short-term bias to monetary policymaking.
B) introduce longer-run considerations to monetary policymaking.
C) lead to better fiscal and monetary policy coordination.
D) do both (a) and (b) of the above.

31) The case for Federal Reserve independence includes the idea that
A) political pressure would impart an inflationary bias to monetary policy.
B) a Federal Reserve under the control of Congress or the President might make the so-called political business cycle more pronounced.
C) a politically insulated Fed would be more concerned with long-run objectives and thus be a defender of a sound dollar and a stable price level.
D) all of the above.
32) Critics of Fed independence argue

A) that an independent Fed conducts monetary policy with a consistent inflationary bias.

B) that it is undemocratic to have monetary policy controlled by an elite group responsible to no one.

C) that the Fed, since it does not face a binding budget constraint, spends too much of its earnings.

D) only (a) and (b) of the above.
1) Answer: D
2) Answer: A
3) Answer: D
4) Answer: A
5) Answer: A
6) Answer: D
7) Answer: E
8) Answer: D
9) Answer: E
10) Answer: D
11) Answer: A
12) Answer: D
13) Answer: A
14) Answer: B
15) Answer: D
16) Answer: A
17) Answer: A
18) Answer: A
19) Answer:
20) Answer: B
21) Answer: D
22) Answer: D
23) Answer: A
24) Answer: B
25) Answer: D
26) Answer: C
27) Answer: D
28) Answer: B
29) Answer: D
30) Answer: B
31) Answer: D
32) Answer: B